Summary

• Highly paid doctors and consultants are at risk of breaching the LTA and AA, so some are avoiding taking on extra shifts, placing strain on the NHS.
• The NHS has loaned staff £35 million to help cover AA and LTA tax charges.
• According to a survey of 4,000 consultants by the British Medical Association, six out of ten said that they expect to retire early, with many giving breaches of the LTA or AA as the reason for doing so.
• Health Secretary Matt Hancock has lobbied the Treasury about the LTA and AA on doctors' behalf.

This may sting a bit…

Maggie Williams explores how medical staff navigating the lifetime and annual allowance limits is affecting how the NHS functions

It's survived epidemics, political antipathy and a population increase of over 16 million since its introduction in 1948. But can the NHS survive its current pensions crisis?

Highly-paid doctors and medical consultants are facing punitive tax bills for breaching the Lifetime Allowance (LTA) or Annual Allowance (AA) and the knock-on effect is biting into the NHS' day-to-day business.

An investigation by the *Financial Times* showed that senior consultants who would formerly have taken on additional shift work to clear patient backlogs or offer specialist treatments are now turning this work down. They are concerned about AA tapering and tax treatment as a result of the additional earnings.

The issue has become so acute that, according to the *Financial Times*, the NHS loaned staff nearly £35 million in 2016/17 to cover AA-related tax charges. And the NHS's malaise could deepen further in future. According to a survey of 4,000 consultants by the British Medical Association, six out of ten said that they expect to retire early, with many giving breaches of the LTA or AA as the reason for doing so. Only 6.5 per cent of those polled said that they intend to work beyond the age of 65.

In an attempt to mitigate the effects, Health Secretary Matt Hancock has even lobbied the Treasury about the LTA and AA on doctors' behalf.

Breaches of the £1.05 million LTA and the £40,000 AA are an issue for the NHS, but it is the AA taper that is causing the most confusion. This is applied to taxable earnings over £150,000. For every £2 of income over £150,000, the AA is reduced by £1. Anyone with an income over £210,000 will have an AA of £10,000.

Medical staff are not alone in being snared in the tax net of the allowances and the taper. According to HMRC figures, the tax taken from AA breaches leapt from £179 million in the 2015/16 tax year, to £561 million in 2016/17 when the tapered AA first came into effect.

Workers in the public sector, such as the NHS, have been particularly hard-hit. "In the private sector, it is now common for employers to offer cash alternatives to employer pension contributions where workers find that pension saving is no longer tax-advantaged. Public sector employees seldom have that choice," says Willis Towers Watson senior consultant David Robbins.

Highly-paid workers in other professions who take on additional shift work or receive other types of one-off payment can be similarly affected. Mazars partner and head of financial planning Sarah Lord adds: "Bonus payments are often paid in March and that leaves it really tight to finalise *[details of earnings]* before the end of the tax year."

Punter Southall managing director for DC consulting, Alan Morahan, describes the LTA and AA with taper as "horrendously complicated".

"People are falling foul of them, often through no fault of their own," he adds. "The AA is impacting the ability of young, high-earning individuals to build retirement pots that are going to get close to providing a reasonable replacement for income in retirement."

What should be done?

Lengthening patient waiting times and loss of long-standing expertise from the workforce cannot have been the intended effect when the Treasury lowered the LTA and slashed the AA in 2010, then introduced the taper regime in 2015/16. Is it time to review the allowances and even consider abolishing them?

"This is mostly an issue for higher earners who are actively engaged with their retirement and tax planning. That fact could reduce the incentive on the government to make any changes," says Gowling WLG director, Christopher Stiles. However, Broadstone director – pensions and financial planning, Rachel Meadows, adds that "by trying to ration tax relief to high earners, the current limits actually draw mass middle savers into the mix, especially if they start to save and engage with pensions early in their career".

"The political calculation at the time the taper was introduced was probably that, even if this were a badly-designed tax, it would be a relatively painless way to raise revenue because there would be little sympathy for the high earners on the receiving end," concludes Robbins. "That judgment may have to be revisited if the tax is having real-world consequences in the NHS, but the Treasury will want to look at offsetting measures to raise revenue elsewhere."

Written by Maggie Williams, a freelance journalist

Remove, review, retain?

Should one, or both of the allowances be removed? Here are the options:

Retain the annual allowance and lifetime allowance, but remove the annual allowance taper

"High earning individuals with an adjusted income between £150,000 and £210,000 face a hugely complex tapered annual allowance," says TLT partner and head of pensions Sasha Butterworth. "And it can be difficult for people to work out how to carry forward unused annual allowances". Lord suggests returning to a single annual allowance for everyone, at the original rate of £50,000.

Pros: Reduces complexity and limits the risk of unexpected and unpredictable tax bills.

Cons: It won't solve the problem of high earners breaching the allowance.

Remove or significantly increase the annual allowance, but retain the lifetime allowance

"As long as it is in excess of £1 million, the LTA is fine as it is. However, the AA should be removed," argues Sanlam UK head of commercial Elliott Silk. "That would give people the opportunity to fund their pension as quickly as they want. If they experience a cash event, such as a property sale, business exit or an inheritance, then they can put money into their plan."

"The reason for giving tax relief on pension savings is to avoid double taxation; the savings will be taxed when they are paid out in the form of a pension, so they should not already have been taxed at the time that funds are put aside for that future purpose," adds Stiles.

Pros: Those who are unable to save for a pension earlier in life could 'catch up' in later life. The approach could better suit variable earnings patterns, including the self-employed.

Cons: High earners could still find themselves breaching the LTA limit.

Remove or significantly increase the lifetime allowance, but retain the annual allowance

"At a £1,030,000 lifetime limit, someone aged 65 purchasing an annuity with the whole pot, and opting for 3 per cent escalation, would only secure a pension income on todays' rates that generates £38,625 per annum – a comfortable pension for sure, but hardly enough to be a true 'high earner'," says Meadows.

Pros: Removing or significantly increasing the LTA would enable individuals to save more for retirement across the whole of their career. Altus Consulting head of retirement strategy John Dean says: "It would remove a heap of administrative burden and cost from providers, reduce the cost of tax collection for HRMC and help individuals plan much more clearly for their future."

Cons: Dean cautions that "removing the LTA would most likely be accompanied by a reduction in the AA to make it tax-neutral, or probably to raise a little more tax".

Remove or significantly increase both the lifetime allowance and the annual allowance

"The LTA and AA are great examples of the government taking the basically simple and fair idea of limiting tax relief on a 'fair use' basis but losing sight of the bigger picture when implementing the detail," says Meadows. "The backlash against higher earners in the immediate wake of the credit crunch, and very tight fiscal conditions, meant that cuts to both went far too far – and especially in the case of the AA, have continued to do so."

"The combination of the LTA and AA mean that people can't save at the point in their career when they want to," says Aon partner Lynda Whitney. "That means there are issues for long-term saving – and as the government keeps tweaking the allowances over time, that also causes issues."

Pros: Everyone would be incentivised to continue saving into a pension, throughout their working life. Senior high earners would continue to engage with pensions, which could have a positive effect for all employees. The risk of businesses losing expertise through early retirement because of tax penalties would diminish.

Cons: The Treasury would likely want to make the move cost-neutral in terms of tax revenue. That would mean painful tax increases elsewhere – plus the risk of political backlash over a policy that predominantly favours high earners.