ISSUE 11

ST. JAMES'S PLACE
WEALTH MANAGEMENT

Enterprise

HELPING BUSINESS OWNERS SUCCEED

AUTOMATIC ENROLMENT

Much has been written on the subject of automatic enrolment and this is no surprise given it is a major government initiative. Within larger companies, many schemes have been established and we have seen some high-profile fines for non-compliance. However, the phasing in of automatic enrolment means there are still many employees who are yet to have engaged.

Automatic enrolment is an obligation on all employers, even those with a single employee, to enrol 'eligible jobholders' in a workplace pension scheme unless they are already a member of a qualifying scheme.

The scheme may be a defined benefit scheme or a defined contribution scheme and it must be a UK registered pension scheme for tax purposes.

In the UK, the scheme must be a direct payment scheme. This simply means that contributions must be collected and paid to the scheme by the employer through the payroll system (if one is in use).

Far-reaching criteria

The automatic enrolment criteria are more far-reaching than many employers might think. Simply put, the scheme must include no provision that could be a barrier to automatic enrolment or re-enrolment and it must not require the member to make a decision or provide information as a condition of active membership.

There is a requirement to include a 'default fund' under a defined contribution scheme so that the jobholder does not have to choose a fund before joining the scheme. The default investment fund must have total charges of no more than 0.75% a year. If the employer is suggesting the scheme is established under a salary sacrifice arrangement, an alternative payment method must be offered so that this does not become a barrier to entry.

The scheme must meet minimum contribution requirements (for defined contribution schemes) or a qualitative test of benefits (for salary-related or defined benefit schemes).

Who is an 'eligible jobholder'?

The starting point is that nearly all UK 'jobholders', including the self-employed doing work for an employer, who are not already members of a qualifying scheme, are eligible and must be auto-enrolled.

A controlling director of a limited company with no other workers does not have to be auto-enrolled.

Continued on page 2

Welcome to Issue 11 of Enterprise, the publication produced three times a year on a variety of subjects that we hope will be of interest to business owners and those who run businesses.

The aim is to make the articles topical and, in order to maintain breadth and variety, contributions will come from St. James's Place and individuals in organisations with whom we work.

We will be delighted to receive any feedback, in particular ideas for topics that you would be interested to hear about.

In this issue:

- Automatic enrolment
- Employment law and holiday pay
- Understanding excepted assets and their impact on your IHT exposure

Where the employer is a partnership or a self-employed individual, the equity partners and the proprietor will not need to be auto-enrolled but other workers will need to be.

The responsibility for automatic enrolment for agency/temporary staff rests with the party that actually employs them i.e. the organisation that directly pays them. Contractors may have to be auto-enrolled, depending on the nature of their contract with the employer.

Even if the employer is based overseas, the automatic enrolment legislation will apply to all workers who are working or ordinarily working in the UK. The employer will need to check whether a worker has become eligible for automatic enrolment at their staging date and at every pay reference period thereafter (e.g. weekly, fortnightly, or monthly).

The employer may operate 'postponement' (a 'waiting period' of up to three months), although the member may choose to join in that period.

For clarification on specific employee circumstances, The Pensions Regulator can assist on 0345 600 1011.

In the next issue, we will look more closely at money purchase and defined benefit schemes in automatic enrolment as well as the rules around communication with employees and opting out.

EMPLOYMENT LAW AND HOLIDAY PAY

In a recent case heard by the Court of Appeal, it was held that contractual results-based commission should be included in the calculation of holiday pay for the 4-week statutory holiday entitlement under the EU's Working Time Directive (WTD). The issue for employers is what this means for their own businesses.

Legal requirement

Under English law, employees are entitled to a minimum of 5.6 weeks' holiday (28 days), including our 8 days of public holidays, which is more than the 4 weeks (20 days) required by the WTD. The question in light of the Court of Appeal's decision will be how this impacts employers with staff receiving commission. If we look at the case itself, the picture starts to become a little clearer.

The case

Mr Lock was employed and commission earned on sales was an important part of his remuneration package, representing around 60% of his total pay. When he took holiday, he was entitled to basic pay only but continued to receive commission based on his earlier sales.

However, his commission payments were lower during the months following his holiday because he had been unable to generate sales whilst on holiday.

Mr Lock argued that as holiday pay should reflect normal remuneration, his pay should be enhanced to reflect the commission that he would otherwise have earned during annual leave. Whilst there was an academic argument as to the wording of English domestic law and the WTD, the outcome was that Mr Lock's normal remuneration should indeed include his commission.

What was not decided

The Court of Appeal, however, declined to speculate on the position of employees who receive annual results-based bonuses or those who receive commission when particular levels of turnover or profit are achieved. These circumstances therefore remain an open question.

Cases where there is a settled pattern of work

In such cases, normal remuneration is easily identified as it is pay which is normally received. Payment has to be made for a sufficient period of time to justify the label normal. However, what constitutes a sufficient time has not yet been specified.

Cases where there is no settled pattern of work

In such cases, average remuneration should be calculated over an appropriate reference period determined by national legislation. Whilst there is no case law to say that this is a 12-week reference period as set down by section 221 of the Employment Rights Act 1996, this is the best guidance that can be given.

What should be included? Commission?

Yes, commission should be included where it is intrinsically linked to the performance of tasks under the employee's contract. In Mr Lock's case, pay during holiday periods generally included commission earned on previous sales (which was paid in arrears); but he suffered a financial disadvantage after the holiday as a result of not having earned commission during that time. The position is that holiday pay must include an element to offset this disadvantage. Whilst the calculation is left up to the national courts to determine under national law, it must be based on an average commission earned "over a reference period which is considered to be representative".

Overtime pay?

Overtime has been identified by courts as being broken down into three categories:

- **Guaranteed (compulsory) overtime:** where even if the employee is not called on to work, the employee is liable to pay him or her for it
- **Voluntary overtime:** where an employee cannot be required to work and the employer does not have to provide it
- **Non-guaranteed overtime:** where the employee is obliged to work overtime if required but the employer is not obliged to provide overtime pay or pay in lieu

Guaranteed overtime is covered by normal working hours and is therefore included in holiday pay in respect of the full 5.6 weeks' leave entitlement.

Non-guaranteed overtime should be included in the calculation, as it is required by the employer and therefore intrinsically or directly linked to the employee's work; but only for the 4 weeks under the WTD.

With regards to voluntary overtime, a recent employment tribunal concluded that these additional elements of pay were not as a matter of contract normal pay. However, based upon the test that what an employee regularly and consistently receives as pay constitutes normal pay, the additional elements should be included.

Indeed, it would appear that the only overtime pay not to be included in the calculation is where it is worked on a rare or occasional basis.

UNDERSTANDING EXCEPTED ASSETS AND THEIR IMPACT ON YOUR IHT EXPOSURE

Gabrielle Beaumont, Senior Investment Director, Ingenious

Most business owners are familiar with Business Relief, or BR (formerly known as Business Property Relief), and the Inheritance Tax (IHT) protection it affords to those holding relevant business property; in essence, qualifying assets can be 100% exempt from IHT provided certain conditions are met.

However, business owners tend to be less familiar with the concept of excepted assets, especially when it comes to applying the rules surrounding excepted assets to their own particular circumstances. Excepted assets are not exempt from IHT; therefore, a failure to recognise and deal with them could result in an unexpected and unwelcome liability.

Excepted assets

An asset is an excepted asset if it meets either of two tests:

1. It has not been used wholly or mainly for the purposes of the business throughout the two years before an event (normally the death of the shareholder); or
2. It is not required for future use in the business.

When HMRC is contemplating a BR claim, it will likely consider shares and other investments not used in the business, assets intended for private use and excess cash in seeking to determine whether BR can be restricted.

As you might imagine, the purpose of the excepted asset rules is to ensure that BR is not being unfairly claimed; in the absence of these rules, it would be easy to access BR on a non-business asset by simply placing it in a business wrapper.

Continued on page 4

For example, a wealthy individual with an expensive yacht might transfer it into her company in the hope the yacht would become sheltered from IHT on the basis that she would be eligible for 100% BR on the value of her company shares. In addition, she might do the same with private cash by subscribing for more shares in the company without that cash actually being needed by the company, i.e. treating the company as a 'money box'. The excepted asset rules are aimed at preventing BR from being exploited in these situations.

To summarise, excepted assets can take many forms, from sports cars to holiday homes, but the focus for the remainder of this piece will be on the most common excepted asset: cash.

Measuring excepted assets

It is usually quite straightforward to identify assets that are not being used in the business and may not, therefore, attract exemption from IHT. However, when it comes to excess cash, it is not always easy to understand where to draw the line as to what level of cash is reasonably needed in the business as working capital and what is surplus to requirements and, therefore, at risk of being deemed to be an excepted asset. To compound matters further, there is no stated limit in the legislation or guidance as to what is and is not acceptable, as it can depend on the type of business in question; so there is arguably risk in holding any amount of cash.

This means that it is necessary to look at the evidence for each particular case and to consider it on its own merits. As above, the first test is whether the asset has been used wholly or mainly for the purposes of the business throughout the last two years.

When considering the second test, requiring the asset to be needed for future use in the business, HMRC's view is that there should be evidence of a positive decision or firm intention to use the cash; which should really be documented, perhaps in the board minutes. However, even when applying these tests, it is not always clear-cut and it is often helpful to refer to case law; of course bearing in mind that the amount of working capital required in a business will depend on the trade in question – travel agents and insurance brokers, for example, might have large amounts of cash for months at a time.

In one notable case, Barclays Bank Trust Co Ltd v Inland Revenue Commissioners, it was held that the cash balance which exceeded 25% of turnover of that business was an excepted asset and, as a result, HMRC now typically reviews cash balances that breach 25% of turnover. So this might be a good place to start in identifying a potential exposure. For example, if a business turns over £500,000 per year and has a cash balance of, say, £400,000 at the time of transfer, potentially £275,000 could be exposed to IHT, resulting in an unexpected IHT bill of £110,000.

Furthermore, HMRC recognises that companies may hold more cash when there are difficult trading conditions or a recession. However, when questioned by the Institute of Chartered Accountants in England and Wales, HMRC made clear its view that holding cash as an 'excess buffer' to weather the economic climate was not reason enough for that cash to avoid being at risk of becoming an excepted asset.

What are the options?

Clearly, establishing the existence of and exposure to excepted assets is not easy and will require an analysis of the particular circumstances of each individual business. However, once an excepted asset is identified correctly, there are a multitude of ways in which it can either be removed from the business and dealt with in an IHT-efficient manner, or converted into an asset that is not 'excepted' – in many instances, with immediate effect. St. James's Place is highly experienced in both analysing and quantifying the risk posed by excepted assets and in providing effective solutions to address the potential IHT exposure.

The levels and bases of taxation, and reliefs from taxation, can change at any time. The value of any tax relief depends on individual circumstances.

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