



## PENSION UPDATE

# Pension tax relief changes - What now for employers?

**Pension contributions are one of the most tax efficient benefits that employers can provide – to a limit. They do not attract employer’s national insurance (currently 13.8%) or the apprenticeship levy (currently 0.5%) and they usually qualify for a deduction against corporation tax (currently 19%).**

In addition, up to the Annual Allowance (“AA”), the employee does not pay income tax (currently up to 45%) or employee’s national insurance (currently 12% or 2%) on the value of the contributions, although may be taxed when drawing income after retirement.

On top of that, many employers operate “salary sacrifice” options which allow employees to give up a portion of their salary in exchange for receiving additional employer pension contributions. Employees do not pay income tax or national insurance on the value of the salary they sacrifice, and the employer makes pension contributions which are treated as above.

The tax efficiency of pension contributions means they are often a key benefit for employers looking to attract and retain talent.

However, from 6 April 2016 the value of employer pension contributions for higher earners (broadly, those with income above £110,000) often became less attractive due to the introduction of the AA taper restriction. The taper meant that the tax efficiency of contributions for impacted higher

earners was reduced. Instead of being able to contribute £40,000 tax efficiently into a pension during a year the highest earners could contribute £10,000 in total. Where the limit was breached, additional employer contributions attracted an employee income tax charge of up to 45% known as the Annual Allowance Charge (“AAC”). Whilst the AAC is, in effect, the removal of tax relief, it is often viewed a “dry” tax charge by individuals – the AAC is calculated by reference to inaccessible pension contributions and paid together with income tax due on submission of the annual self-assessment tax return. However, in certain circumstances individuals can request the charge is paid directly by their pension provider from their pension savings.

## What is changing?

From 6 April 2020 higher earners, with income above £110,000, may be able to put more into their pension tax efficiently.

Whilst the standard AA, the amount that an individual can save tax efficiently into their pension, is remaining unchanged at £40,000, the taper restriction for higher earners is becoming more generous. Broadly, individuals with income above £110,000 but below £200,000 will no longer need to worry about their AA being tapered – they will retain the full £40,000 allowance. Those with income above £200,000 may also find that their AA is not restricted to the same extent as before.

However, the very highest earners, those with combined income and pension contributions of over £300,000 will see their AA restricted further than previously.

## What is the taper restriction?

The taper restriction reduces the standard AA for higher earners. The AA is reduced by £1 for every £2 of income above a set limit, known as “adjusted income”.

Individuals firstly need to calculate their “threshold income”- this determines whether they are within scope of the taper at all. Threshold income is, largely, net taxable income. From 6 April 2020 individuals with threshold income of less than £200,000 for the year will not have their AA tapered – i.e. they will retain the standard £40,000 AA.

Individuals with threshold income of £200,000 or more may have their AA tapered. To determine the amount of the taper an individual needs to calculate their “adjusted income”. Adjusted income is, broadly, net taxable income plus pension contributions (including employer contributions) for the year. For every £2 of adjusted income above £240,000 the AA is reduced by £1, until it reaches a minimum of £4,000 for those with adjusted income of £312,000 or more.

This means that only individuals with adjusted income of over £300,000 will be worse off from 6 April 2020, with those with a lower adjusted income receiving more generous tax relief than before.

## What does this mean for employers?

Most employers provide employees with pension contributions in one, or both, of two underlying ways:

- Non-contributory: an employer will make pension contributions at a set percentage of an employee’s salary, without the need for any contributions from the employee, often up to a maximum reference salary for the highest earners
- Matching: an employer will “match” employee contributions to a pension, either on a 1:1 or weighted basis (e.g. if an employee contributes 5% of their salary, their employer will contribute an additional 5% of their salary if on a 1:1 basis).

For higher earners who are subject to AA tapering, both approaches may have ostensibly negative results in the employee’s eyes. Employees may not value non-contributory employer contributions which are in excess of their AA and result in an AAC. For matching schemes, employees may reduce their contributions to avoid breaching their AA, but feel that they are missing out on the value of additional contributions from their employer in doing so.

To help higher earning employees make maximum use of tax efficient pension savings, whilst also ensuring they do not feel they are “losing out”, many employers have introduced additional options for impacted employees. These normally take one of the following approaches:

- Employers reduce the value of non-contributory employer pension contributions, often in line with the minimum possible AA (previously £10,000), and make a monthly cash payment to employees in lieu of what they would otherwise have contributed; or
- Employers cease the requirement for employee contributions on matching schemes – either basing their “matching” contribution on the employee’s personal contribution history, or a self-declaration of the amount the employee would otherwise have contributed but for the AA restriction

Where employers make a case payment in lieu of pension contributions, the gross amount is often based on the cost to the employer of the original pension contribution (i.e. to account for the fact that an employer will now be paying, for example, employer national insurance contributions). Of course, this cash payment is subject to income tax and national insurance for the individual concerned.

Given the more generous AA now available for certain high earners, employers will want to revisit their policies with effect from 6 April 2020. We anticipate that many employers will wish to amend their policies, potentially reverting to standard conditions for individuals with earnings from employment of less than £200,000 a year. Where flexible options are retained, employers may be wise to consider whether to include any additional flexibility for their highest earners, given that most current options are based on a minimum AA of £10,000 which may now decrease to £4,000.

Employers with impacted individuals will also want to ensure they issue clear communications to all individuals as soon as possible in the new tax year – this helps to ensure that employees are not surprised by the tax implications of any employer supported pensions.

## About the Employment Tax and Reward Team

FTI Consulting has a technically minded, commercially focused and pragmatic team providing advice on all employment related tax and social security matters, for both domestic and internationally mobile employees.

Our services include payroll health checks and due diligence, assisting with HMRC enquiries and "Know Your Customer" discussions, and providing advice to business on expenses and benefits arrangements (including PAYE settlement agreements, termination payments, disguised remuneration considerations, and employment related share schemes) together with employment status and off-payroll worker issues.

We also help businesses with their internationally mobile employees, including assisting with non-resident directors, short term business visitors, and assignment planning, policies and implementation. We also provide advice and support for specialised payroll compliance arrangements such as modified and shadow payrolls and net of foreign tax credit arrangements.

In addition, we provide support to employers in creating attractive reward packages. We provide assistance with the planning and operation of share schemes (both tax approved and unapproved) and other long term incentive plans. This includes the design of plan rules and tax considerations, assistance with plan implementation and employee communications, and related tax valuation and compliance activities.

We help clients across a wide range of sectors, with extensive experience with life sciences, real estate, private equity backed companies and family businesses.



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Lewin has over 12 years of experience advising clients on employee related tax matters – both for domestic and internationally mobile employees.

Lewin has advised a wide range of clients across various sectors on all tax issues relating to employees including expenses and benefits, termination and inducement payments, employment status, off-payroll working, disguised remuneration, employment related securities, carried interest, management incentives, PAYE compliance, residence and domicile positions, inpatriate and temporary workplace relief, short term business visitors, international social security, and international aspects of UK and overseas pension schemes.



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