TLT Reward, Resource, Retain

Lifetime and annual allowance changes: does this impact your high earners?

Lifetime Allowance

Update

From 6 April 2016, the lifetime allowance (LTA) for tax efficient pensions savings has been reduced to £1 million. This follows a series of reductions over the years, from £1.8 million to £1.5 million in April 2012 and from £1.5 million to £1.25 million in April 2014.

Effect

Those individuals who reach the new LTA may experience punitive tax charges if they continue to make pension contributions over and above the LTA. Some individuals may have fixed protection or individual protection for their £1.25 million LTA - further contributions to their pensions schemes may not be permitted.

Death in service benefits will count towards the individual's LTA - meaning high and even moderate earners are at risk of hitting their LTA. Employers should consider what changes (if any) they will introduce to protect affected employees.

Annual Allowance

Update

In addition to the reductions made to the LTA, the Government has also restructured the way in which individuals' annual allowance (AA) for tax efficient pensions savings is calculated. For the 2015/16 tax year, the AA is £40,000 for all individuals with annual income below £150,000. For individuals with annual income of between £150,000 and £210,000, the AA of £40,000 is tapered so that those individuals' AA is reduced by £2 for every £1 of income between £150,000 and £210,000, subject to a minimum AA of £10,000.

Effect

Calculations need to be made by any employees with 'threshold income' of more than £110,000

High earners who make annual contributions to their pension scheme in excess of their decreased AA may experience punitive tax charges on pensions contributions made

Employers should consider what changes (if any) they will introduce to protect affected employees

Possible responses

LISA

In the 2016 Spring Budget, the Chancellor announced that a new Lifetime ISA (LISA) would be introduced. The LISA will be available from April 2017 and will allow individuals aged between 18 and 49 to save up to £4,000 per year, in return for which the Government will pay in a 'bonus' of 25% of the amount saved. The funds in the LISA can only be withdrawn after turning age 60 or for purchasing a first home, otherwise penalties are payable.

Excepted group life policy

A qualifying excepted group life policy can provide for lump sum benefits for employees that do not count towards the LTA and which do not trigger a punitive tax charge. It may also be possible for the employer to offset the premium for the policy against tax. Helpfully, excepted life policies will not jeopardise those employees with LTA protection, such as fixed protection.

Cash supplement

Restricting the level of employer contributions to a maximum of £10,000 a year and then paying the difference between the original level of contributions and the new level as a cash supplement.

Unfunded EFRBS

An Employer Financed Retirement Benefit Scheme (EFRBS) is an unregistered pension scheme that will pay out benefits when the employee retires (although note that following an informal consultation on this in summer 2015, the government is keeping this under review).

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Issues and considerations

Reward structuring

Provision of a competitive benefit package

General Anti Avoidance

Specific provisions have been introduced to combat avoidance activity. Broadly speaking, the taper will continue to apply if an individual has entered into any "arrangements" and all particular conditions are met:

Condition A. It is reasonable to assume that the main purpose (or one of the main purposes) of the arrangements is to reduce the amount of the reduction under the taper for an individual for one or more tax year. An "arrangement" includes "any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable)."

Condition B. The arrangements involve either or both of reducing an individual's adjusted income or reducing their threshold income for a tax year.

Condition C. The reductions referred to above are redressed in another tax year.

Employee Assessment

Assess who these changes will impact

Automatic enrolment

Following changes to the automatic enrolment legislation where an employee has applied for fixed protection an employer is no longer required to enrol an eligible jobholder into a scheme, however, in other circumstances employers have to be mindful that any alternative arrangements put in place do not amount to an incentive to opt out.

Salary Sacrifice

Salary sacrifice arrangements implemented after 9 July 2015 will not have an impact in reducing an individual's threshold income. It is not clear how this relates to salary sacrifice arrangements that renew every year.

For more information please contact one of our specialists on the details provided below.

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