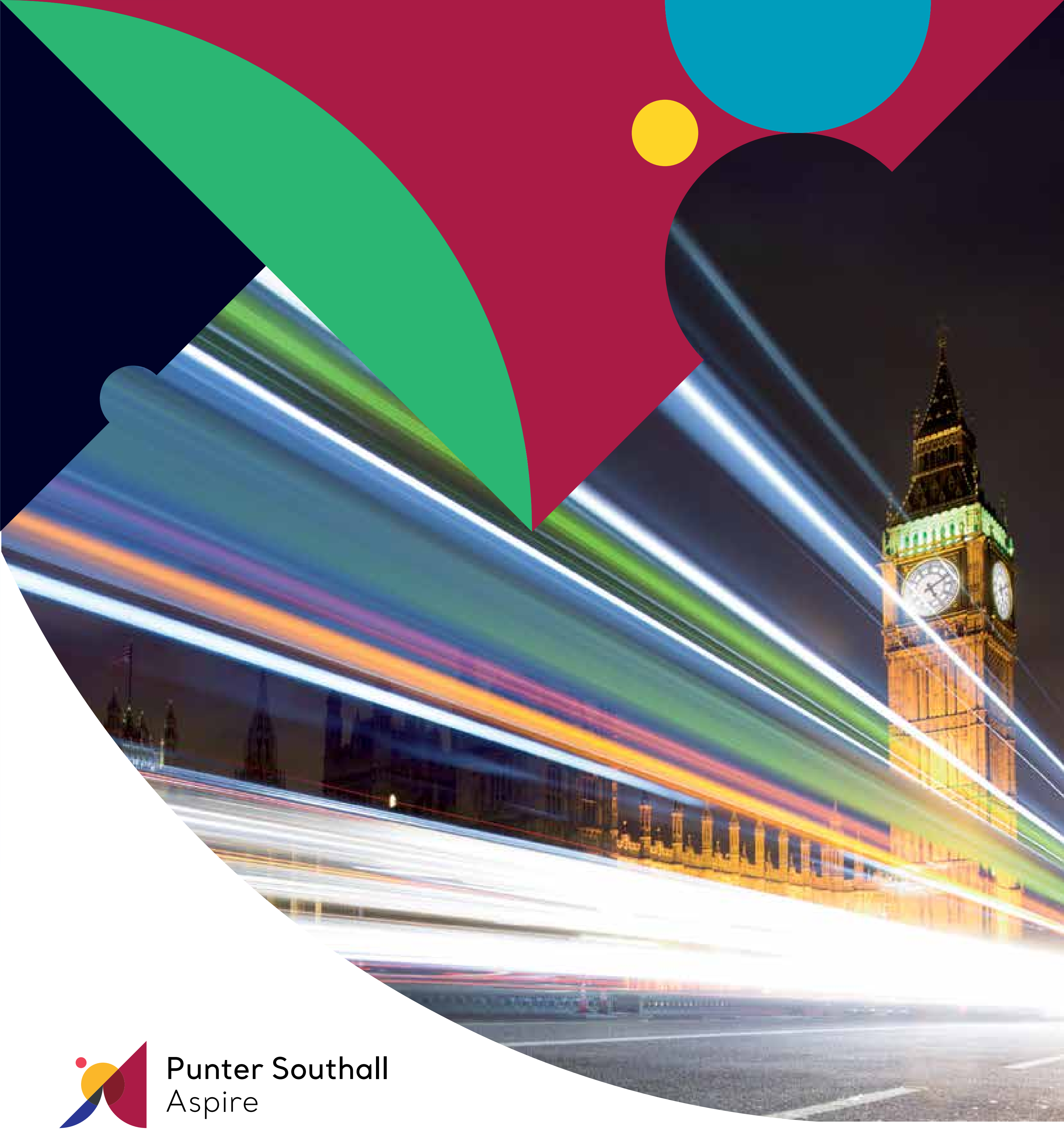


Punter Southall
Aspire

Taxing times for high earners

AA and LTA changes: How are high earners affected

How a taxation minefield has evolved in recent years

6 April 2016 marked the tenth anniversary of Pension Simplification, the great misnomer given to the day that marked the start of the new pensions tax regime that we're currently working in.

Prior to its introduction there had been the best part of five years worth of consultation including the consultation document, 'Simplifying the taxation of pensions: increasing choice and flexibility for all'.

This document laid out the need for a major overhaul of the vast layers of legislation that were in danger of crippling the pension industry and which were seen as being a barrier to pension saving. Part of the document stated:

'These proposals for radical simplification will enable people to make clear and confident decisions about pension saving. They will mean far greater individual choice and flexibility about when and how much to save in a pension. And they will reduce administrative burdens on employers and pension providers alike… For the vast majority of people, the tax system will simply cease to be a consideration when planning for retirement. Instead they will be free to concentrate on the real issues – deciding when and how much to save.'

Two main tenets of the new regime were the introduction of the lifetime allowance at £1.5m and the annual allowance at £215k. These allowances were subject to annual increases and peaked in 2010 at £1.8m and £255k respectively.

Along the way we hit the economic crisis of 2008/09 and the then Chancellor, Alistair Darling started to tinker with the tax relief being granted to higher earners, which eventually led to the much derided high income excess relief charge (HIERC).

Since then every Budget, bar the one in 2013, has brought further changes to pension legislation and the two allowances have been pecked away at.

The lifetime allowance now stands at £1m, some 45% lower than its peak and the annual allowance is now £40,000, a whopping 84% lower than the height it reached only six years ago.

And, in addition higher earners are likely to be impacted by the tapered annual allowance rule which was announced in the post-election Summer Budget in 2015 and implemented in April this year, exactly 10 years after the fanfare of so called Pension Simplification.

The tapered annual allowance reduces the annual allowance by 50p for every £1 of income between £150,000 and £210,000, to a minimum of £10,000.

Given these changes it would be of little surprise if employees and their employers have ended up totally confused as to what their pension strategy should be. And the objectives, set out in the consultation document, of reducing administrative burdens on employers and leaving people free to concentrate on saving without consideration of the tax system must now viewed as no more than pie in the sky.

City firms and taxation for high earners – a very mixed picture

At Punter Southall Aspire we realised that the most recent changes to the lifetime allowance and annual allowance were likely to have impacted many employees of businesses operating within the financial services sector (asset management, private banking, private equity, corporate finance, stock trading, insurance and underwriting).

This is a core market for us so we were keen to understand more about how businesses in this sector had reacted to these changes.

Therefore, with six months having elapsed since the changes were introduced, we carried out a short survey of London-based businesses, collecting data from 50 of them.

Given the potential impact of breaching the allowances, some of the results were quite surprising.

For example, 32% of companies had not provided any additional flexibility to their employees, meaning that their employees either continue to take their pension contribution and face a potential tax liability or have ceased contributions with no cash allowance in lieu of the employer contribution. Indeed, in some circumstances we believe that the employees are oblivious to the tax consequences and are sleep-walking to a future tax bill, which could be substantial.

We also saw evidence that whilst some companies are offering flexibility, this didn't extend to allowing employees to take a cash allowance.

We can imagine that organisations that offer flexible benefits are allowing employees to use contributions for other benefits, but we intend to do further research to understand what alternative options may have been made available.

> "Given the potential impact of breaching the allowances, some of the results were quite surprising"

In the lead up to the introduction of the tapered annual allowance, a number of organisations indicated that they were considering capping contributions to £10,000 per annum. Our survey indicates that 28% have taken this route, which obviously ensures that the annual allowance is not breached, but this could be viewed as a very blunt tool to deal with the issue.

For example, an employee's income may not reach the £210,000 level at which the full taper applies and therefore they may be entitled to contribute more than £10,000. Additionally, many people will have unused pension tax relief from previous tax years, which could be carried forward to allow contributions to remain unchanged in the current year.

Another area we were keen to find out about was the treatment of employer's National Insurance Contributions when a cash allowance is being paid.

Employer pension contributions do not generate an NIC liability on either employer or employee but if the contribution is converted to a cash allowance, both parties pick up this liability. The employer NIC rate is 13.8% and just over half of our respondents are deducting this amount from the cash allowance being offered to their employees. In addition, employees will be subject to tax and NI on the cash allowance meaning their net position will be substantially lower than the gross pension contribution would have been.

Looked at from the other side this also means that just under half of employers have seen their overall costs increase as a result of shouldering the additional NI burden caused by paying a cash allowance.

The next area we investigated was whether employers are asking to see proof of the fact that people are affected by the reduction of either or both of these allowances.

We found that over half of respondents are asking for proof, which is likely to mean that employees have to provide evidence of earnings from outside their daily employment e.g. buy-to-let rental income or are having to provide benefit statements for pension arrangements accrued with previous employers.

To many this may appear to be a gross invasion of privacy and could give rise to some data protection issues dependent on how employers are storing whatever information they receive.

The final area we asked about was whether employers had reviewed their life assurance arrangements as a result of the reduced lifetime allowance.

Are life assurance arrangements under review?

The lifetime allowance applies to death benefits paid in lump sum form from all registered pension arrangements, which could include a group life assurance scheme.

Group life cover is normally provided in one of two types of arrangements, registered or excepted.

Under a registered scheme death benefits are tested against the lifetime allowance and when combined with other pension benefits could result in it being breached, with the consequent tax liability.

The death benefits from excepted group life schemes do not count towards the lifetime allowance.

With group life schemes often offering four times salary as a death benefit it would be very easy for high earners to breach the lifetime allowance on death and many employers are establishing excepted schemes to avoid this situation.

However, our survey shows that 68% of respondents had not reviewed their life assurance arrangement as a result of the recent reduction in the allowance.

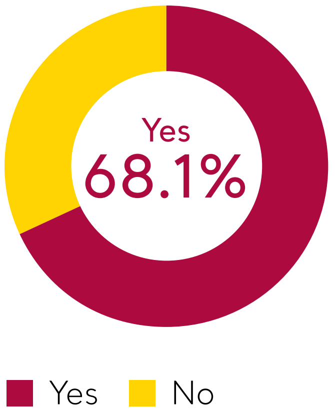
This may be because they have already established excepted schemes although we suspect that many have not yet considered this option.

Over the following pages we have laid out the questions we asked along with a graphical representation of the results we received.

"Group life cover is normally provided in one of two types of arrangements, registered or excepted."

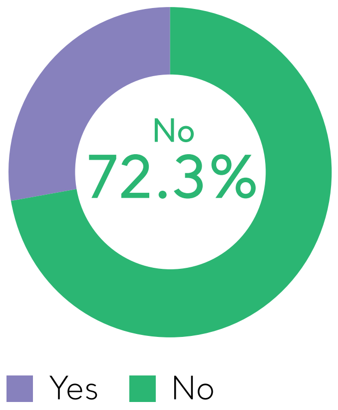
Key findings and survey highlights

As a result of these changes, have you provided any additional flexibility for your employees?



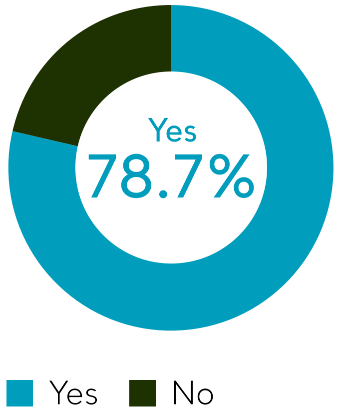
Almost a third of employers haven't provided any additional flexibilty to helphigh earners deal with the tax changes.

As a result of the tapered annual allowance, have you capped contributions to £10,000 per annum?



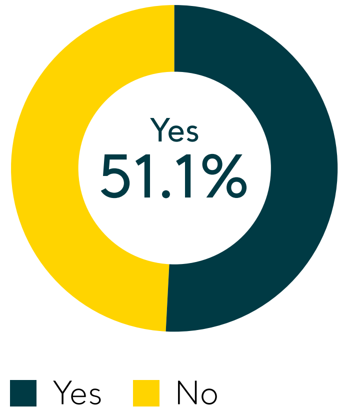
28% of employers have capped lifetime and annual allowance contributions to £10,000 - a move that will not benefit all employees. The full taper only applies when an employee's total income reaches £210,000. Anyone anyone earning less could contribute more tax free.

Do you now allow employees to take a cash allowance in lieu of pension contributions?



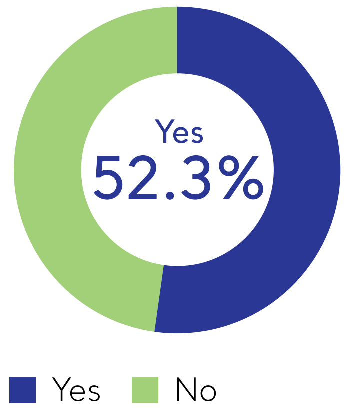
A fifth of companies aren't allowing employees to take cash in lieu of pension contributions.

Do you ask to see proof that an individual is affected by either of the changes?



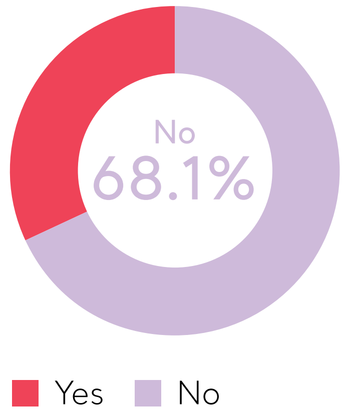
Only a half of companies asked to see proof that an individual is affected by tax changes.

If you offer a cash allowance, do you deduct the additional employer's National Insurance that is due?



Just over a half of employers deduct the additional National Insurance cost from the cash allowance, 48% do not - allowing employees to pick up the bill.

Did you review your life assurance arrangements as a result of the reduced lifetime allowance?



Over two thirds of companies haven't reviewed their life assurance in light of reduced lifetime allowance even though death-in-service benefits count towards the allowance.

Conclusion

Overall, we believe our survey indicates that there is more that employers in the high-paying financial services sector could be doing to help employees understand the implications of the reduced lifetime allowance and the impact of the tapered annual allowance.

In September HM Revenue & Customs confirmed that tax collected from those pension holders who exceeded the £1.25m pensions lifetime allowance reached £126m in the 2015-16 financial year. This was an increase of 62 per cent from the £78m reported in 2014-15.

According to a Freedom of Information request 449 people whose pension funds breached the LTA in 2015-16, were handed a 55% tax charge for taking the excess as a lump sum. A further 1,100 savers were taxed at 25% for withdrawing savings above the LTA as income.

It would be no surprise if we see HM Revenue & Customs reporting in a year's time that there has been an increased tax- take as a result of the changes to these two allowances. Whilst that is obviously their intention, driven by government policy, we do fear that many people are blissfully unaware that they are accruing a tax liability, which will only become apparent when they complete their 2016/17 tax return.

Let's hope that they don't blame their employer for the additional tax they will have to pay.

Who are we

We are Punter Southall Aspire. And we're part of the Punter Southall Group, which is proudly independent and majority employee-owned.

We're a major investment and savings business that blends a strong customer focused heritage with a modern and technology-led outlook.

Uniting pensions consultancy, workplace savings and individual financial advice, we work with employers, trustees and private clients through our regional UK offices to design and manage solutions that meet their unique needs.

Our new and innovative Master Trust solution provides cost-effective pension scheme management for employers and pension freedom solutions for individuals.

1,250
PENSION SCHEMES

£3.5bn
OF ASSETS UNDER ADVICE

200,000
SCHEME MEMBERS

10
OFFICES ACROSS THE UK

How we help

We bring together different skills and experience, tailoring them to the needs of you, your scheme and your employees.

Master Trust

The Aspire Savings Trust is a multi-employer, occupational pension scheme. It brings together governance, investment, administration and communications expertise within a technology-led solution.

Governance

Establishing and governing the ideal workplace pensions and savings for your employees can be complex and time consuming. That's where we come in.

Engagement

Our online platform educates and inspires employees across a range of financial topics. It helps them understand the importance of saving for their long-term future.

Retirement

With greater choice and freedom in how and when individuals are able to access their pension fund, there is now an even greater need for early education and advanced planning. Find out how we help.

Investment

Our investment research division analyses and rates over 18,000 DC investment funds. The insight we have enables us to support your investment objectives, making sure they're on track to deliver.

Education

Our financial wellbeing and education service helps employers explain finances and their implications to employees, giving them the tools to make better financial choices at all stages of their working lives.

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