



Regis House, 45 King William Street, London EC4R9AN  
Tel: +44 (0)20 3102 6761 EMail: [acahelp@aca.org.uk](mailto:acahelp@aca.org.uk) Web: [www.aca.org.uk](http://www.aca.org.uk)

10 August 2015

By email to [pensions.policy@hmrc.gsi.gov.uk](mailto:pensions.policy@hmrc.gsi.gov.uk)

Dear Sirs

**READERS: PLEASE ALSO NOTE  
LATER UPDATE SHEET  
16 February 2016 ON ACA WEBSITE**

**Finance Bill 2015/16 version date 14 July 2015  
Tapered Annual Allowance and interaction with salary sacrifice**

I refer to the Bill and in particular to the definition of Threshold Income in Part 4 (clause 23), and Schedule 4 para10 (1).

**Clarification of “made on or after 9 July 2015”**

The new section 228ZA(5) (b) provides that Threshold Income is calculated after (explicitly or implicitly) netting off relievable pension contributions made by the individual, and pensions savings funded by the employer are usually ignored. But there is a special provision that means Threshold Income is increased by the amount of any employer pension contributions made by way of “relevant salary sacrifice arrangements or relevant flexible remuneration arrangements” .. “made on or after 9 July 2015”.

We have queried with you what counts as “made on or after 9 July 2015”. I note that you have referred us to a letter that Peter Seedhouse wrote in 2010 (attached) in the context of the then Government’s “HIERC” proposals (not pursued) and anti-forestalling measures – and you have confirmed that “*These principles remain but it will of course depend on the facts of each case.*”.

So if the draft legislation is indeed put into place as written, the 2010 letter’s reading will be relevant to our members and I am duly passing this information on to them by way of this letter.

**However, given the unnecessary complexity this will cause, we would really like to check with you that the provision is necessary to achieve the Government’s aims. If not, we would propose that the draft legislation is changed to remove the provision.**

Such salary sacrifice measures **were** a necessary feature of HIERC because the Threshold Income there did **not** net off member pension contributions. Without the measure, an individual could have “moved” member contributions to employer contributions so bringing Threshold Income below the key amount, which would have been a material loophole.

*For example, suppose an employer was prepared to spend £139,000 on an individual. If this is delivered all as salary (and this is the individual’s only income) but from it the member pays pension contributions of £10,000, the fact of the contribution would not have been taken into account under the 2010 HIERC anti-forestalling legislation. His Threshold Income would have remained at £139,000 ie over the £130,000 income threshold for anti-forestalling provisions to apply.*

*However, if the member instead received £129,000 and benefited from a £10,000 employer pension contributions then his Threshold Income would not have been over the £130,000. Hence the need in 2010 for a measure to stop the deliberate creation of this situation.*

For the 2015 definition of Threshold Income for the tapered Annual Allowance measure, the political decision has been made that member contributions **are** to be netted off. Therefore there is not the same loophole, as shown in the following examples.

*Using the same type of example as above, suppose an employer wants to spend £119,000 on an individual; the same outcome arises under the 2015 Bill from both of the following cases:*

- A) the employer paying a salary of £119,000 from which the member contributes £10,000; and*
- B) the employer paying a salary of £109,000 and contributing £10,000 not by salary sacrifice (or by a salary sacrifice arrangement set up on or before 8 July 2015).*

*For both A) and B) the individual's Threshold Income is under £110,000 and therefore "adjusted income" does not need to be considered and their Annual Allowance is £40,000.*

*However, the salary sacrifice provisions as drafted create a variation of the above for special treatment, where a salary of £109,000 is received alongside employer contributions of £10,000 that happened to be structured by way of a new salary sacrifice. This case would be in a completely different position from A and B, ie the Threshold Income would be £119,000, which is more than the £110,000 minimum, so would trigger the need to assess "adjusted income" and could then result in a reduced AA.*

### **What is the complexity?**

Keeping the provision in the legislation – which the above shows is not needed – will also mean:

- Uncertain variations will need clarification.
- There will be a difference in treatment of salary sacrifice or flexible remuneration arrangements made before 9 July 2015 between one arrangement which happens to require the employee to confirm the same level of sacrifice say on an annual basis and another where the same level of sacrifice (whether percentage or amount) continues by default. The former would (from the renewal date) be regarded as a new arrangement and must be added back to derive Threshold Income; the latter case must be treated as a pre-9 July arrangement and not added back.  
This difference in outcome arises solely because of the mechanics of set up.
- For the annual arrangements, the practical position will soon be clear. From next renewal, all employer contributions under salary sacrifice will need to be added back to derive Threshold Income for the 2016/17+ tax year. But if the individual does not renew/elect for the sacrifice to continue, and contributions revert back to being personal ones, this will reduce his Threshold Income again.

For continuing-by-default schemes, the position will depend on historic information as at 8 July 2015 and a trail of history thereafter. Peter's 2010 letter indicates what happens if the sacrifice level is solely reduced or increased compared to that level (although is this an amount or a percentage test?). It does not say what happens if there is greater variation (would stopping sacrifice followed by restarting mean a "new" arrangement so add-back?). And if the employment contract itself stopped and restarted (and for new employees), thereafter all salary sacrifice would be added back, we assume.

- Neither the individual nor HMRC will be able to derive Threshold Income from the tax return information alone. Individuals will need to request information regarding their salary sacrifice, administration systems will need to be adapted and HMRC will need additional information input if it is to be able to do any checking.

The number of cases for which the salary sacrifice will make a difference to the AA position will be relatively small (it will only make a difference to outcomes if the salary sacrifice element pushes Threshold Income above £110,000). But the administration burden and data confusion will be large. And where the difference “bites” (and if the adjusted income is then above the £150,000 level), this will - at best - bring the member/scheme into the complexities involved with having a tapered AA; and may involve managing an AA charge (which in some cases could be significant).

We hope very much that you can confirm our analysis set out in the above examples, and that the Government can propose a change to the Bill – and do so as early as possible (though we realise that this cannot be before Parliament comes back into session in September).

Karen Goldschmidt  
Chair, ACA Pensions Taxation Committee  
Direct Dial: 020 7432 6622 Email: [Karen.goldschmidt@lcp.uk.com](mailto:Karen.goldschmidt@lcp.uk.com)

Enc 2010 letter from Peter Seedhouse

## APPENDIX

### Extract from Finance Bill 2015/16 version date 14 July 2015

Insert to 228ZA by way of Schedule 4 Part 4 para (10)

(5) The individual's "threshold income" for the tax year is-

(a) the individual's net income for the year (see Step 2 of the calculation in section 23 of ITA 2007), plus

(b) any amount by which what would otherwise be general earnings or specific employment income of the individual for the year has been reduced by relevant salary sacrifice arrangements or relevant flexible remuneration arrangements, less

(c) the amount (before any deduction under section 192(1)) of any contribution paid in the year in respect of which the individual is entitled to be given relief under section 192 (relief at source), less

(d) the amount of any lump sum which accrues in the year and in relation to which section 579A of ITEPA 2003 is applied by section 636A(4ZA) of ITEPA 2003.

(6) In subsection (5)-

"relevant salary sacrifice arrangements" means arrangements-

(a) under which the individual gives up the right to receive general earnings or specific employment income in return for the making of relevant pension provision, and

(b) which are made on or after 9 July 2015 (and whether before or after the start of the employment concerned), and

"relevant flexible remuneration arrangements" means arrangements-

(a) under which the individual and an employer of the individual agree that relevant pension provision is to be made rather than the individual receive some description of employment income, and

(b) which are made on or after 9 July 2015 (and whether before or after the start of the employment concerned).



**HM Revenue  
& Customs**

**Charities, Assets and  
Residence (Pensions Policy)**

100 Parliament Street  
London  
SW1A 2BQ

Karen Goldschmidt  
Lane, Clark and Peacock LLP  
30 Old Burlington Street  
London  
W1S 3NN

**Tel** 020 7174 2529

**Fax** 020 7147 2531

**Email** Peter.Seedhouse@hmrc.g

l si.gov.uk

www.hmrc.gov.uk

**Date** 31 March 2010

**Our ref**

**Your ref**

Dear Karen,

**Salary Sacrifice and the Special Annual Allowance**

Thank you for your e-mail of 17 March 2010 which we discussed briefly at our meeting on Friday 19 March.

I understand you are concerned about differences in outcomes where an employee's existing salary sacrifice continues year after year (without the need for further agreement from the employee) compared to the scenario where the employee is required to agree to the salary sacrifice continuing or salary will revert to the pre-sacrifice amount. HMRC's view is that in the former scenario the existing salary sacrifice continues, whereas in the latter there is a fresh salary sacrifice. This is of significance because of the 22 April cut off date for salary sacrifice arrangements that will be taken into account in the income calculation for the anti-forestalling legislation in Schedule 35 Finance Act 2009 and the main measure that is intended to come into force from 6 April 2011.

I agreed to discuss the points raised in your e-mail further with colleagues dealing with employment income issues, where salary

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Director: David Richardson



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sacrifice is a regularly recurring issue, to ensure the approach we have taken, as outlined in the Registered Pension Scheme Manual and in Trevor Smeath's letter dated 12 January 2010, is consistent with the approach taken to salary sacrifice in HMRC more generally. I have now done so and, in the light of this, confirm that the approach to salary sacrifice outlined in the earlier correspondence is consistent with the approach taken across HMRC. It is also, in our view, correct in terms of how the legislation in question should be applied in the context of the wider employment issue of salary sacrifice. Therefore, I am unable to agree to your request to adopt an approach that would treat the two scenarios in the same way.

I appreciate you will find this response disappointing, so I have set out in more detail below why I have come to this conclusion.

Salary sacrifice occurs when an employee gives up cash pay for some other form of remuneration, whether pension contributions or another form of non-cash remuneration. Whilst the reason for entering into a salary sacrifice arrangement is often driven by fiscal considerations, such as lower tax and national insurance contributions (NICs), salary sacrifice is an employment law issue since, for it to work, there has to be a variation to the employee's employment contract to reduce their cash pay. Any tax and NICs consequences are determined by there being a binding change in the employee's contract that both the employer and employee have agreed to.

Where there is a change to the employment contract that is not simply a matter of how the remuneration package is formally documented. Rather, it is a binding change to the employment relationship. The contract determines the employee's remuneration package and, therefore, also the tax and NICs consequences. HMRC has to follow the agreement between the employer and employee in determining the fiscal consequences because that determines what the employee is entitled to.

If the employee effectively varied their employment contract before 22 April to sacrifice cash pay for pension contributions then HMRC accepts that there was a pre-22 April salary sacrifice. In order to do so, the employee must have had a contractual right to a lower salary and increased pension contributions before that date and that will last as long as the agreement is effective. Hence HMRC's position that continuation of an existing level of salary sacrifice does not count as a "post-22 April" salary sacrifice.

However, if the original agreement comes to an end at a particular date with salary reverting to the original pre-sacrifice agreement unless the

employee confirms otherwise, then there is a new salary sacrifice at the time of the employee's confirmation. The original agreement is time limited and at the end of that time the employee's entitlement is to the original salary. When they confirm they want the level of pension contributions, the employee is effectively entering into a new agreement and making a new salary sacrifice. If this occurs after 21 April, that new sacrifice is not protected.

There is often more than one way of giving effect to a particular transaction and it is not for HMRC to tell employers and employees how to go about framing their relationship. However, HMRC has to apply the tax and NICs rules to the way that relationship is structured. If the structure of two relationships is different then they may also produce different tax and NICs outcomes. That is the case in the circumstances that you are concerned about.

I appreciate why you consider the different treatment is unfair, but HMRC is simply applying the legislation to the facts. Where an existing sacrifice rolls on without the employee having to do anything there is only one sacrifice, whereas if the employee has to agree to the sacrifice continuing so the original sacrifice no longer stands then, for the reasons I have outlined above, there is a new sacrifice determined by the date of the new agreement which will affect the tax and NICs consequences.

You have also taken issue with the scenario whereby an individual with a continuing salary sacrifice, simply reduces his/ her salary sacrifice to increase their salary and reduce their pension contributions. If I understand you correctly, you question whether this creates a new sacrifice that would lose the original protection. I can give you a more encouraging response here. If the employee is varying their original sacrifice so that the only change is to reverse part of the original sacrifice so that cash salary is reinstated and pension contributions are reduced, HMRC does not see this falling with the definition of salary sacrifice.

At the time of the reduction, the contractual right is to the lower (post-sacrifice) level of salary. In order for there to be a "salary sacrifice scheme", the individual has to give up the right to receive general earnings or specific employment income. If an individual simply varies that arrangement to reduce the amount of his pension contributions and increase salary, then there is no salary sacrifice. The individual has not sacrificed general earnings or specific employment income but instead has sacrificed exempt pension contributions for salary. To the extent that any part of the original sacrifice continues (i.e. is not reversed), this too will be unaffected. As long as the agreement covering that original sacrifice was made before 22 April 2009 it will continue to be protected.

Similarly, if the original sacrifice holds good but a further sacrifice is made, the original sacrifice is unaffected and only the further increase will need to be taken into account in the income calculation.

I appreciate my letter does not give you the response you might want but I hope it gives you a clearer understanding about why we have taken the position that we have done around salary sacrifice.

Peter Seedhouse  
Policy Adviser