BARNETT WADDINGHAM
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Briefing

How employers can use DB SSASs to reward key employees

RISK | PENSIONS | INVESTMENT | INSURANCE

Despite the current trend to move away from defined benefit (DB) provision in favour of more flexible defined contribution (DC) arrangements, employers wanting to maximise provision of pension benefits for key employees without breaching the Annual Allowance (AA) and Lifetime Allowance (LTA) limits (see our briefing note here on the AA and LTA limits) may find a DB SSAS suits their needs.

Furthermore, such pension provision is a significantly more tax-efficient way of enhancing remuneration packages compared with additional salary. Traditionally SSASs were set up on a DC basis and there is more information about DC SSASs here.

What is a DB SSAS?

A DB SSAS is a Defined Benefit Occupational Pension Scheme in that it offers a defined level of annual pension for members at retirement. However, a DB SSAS can be set up so that it can be exempt from many of the usual legislative requirements that typically fall on DB arrangements. In order for a scheme to qualify as a SSAS the following will usually apply:

- fewer than twelve members in the scheme
- all the members are trustees of the scheme
- the rules require all decisions to be made unanimously by member trustees

The scheme actuary will calculate the contributions required to provide those benefits in much the same way as for a regular DB scheme. It is also possible to set the benefits flexibly from year to year to take advantage of, or mitigate the impact of, any changes in the tax framework.

The DB SSAS can provide generous benefits - (for example a high accrual rate, higher spouses pensions and even index linked increases to pensions in payment) - and can be flexible from year to year and are at the discretion of the sponsoring employer.

Tax and NI saving

Setting up a DB SSAS allows more contributions to be paid into the scheme compared with DC arrangements which are restricted by the AA (currently £40,000 for the 2018/19 tax year before any 'tapering'). The AA still applies for DB schemes but HMRC currently apply a value test assuming £1 pa of pension to be worth £16 for comparison against the AA.

This means that for an individual with an AA of £40,000, a pension of £2,500 pa can be accrued in a DB scheme even though it is almost always worth a lot more than £40,000. Therefore a significantly higher level of contributions can be paid into the scheme, with a correspondingly bigger tax benefit. In addition to the AA each year, it will be possible to take advantage of the carry forward rules and use up any unused allowance from earlier years.

There is also the usual National Insurance (NI) savings that employers and employees receive when paying pension contributions.

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Tax-efficiency of DB schemes - an example

The net value of the benefits in a pension scheme are likely to be much greater than if the employer were to spend the same cost on granting additional salary.

To illustrate, consider the individual below:

BOB SMITH Taxable income no more than £110,000 pa	
Applicable Annual Allowance	£40,000
Marginal rate of income tax	40%
Marginal rate of NI above income tax	2%
Employer NI rate	13.8%

For every, say, £100,000 paid by the employer:

- the individual could receive an extra net salary of £50,000 = 100,000 x (1-13.8%) x (1-42%)
- or the individual could receive a net amount of £70,000 of pension benefits, allowing for a quarter to be tax free = £100,000 x (25% + 75% x (1-40%).

This implies a saving of £20,000 pa (not to mention tax efficient investment returns or the possibility of a lower marginal rate of tax in retirement) compared with salary.

The key appeal of a DB SSAS is that instead of being limited to contributions of £40,000 pa, the value of the DB benefit could justify a contribution of say, £100,000 pa, thus permitting pension benefits to be built up more quickly, greater tax efficiency and the certainty of a DB pension. Members do of course have the right to transfer out to a DC arrangement before retirement if they wish.

The famous tax-efficiency of employer contributions into occupational pension schemes, combined with the increased scope for large pension contributions offered by DB SSASs provides an opportunity for tax-efficient benefit provision to key employees.

HOW WE CAN HELP

We have a significant amount of experience with DB SSASs and can assist in the following areas:

- consulting service to outline DB SSAS and consideration in setting up requirements; including LTA implications for members, flexibility on death and on retirement and investment decisions for member trustees
- discussion of who should be included as members (directors, any family members of directors working for the sponsoring employer and senior staff)
- benefit design and indication of contributions that would be required
- actuarial valuation report for contribution funding requirement
- setting up of the DB SSAS, opening Scheme bank accounts
- communications to scheme members
- registration with HMRC and other regulatory authorities
- ongoing administration and actuarial care

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively get in touch with Bhargaw Buddhdev or John Cormell via the following:

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