illuminate technical

Tapered annual allowance

The annual allowance is set at £40,000 each tax year, which is the maximum an individual can pay into a pension and receive tax relief (subject to earned income). If contributions are over this limit, there will be a charge on the excess.

For very high earners the annual allowance will be lower than £40,000. The tapered annual allowance was introduced from April 2016 to reduce the tax benefits available to those with earnings of over £150,000.

What is the tapered annual allowance?

For higher earners, their annual allowance of £40,000 will be reduced by £1 for every £2 of income above £150,000 (subject to a minimum of £10,000 annual allowance).

(If the individual has flexibly accessed their benefits then different rules apply – see overleaf.)

Adjusted income	Tapered annual allowance
£150k	£40k
£160k	£35k
£170k	£30k
£180k	£25k
£190k	£20k
£200k	£15k
£210k and above	£10k

Who does the tapered annual allowance apply to?

For the tapered annual allowance to apply, an individual has to have both an 'adjusted income' of over £150,000 and a 'threshold income' of over £110,000.

Broadly, the adjusted income and threshold income are defined as:

Adjusted income of over £150,000 – Total income (earnings and investment) subject to tax	Threshold income of over £110,000 – Total income (earnings and investment) subject to tax
⊕ Add in member contributions	⊖ Deduct any gross member contributions paid (whether relief at source or net payment)
⊕ Add in value of any employer pension contribution	⊕ Add in any employment income given up under salary sacrifice if set up from 9 July 2015
⊖ Deduct contributions paid under relief at source	⊖ Deduct value of any taxed lump sum death benefits received
⊖ Deduct value of any taxed lump sum death benefits received	Ignore any employer contributions

Examples

Example – Hassan

Hassan has an annual salary of £160,000, and employer pension contributions of £16,000.

His adjusted income is £176,000 (£160,000 + £16,000)

This is £26,000 over £150,000.

His annual allowance will be reduced by £1 for every £2 of income above £150,000. So his tapered annual allowance is £40,000 - £13,000 = £27,000.

Example – Erica

Erica has an annual salary of £100,000, and pays a personal pension contribution of £60,000 using carry forward.

Her adjusted income is £160,000 (£100,000 + £60,000)

But her threshold income is £100,000 so no tapering applies.

Shaping the taper

The extent (if any) to which the annual allowance will be tapered is only decided at the end of the tax year. This is because the calculation depends upon the individual's taxable income in the tax year, as well as other factors.

Tapered annual allowance

This can cause problems for the individual as they might not be aware until the very end of the tax year that their annual allowance will be tapered. For example, they may be self-employed or they may receive a bonus paid at the end of March which will increase their adjusted and threshold incomes. As a result, their annual allowance may be tapered, but they may find they have exceeded the tapered annual allowance through contributions already paid, meaning they will be taxed at their marginal rate on the excess.

However, individuals might have the chance to shape their tapered annual allowance. They could pay (further) personal contributions before the end of the tax year to reduce their threshold income and possibly avoid their annual allowance being tapered.

Example – Justin

Justin has been made redundant and his total income for tax year 2019-20 is £200,000. His employer contributions into his Sipp for the tax year are £15,000. He has unused carried forward tax relief from the previous three years of £75,000.

Justin's adjusted income is:

£200,000 + £15,000 = £215,000

His tapered annual allowance would therefore be £10,000.

However, Justin can reduce his threshold income by paying a member contribution. The maximum he can pay is:

£25,000 (£40,000 - £15,000) for 2019-20

+ Carried forward annual allowance of £75,000

= £100,000

This would reduce his threshold income to:

£200,000 - £100,000 = £100,000

This brings his threshold income below £110,000, and his annual allowance would not be tapered, and instead remains at £40,000.

Carry forward

Individuals who have a tapered annual allowance can carry forward any unused annual allowance from the previous three years (as long as they were making pension contributions or a member of an employer-sponsored pension scheme for those years). From 2016-17 they must use their tapered annual allowance.

Those who have flexibly accessed their retirement benefits

For individuals who have flexibly accessed their benefits then the money purchase annual allowance (MPAA) will apply. If so, the amount they can pay into money purchase or defined contribution pension plans is £4,000. Individuals who flexibly access their benefits will trigger the money purchase annual allowance (MPAA). This reduces the amount they can pay into money purchase or defined contributions schemes to £4,000 a year.

If they are also saving in a defined benefit scheme, the 'alternative annual allowance' is the maximum amount of defined benefit pension savings that qualify for tax relief once the MPAA is triggered. The alternative annual allowance is £36,000 but tapering will reduce this.

If you only read one thing…

- The annual allowance is reduced for those with an adjusted income of over £150,000 and a threshold income of over £110,000.
- Adjusted income is total income subject to tax, plus the value of any employer pension contributions.
- Threshold income is total income subject to tax. Deduct any member pension contributions, but add in any salary sacrificed employment income entered into after 9 July 2015.
- The annual allowance of £40,000 will be reduced by £1 for every £2 of income above £150,000 (subject to a minimum of £10,000 annual allowance).

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producttech@nucleusfinancial.com @nucleuswrap www.nucleusfinancial.com/technical-studio