# A Taxing Matter for High Earners

## Q&A for Finance and HR Directors

May 2009


Discover more by contacting us:

London:
nick.rudd@bdo.co.uk
simon.nicol@bdo.co.uk
matthew.brown@bdo.co.uk

Leeds:
steven.banks@bdo.co.uk

Glasgow:
alastair.mcquiston@bdo.co.uk

Manchester
paul.mills@bdo.co.uk

Birmingham
andy.mcgowan@bdo.co.uk

Eastern region:
sharon.thorpe@bdo.co.uk

Southern region:
mark.wooldridge@bdo.co.uk
malcolm.lay@bdo.co.uk



BDO Stoy Hayward Investment Management Limited is authorised and regulated by the Financial Services Authority. BDO Stoy Hayward Investment Management Limited is registered in England and Wales No. 2096406.

The registered office is:
55 Baker Street, London.
W1U 7EU.
T: 020 7486 5888



The material contained in this document is based on data obtained from sources considered reliable and believed to be correct at the date of issue, but its accuracy or completeness is not guaranteed, is for guidance only, and should not to be construed as a advice by BDO Stoy Hayward Investment Management Limited.


### "The new rules return pensions to the complexity of string theory" (*Economist 2 May 2009*)

Higher rate pension tax relief came under scrutiny in the Budget with proposals to restrict tax relief for those with annual income of more than £150,000. Relief will be tapered away between £150,000 and £180,000 with the result that tax relief will be worth 20 per cent, the same as a basic rate taxpayer, for those with income above £180,000. It is anticipated that consultation will take place with interested parties on how to ultimately implement this procedure.

In the meantime, however, transitional arrangements have been introduced to prevent those who might be affected by the new rules accelerating their pension contributions to take advantage of existing tax relief provisions.

These transitional arrangements are extensive and have far reaching implications for higher earners.

### Who is affected by the transitional arrangements?

All individuals whose income exceeds £150,000 in 2009/10, or has done in any of the previous two tax years. Income for this purpose includes all taxable income received from employment and also includes dividend income, interest on deposits and rental income.

The transitional rules cover all pension contributions made by high earners after 22 April; exemptions exist for continuing regular contributions and contributions under £20,000 per annum

As investment and other non employment income is included in this calculation it will be difficult for employers to judge which of their employees might be subject to the transitional arrangements.

### What are the transitional arrangements?

Individuals who fall under the category described above may be subject to a new tax on pension contributions made by them as individuals or made for them by an employer.

Employees who receive employer pension contributions, outside of some exceptions, will be required to declare these upon their self assessment tax return and will suffer a 20 per cent special annual allowance tax charge on the gross value of these contributions.

Individuals who personally contribute to a personal pension will continue to pay net of basic rate tax which will be reclaimed by the pension provider but they will no longer be able to offset those contributions against higher rate tax relief through their self assessment returns.


**continued on page two**

# A Taxing Matter for High Earners

## Page two

### How does this affect employers?

The employer's tax situation is unchanged; employer contributions will continue to be eligible for tax relief as currently and will continue to avoid employer's National Insurance contributions.

However, employers may become involved in talking with those employees who, because of the new tax, no longer wish to make pension provision and are seeking to re-negotiate their remuneration packages accordingly.

### What's happened to Salary and Bonus Sacrifice?

Specific measures within the transitional arrangements prevent employees from attempting to artificially reduce their income below £150,000 by sacrificing bonuses or salary. Any salary or bonus sacrifice provisions entered into after 22 April will not, for the purposes of the new tax have the effect of reducing an employee's income. Although such sacrifices can still take place, any amount sacrificed will still count when calculating total income for the high earner test (but not for any other purpose).

Salary or bonus sacrifice arrangements entered into prior to 22 April will continue to have the effect of reducing an individual's income for the high earner test. However, the extra amounts contributed as a result of the sacrifice will still potentially be subject to the special annual allowance charge if an employee's income, despite the sacrifice, remains above £150,000.

### What about Pension Contributions made prior to 22 April?

All contributions paid prior to this date should avoid the new tax.

### What are the exceptions?

There is provision for certain existing contributions to be deemed as "protected pension input". This allows individuals whose income is over £150,000 to continue to receive full tax relief on regular pension contributions which were in existence prior to the Budget. Regular contributions for these purposes must be at least quarterly payments; note annual contributions do not count as regular contributions. Individuals therefore who are members of an employer's pension scheme and who will generally be making monthly contributions will not suffer the new tax by continuing with those contributions.

Pension members also may contribute up to £20,000 per tax year without being subject to the new tax. The £20,000 includes all existing pension contributions including those which might be protected under the exceptions above.

Certain increases in contributions will be permitted, for example, if an individual is contracted to pay a percentage of their salary into the pension scheme and their salary is increased during the year, the resultant increase in contributions will generally not be subject to the new tax.

The rules on permitted increases in contributions are complicated and further advice should be sought before these are considered.

There are also special provisions for new employees joining an existing employer's pension scheme and if an employer restructures their pension provision.

### What about Defined Benefit (Final Salary) Schemes?

In general most members of Defined Benefit Schemes will avoid the new tax on their ongoing employer and personal contributions. Increases in contributions should also be covered if they relate to an increase in salary. Again, there are specific anti-avoidance provisions to prevent Defined Benefit Schemes improving the benefits payable perhaps by increasing the accrual rate. Further advice should be sought in this regard if appropriate.

### What happens in 2011/12?

The intention is to introduce a system of taxation on pension contributions for all high earners exceeding the £150,000 income threshold. At this time we expect all contributions for such employees to be subject to the new tax.

It is anticipated that tax relief will be tapered for those with income between £150,000 and £180,000.

It also seems likely, although this has not been confirmed, that the tax charge will rise from 20 per cent to 30 per cent in line with the new 50 per cent tax band, probably from next year.

### How can BDO help?

- Employers may wish to seek advice before proceeding with increases in contributions or changes to pension schemes that may affect high earners. It should be borne in mind 'high earners' may be difficult to identify due to the broad definition of income.

- Inevitably some employees will wish to cease receiving employer pension contributions. We can help you consider and form a strategy on alternative, compensatory payments.

- Individuals should also be wary of making changes to any existing pension plans which carry regular contributions. Such changes can result in the loss of protection on those contributions. We can assist you by constructing a communication strategy.

Copyright © May 2009 BDO Stoy Hayward Investment Management Limited. All rights reserved. This document has been produced based on current Law and HMRC current practice, which may be subject to future change.