HIGH EARNERS AFFECTED BY A CHANGE IN PENSION LEGISLATION

A Change to pension legislation means that high-earning individuals might have to pay more income tax and National Insurance contributions on the value of their employment package than has previously been the case.

Anyone with what is known as "threshold income" over £110,000 could be affected.

The legislation came into effect in April 2016 and could adversely affect anyone whose "adjusted" income exceeds £150,000 in a tax year. This is because the amount of their pension contribution Annual Allowance of £40,000 in the current tax year will gradually be reduced by £1 for every £2 of adjusted Income, which is in excess of £150,000, until for those with an adjusted income of £210,000 or more their Annual Allowance is reduced to £10,000.

However, the definition of 'adjusted' income is not solely comprised of salary. Income is 'adjusted' to include employer pension contributions or any other income; including bonuses, dividends and savings income, with the latter including rental income. This means that many more people will be caught by this change than at first sight.

WHAT IS ADJUSTED INCOME?

It should be noted that the tapered reduction doesn't apply to anyone with 'threshold income' of no more than £110,000. The difference between the two definitions is simple: 'adjusted' income includes all pension contributions (including any employer contributions) while 'threshold' income excludes pension contributions.

Therefore anyone with income over £110,000 needs to consider this issue.

UNINTENTIONAL TAX CHARGE

The consequences of not tackling this issue could result in a tax charge.

For example, if a bonus is paid close to the end of the tax year, then an employee may not know that they may already have inadvertently exceeded their pension contribution allowance for that tax year - and therefore would have paid/ had paid for their benefit, too much by way of pension contributions.

It's possible that they may have paid £40,000 into their pension, thereby utilising their full £40,000 Annual Allowance, but an unexpectedly high bonus at the end of the tax year may mean their adjusted income exceeds £150,000, which would result in a tax charge on the excess contribution at their highest rate of income tax.

Individuals affected by this change could be concerned about paying higher rate (40%) or additional rate (45%) income tax on part of the value of the package their employer provides for them.

WHAT IS THE SOLUTION?

In some cases, and with the assistance of a specialist adviser, high-earning individuals might be able to mitigate the impact of the legislation by making sure they have made use of all the allowances available to them.

Employers can help by educating and training their senior team and all those in HR or payroll who deal with Workplace Pension schemes.

But if pension specific language like 'carry forward of unused relief' and 'applications for fixed or individual protection' are met with glazed expressions from your senior team, then it is likely that they are not familiar with the meaning of such terminology - and the potential fiscal penalties that individuals' pension funds will incur if rules are broken.

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FLEXIBLE REMUNERATION STRATEGIES

Because this is, essentially, a personal tax issue, companies will tackle it in different ways: some might avoid a discussion with employees - but that would mean missing out on an opportunity to create goodwill by highlighting the issue.

A preferable route would be to offer some flexibility in remuneration strategies to help employees find the best solution for their own personal situation. But there is not a perfect 'one size fits all' solution because there are some issues that employers should consider:

- Reliance on cash rewards – motivating employees solely through cash is proven to have diminishing returns on value and productivity in many cases.
- Motivation of executives – it is questionable whether executives will be motivated to deliver excellence if they feel they are operating in a tax disadvantageous way or where their employer has not provided some support to help them deal with these complex planning issues.

ACTION YOU CAN TAKE

Here is an outline of some steps you can take to deal with this issue:

Training: Consider a high level training session for those involved in HR and the administration of your Workplace Pension scheme, and your senior executive team, so they are aware of these issues. It would also be advisable to facilitate a regular reminder session towards the end of the tax year when the executive team will have a better idea of their likely total earnings and desired pension contributions for the current tax year.

New joiner process: If you do not already pre-screen new joiners who may have high value pension funds prior to joining, introduce a form to ensure you and they are aware of any potential issues. Beckett's can provide this, if required. You should also ensure they meet with a qualified adviser.

Group Life Assurance: Review your group life assurance scheme and ensure you utilise an excepted scheme where appropriate. This is a technical issue that can help mitigate large tax penalties and contribute towards making your benefits package far better value.

Pre-retirement education: In most circumstances, anyone over age 55 has the option to commence taking pension benefits even if they continue working; but it is highly likely that they will not understand the multiple impacts (not all good by any means) this is going to result in. Consider running annual pre-retirement presentations for those approaching age 55 and over to highlight this issue and what their retirement options are in general.

Encouraging senior employees to understand the impact of new pension rules: Encourage all senior employees to review their pension provision in light of the new rules with a Chartered Financial Planner. In particular encourage them to find out how they might be affected by the new rules.

Review drafting of documentation related to pension benefits and amounts: If you want to offer some flexibility, you should consider how you will document this in contracts or variations to the terms and conditions of employment for your senior team.

Select an informed benefits partner and a Chartered Financial Planner: Tackling this issue requires experience and capability. One of Beckett's Employee Benefits Consultants can work with you to identify employees affected by these issues. Once identified, our team of Chartered Financial Planners can help those individuals put solutions in place.

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THE CONTENT OF THIS ARTICLE IS FOR GENERAL INFORMATION ONLY AND IS BASED ON OUR UNDERSTANDING AS AT JANUARY 2017. SPECIFIC PROFESSIONAL ADVICE SHOULD ALWAYS BE TAKEN.

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