Secondsight
Part of the **Foster Denovo Group**

Will your top talent lose out when it comes to their pension pots

What you need to know about managing the changes to pension allowances for higher earners

Pension allowances have fallen

This April the new finance act came in to effect, bringing in a number of changes to the rules surrounding pensions.

The changes are likely to impact the nation's highest earners and some middle income earners may be affected too.

Taken together, these changes could pose a real and present danger to the pension pots and long term financial futures of your valued employees.

Identifying the risk

This legislation is complex. And although the changes have come in to effect, as an employer, you can still implement some changes to help protect your employees.

Liability and best practice

So what are your obligations to communicate the implications of the new laws to your employees?

Where does liability sit if you fail to inform your people adequately?

And how far might you be held accountable if employees incur substantial tax liabilities that could have been avoided?

The complexity of the issues demands that individual employees take financial advice, and the earlier the better.

There's a need on the part of employers to:

- educate individuals who may be at risk;
- recommend that those employees take advice now; and
- agree a flexible pension contribution strategy for affected employees.

The issues explained

TAPERED ANNUAL ALLOWANCE 2
Could leave your top talent too rich for a pension.

LIFETIME ALLOWANCE 7
Could create 'full up' pensions for your best people, complete with a potential 55% tax liability!

DEATH IN SERVICE 11
Could be a flawed 'benefit' for your higher earners, whether they live or die.

Tapered annual allowance

The tapered annual allowance will affect anyone with income over

£150,000 per year.

But isn't solely based on your employees' annual salary.

Instead it is your 'adjusted' income – something that is made up of a number of variables, some of which will be private to the individual.

'Adjusted income'

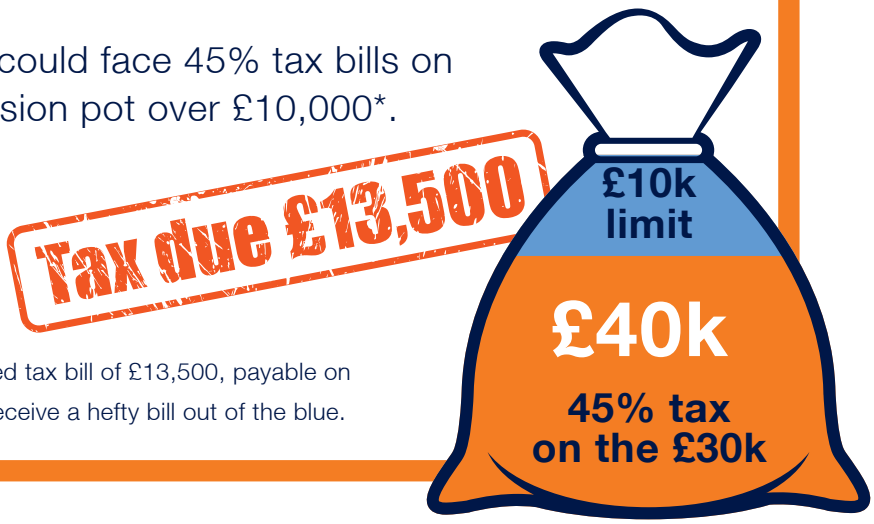
Just to make things easy for you, the calculation for adjusted income includes:

- an individual's pension contributions;
- your contributions into their pension;
- salary sacrifice and benefits in kind;
- commission;
- income from a pension; and

- '**income**' also includes any additional taxable private and employment income they may receive from savings, investments, and buy-to-let income.

Why should you be concerned?

In the future your top people could face 45% tax bills on any contributions to their pension pot over £10,000*.



*Your high earners could receive an unexpected tax bill of £13,500, payable on 31st January 2018. So your high flyers could receive a hefty bill out of the blue.

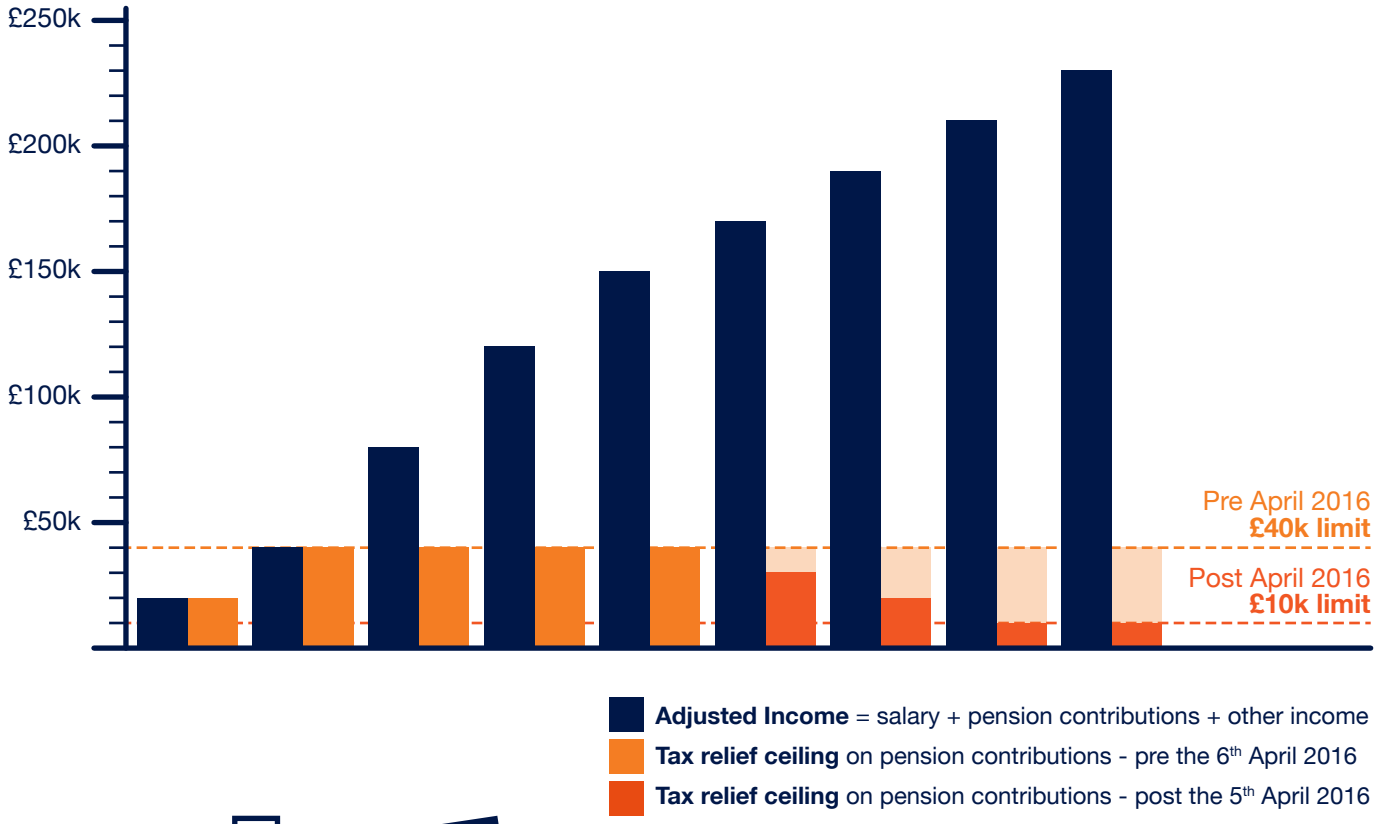
Could your well intentioned pension contributions result in unexpected tax bills for your top talent?

Until now, one of the most tax-efficient ways for your employees, including your high earners to save for their futures (and for you as an employer to reward them) was through pension contributions.

However, if you continue paying pension contributions at the same rate, some of your best people could face an unexpected tax bill of as much as £13,500.

The £40,000 annual allowance will be reduced by £1 for every £2 of adjusted income above £150,000 until it reaches £10,000 for adjusted incomes of £210,000 and above.

Drastic reductions in the tax efficiency of pensions for high earners



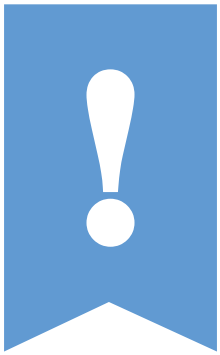
How the new rules could make your top people 'too rich for a pension'

	Before the 6th April 2016		Current rules after the 6th April 2016
Your employees' **'adjusted income'**	**£100,000**	**£150,000**	**£210,000**
Total **maximum contributions** before tax is incurred	**£40,000**	**£40,000**	**£10,000****
What the **taxman pays in** for the employee (this forms part of the annual £40k limit)	**£16,000**	**£18,240***	**£4,500**
***How big an individual's pension pot could be in 'today's' terms after 30 years of contributions	**£1,300,000** Approx.	**£1,300,000** Approx.	**£325,000** Approx.
			A loss of £1million

Source: Secondsight.

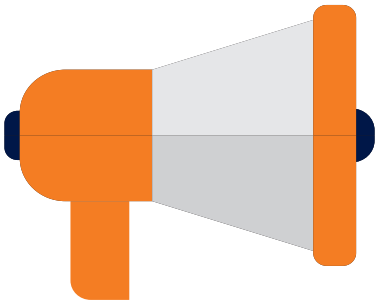
*£11,200 of this contribution enjoys an effective relief rate of 60% due to reclaiming some of the personal allowance. **This figure assumes no annual allowance relief has been carried forward. ***Forecast based on 5% growth per year and 2.5% inflation per annum. Figures are rounded to assist clarity.

Best practice; what you can do right now:



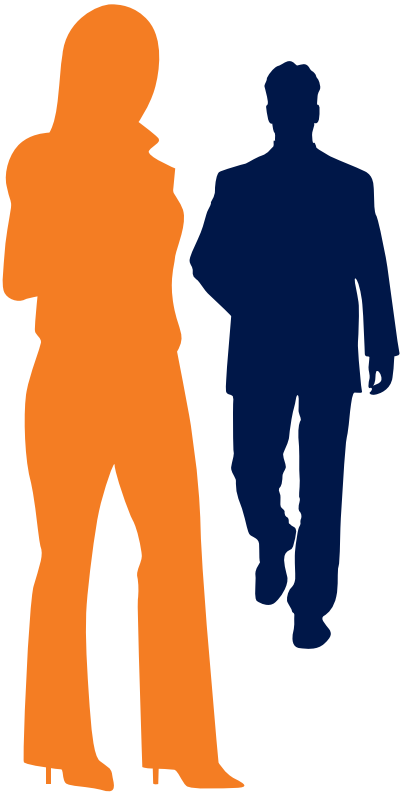
You can provide accessible and engaging financial education

- so you'll flag up these issues to staff who might be affected; as well as
- alerting those people who you know from payroll definitely will be.



By informing all personnel, you can help employees to self-identify and take appropriate action

- the appreciation, loyalty and engagement generated among top talent who make significant savings as a result, could have enduring value.



Alongside education, you may want to consider introducing alternative retirement planning arrangements for affected employees. This would involve exploring how flexible you can be. Could you:

- offer other savings mechanisms to reward and retain this higher earning group?
- provide a pension on a non-contributory basis; or
- consider alternative cash rewards?

What your affected employees can do right now

If they take **professional advice** your top talent can do a great deal to mitigate the effects of this new legislation. They could:

1. apply to 'protect' the higher lifetime allowance of £1.25m for 2016 or even the £1.5m allowance from 2014; and

2. talk with you about re-thinking their contribution strategy. Review and re-assess their retirement planning.

While it's up to individuals to make these decisions, by flagging them you could save the people you value most a great deal of money.

Take immediate action

Communicate this information to your top talent now so they can make informed decisions.

Agree a corporate policy for pension contributions for higher earners.

Lifetime allowance

Don't let the cut in the lifetime allowance stop your top talent achieving their planned retirement.

A prosperous retirement is the result of careful planning, however your employees' pension pots are now capped at £1million. This may sound like a lot, but we'll demonstrate that it really isn't.

With this latest pension pot reduction, it's a cool £0.25million* less than any of us previously enjoyed.

*This figure may change in line with indexed CPI from 2018/19.

An accident waiting to happen?
Full up pensions = painful tax liabilities

Something else to consider, any group life assurance benefits you provide may count towards an employee's lifetime allowance. This is because 90%[1] of death in service benefits are classified as 'pension arrangements'.

Pre 6th April 2016 allowance

Current Allowance*

*Indexed from CPI from 2018/19 tax year.

This is bad news not only for high earners but for middle-income employees too.

For example, someone earning £80,000, with 6 years to retirement, death in service benefit of four times salary and an existing pension pot of £533,000** should seek immediate financial advice. Paying into a pension may no longer be the best way for them to plan for retirement.

**Assume a 6% matching pension contribution, a 0.5% AMC and a 5% assumed growth rate excluding inflation. Please note: depending on the term to retirement, the current value of their pension pot and the value of any future contributions, individuals with earnings lower than £80,000 could also be affected.

[1] Source: Canada Life. Based on figures from 14,000 group life assurance schemes.

So who do you need to talk to, and who should you be concerned about?

Just as it's impossible to know an employee's 'adjusted income', you have no way of knowing the value of an employee's pensions from previous jobs. So an employee may have £100,000 in their pension with you, but have other pensions that would contribute to their overall pension pot.

And these could include defined benefit pensions, or final salary pensions. If an employee is expected to receive benefits of £20,000 at retirement from their defined benefit pension, a multiple of 20 would be used to calculate their lifetime allowance. In this instance, one employee's pension from a past job would account for £400,000 of their lifetime allowance. A significant amount.

Employee education alert

It may be stating the obvious, but it's vital that employees understand that their lifetime allowance applies to the value of their pension when they come to draw money from it. Not the value today.

So employees need to base their calculations on their current pension pot.

For example, this forecast (below) is based on a 45 year old, earning £80,000 per year, 6% matched pension contribution, 5% growth, and 0.5% AMC.

Years until retirement

Fund size

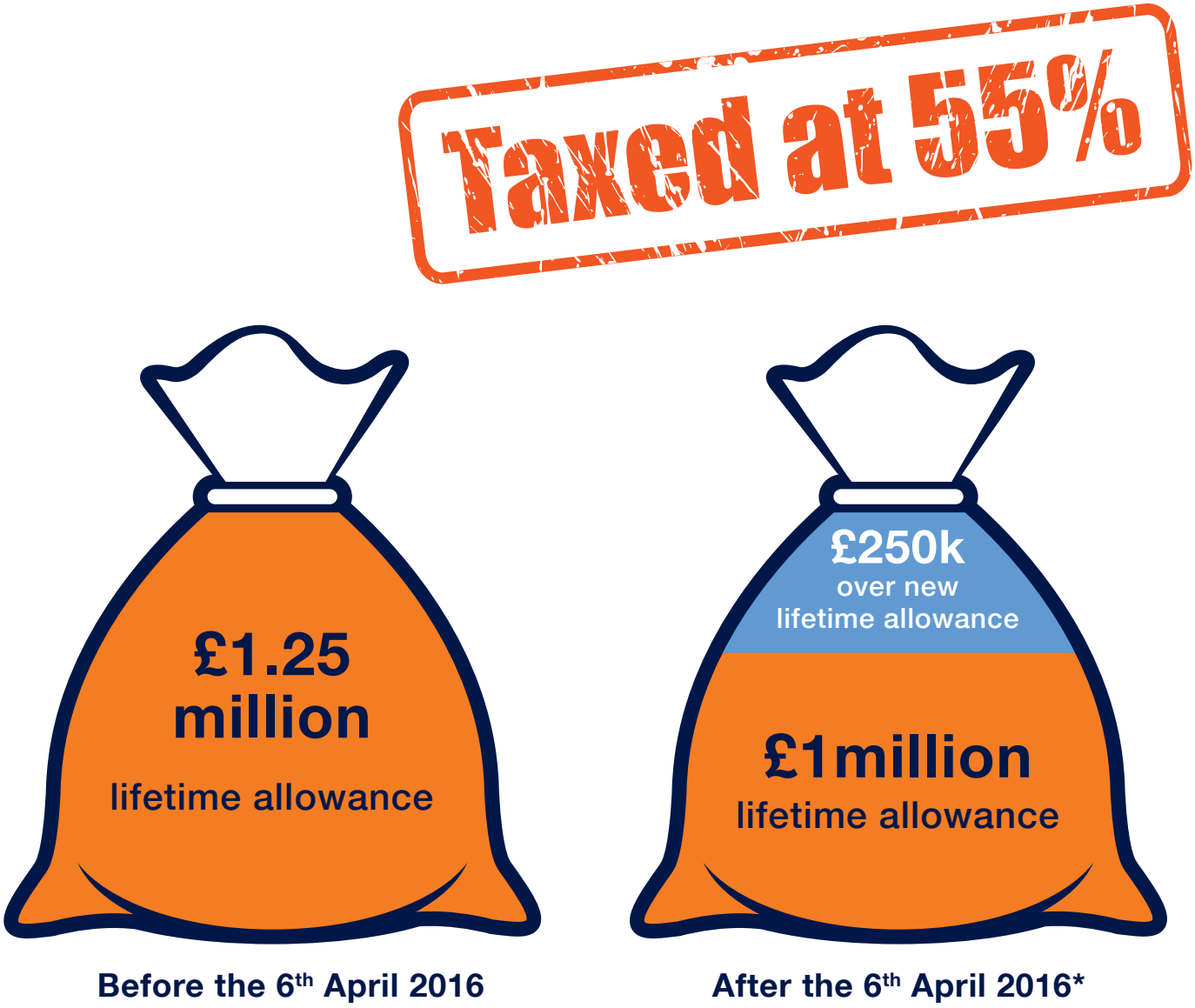
Re-valued lifetime allowance at 1.9% from April 2018.

Halt all contributions! Typical employee profile

Employees fitting the profiles above may wish to consider ceasing all pension contributions after taking advice.

What could happen to employees who don't act?
Tax at 55%.

With this new lower limit, your employees may be liable to pay 55% tax on any money that they take out of their pension pot over the new lifetime allowance of £1million. So some of your most valuable employees could be at risk of sleepwalking into unnecessary taxes, with grave consequences.



*This figure is subject to change in line with indexed CPI from 2018/19.

What your affected employees can do right now:

1. apply to HMRC for individual protection 2016 or 2014;
2. seek financial advice. After seeking advice, it may be they are advised to stop pension contributions due to the levels of taxation that may be applied to their pension pot; and
3. be aware of the pitfalls of changing jobs; automatic enrolment and group life assurance contributions made in all good faith on your part could nullify any fixed protection that a new employee brings with them from HMRC.

Best practice; what you can do right now:

1. information is power. Educate employees as to the risks;
2. put in place a robust system to safeguard the interests of employees who have previously applied for fixed protection. This is vital since a single contribution made on their behalf now would make them liable to 55% tax. And you could be open to possible litigation;
3. agree a flexible pension contribution strategy for affected employees;
4. introduce a new-joiner consultation process for high earners, covering death in service benefit and auto-enrolment; and
5. explore the death in service 'excepted scheme', see page 11.

Take immediate action

For those potentially affected:

- cease pension contributions*
- offer employees an analysis of their likelihood of being affected by the lifetime allowance cap – a financial adviser can help you provide this service.

*You must seek advice if you are considering ceasing pension contributions.

Please note: In the future, if the indexed standard lifetime allowance overtakes an employee's enhanced personal lifetime allowance under fixed or individual protection, they would benefit from the higher standard lifetime allowance.

Death in service implications

How group life assurance benefits could rebound for employees and a grieving family.

It's estimated that 90% of today's group life assurance benefits are set up as pension arrangements. Under this system a death in service payout can't be classed as a P11D taxable benefit. With the new lifetime allowance, this could prove very costly for the intended beneficiaries.

Example

- An employee, earning £80,000 dies after the 5th April aged 48.
- At the time of death his pension pot is £1million.
- His death in service benefit of £320,000 is calculated as part of his pension pot.
- As the £320,000 is in addition to the £1million lifetime allowance, it is taxed at 55%.
- Leaving his family with £144,000 – less than half the money paid out.

Best practice; what you can do right now:

- an 'excepted' group life assurance scheme is a route that some organisations may explore. It's a complex area, but at its simplest, it treats a selected group of employees as a different entity. The death in service element of pension classification doesn't apply to this 'excepted' group. Instead they receive a fixed group life assurance benefit as part of their package (in terms of £s or salary multiples);
- this is a great place to protect new hires (who join you with fixed protection from HMRC) from future death in service liabilities. If it sounds complicated, it's because it is! But it's well worth exploring;
- alternatively, you may want to consider putting in place an altogether different benefit for those employees likely to be affected; and
- above all, it's essential that you communicate these issues to employees, and given their complexity, suggest that those who suspect they may be affected, seek financial advice.

Take immediate action

For those potentially affected:

- consider introducing an 'excepted' group life assurance scheme for new hires; or
- consider alternative benefits for this group; and
- educate employees likely to be affected.

Why have we published this guide?

We are a multi-award winning employee benefits adviser, we specialise in financial, health and mental wellness, including financial education, pension advice and employee benefits provision, as well as group risk and healthcare.

So as you'd expect, we keep a close eye on new financial legislation and the implications for our clients and their employees.

Alarm bells

The more we analysed the cumulative and knock-on effects of the changes we've outlined here, the more concerned we became, for our corporate clients, and for their top talent.

Perhaps unwittingly, HMRC's actions may undermine many carefully made pension plans, to disincentivise retirement planning for higher earners, and to cause multiple headaches for employers trying to reward their most valued people. **We can help.**

Support

Our aim is to flag up these issues immediately and to offer you support.

- Firstly, we can help you educate your employees so they can protect their interests.
- Secondly, we can advise you on planning new ways to reward and empower your best people to access efficient retirement planning.
- Thirdly, our national status and reach, means you can invite your employees to discuss their wider financial planning concerns with one of our many specialised financial advisers.

Your employee benefits package is designed to benefit your employees. It's no small investment on your part. So the last thing you want is for it to fall short of expectations, or worse still, alienate your most valued people.

As this guide illustrates, without preventative action your top employees, maybe even those at Board level, could:

- receive an unexpected tax bill;
- have their retirement impacted by a large tax liability when they take their pension benefits; and
- have family receive less than half their death in service payout due to tax.

Imagine if they, or their dependants, found out that these issues were avoidable.

We'll work with you to minimise the impact of these new changes.

Call us now **0330 332 7143***

We are a multi-award winning employee benefits adviser, we specialise in financial, health and mental wellness, including financial education, pension advice and employee benefits provision, as well as group risk and healthcare.

About us

Probably best to let external sources do the talking:

- we've been awarded over 20 accolades; ranging from 'IFA of the Year' for Foster Denovo through to formal recognition for our employee benefits and pension work, including Best Employee Benefits Advisory Service UK and Workplace Financial Education Firm of the Year UK at the Finance Awards 2015;
- in 2015, we were awarded Money Marketing's Best Auto-enrolment Solution. We won this award for the innovative workplace pension solutions we created to help large and small companies, as well as charities. This included the groundbreaking, online auto-enrolment tool www.enrolsme.com;
- our Net Promoter Score (NPS) revealed that our clients rate us as +56 and 83% and say we are, 'easy to do business with'; so
- you can trust us for innovative solutions.

Contact us for more information and guidance as to how the changes may affect your employees and what you can do about it:

call 0330 332 7143*

email info@second-sight.com; or

visit www.second-sight.com.

*Calls are charged at your standard landline rate.