Tapered annual allowance – Information Sheet

Introduction

The annual allowance is the maximum amount of contributions (personal and employer) that can be made to registered pension schemes each year. The annual allowance is currently £40,000 gross.

With effect from 6th April 2016 a different annual allowance came into effect. This annual allowance is called the tapered annual allowance. In assessing whether the tapered annual allowance applies, two income definitions need to be considered, 'Threshold Income' and 'Adjusted Income'. These are defined later in this document.

The current tapered annual allowance will apply to any individual from 6th April 2020 onwards when:

- the individual's adjusted income for the tax year is more than £240,000, and
- the individual's threshold income for the same tax year is more than £200,000.

It is our understanding that an adjusted income calculation is not required if someone's income does not breach the level of threshold income.

Please note that for the 2016-17 to 2019-20 tax years a different threshold income and adjusted income figure applied this was as follows:

- the individuals adjusted income for the tax year was more than £150,000, and the
- individuals threshold income for the same tax year was more than £110,000

This documents reflects our understanding of the rules as they currently stand and we acknowledge that rules and tax rates may change in the future.

For further guidance on the tapered annual allowance and how this might affect you personally we recommend that you speak with your financial adviser or accountant.

Impact

It should be noted that it is possible for an individual to be subject to the tapered annual allowance one year and not the next and so an assessment may need carrying out each year.

The current annual allowance is reduced by £1 for every £2 of income in excess of £240,000 but remains subject to a minimum of £4,000 so in effect the maximum reduction to the current annual allowance is £36,000.

Examples

1) Mr Bloggs has income of £265,000. This is £25,000 over £240,000 and the standard annual allowance of £40,000 is reduced by £12,500 (£25,000 / 2). The tapered annual allowance is therefore £27,500 (£40,000 - £12,500).

2) Mrs Smith has income of £315,000. This is £75,000 over £240,000 and the standard annual allowance would ordinarily be reduced by £37,500 (£75,000 / 2). As this would put the tapered annual allowance at only £2,500 the minimum of £4,000 will apply.

Carry forward

Despite an individual being subject to a tapered annual allowance they will still retain the ability to carry forward any unused allowances from the previous three tax years with the annual allowance from those previous years applying.

It should be noted, however, that at some future point when the tapered annual allowance applies, it is the tapered annual allowance amount that should be used in determining any carry forward position.

Threshold Income and adjusted income definitions

The following table* illustrates the income calculation for both threshold and adjusted income.

The table refers to 'net income', 'relevant salary sacrifice arrangement' and 'relevant flexible remuneration arrangement'. These terms are defined later in this document.

Significantly threshold income includes any payments made under a salary sacrifice arrangement made on or after 9 July 2015.

Threshold income	Adjusted Income
the individual's net income for the tax year as calculated under steps 1 and 2 of section 23 of the Income Tax Act 2007, **add**	the individual's net income for the tax year as calculated under steps 1 and 2 of section 23 of the Income Tax Act 2007, **plus**
the amount of any reduction of employment income for pension provision as a result of any 'relevant salary sacrifice arrangement', or 'relevant flexible remuneration arrangement', made on or after 9 July 2015, **less**	the amount of any relief under section 193(4) of Finance Act 2004 (a claim for excess relief under net pay, see PTM044240) and section 194(1) of Finance Act 2004 (relief on making a claim) deducted at step 2, **plus**
the amount (before any deduction under section 192(1) Finance Act 2004) of any contribution paid in the year in respect of which the individual is entitled to be given relief under section 192 Finance Act 2004 (relief at source, see PTM044220), **less**	the amount of any pension contributions made from any employment income of the individual for the tax year under net pay, under section 193(2) of Finance Act 2004 (see PTM044230), **plus**
the amount of any lump sum death benefits mentioned in section 636A(4ZA) Income Tax (Earnings and Pensions) Act 2003 accruing to the individual in the tax year	where non domiciled individuals make contributions to overseas pension schemes, any relief claimed under Chapter 2 of Part 5 of the Income Tax (Earnings and Pensions) Act 2003 for the tax year, **plus**
	the value of any employer contributions for the tax year, but **less**
	the amount of any lump sum death benefit mentioned in section 636A(4ZA) Income Tax (Earnings and Pensions) Act 2003 that accrues to the individual in the tax year, see PTM073000.

*Source: Pensions Tax Manual PTM057100

Definitions

Income

In broad terms 'net income' is an individual's taxable income left after deducting any reliefs due under section 24 of the Income Tax Act 2007. These reliefs are numerous and can be accessed from the following link http://www.legislation.gov.uk/ukpga/2007/3/section/24 but include for example tax reliefs on pension contributions, gifts of shares to charity and patent royalties.

An individual's taxable income might be derived from the following sources. Where income is received from any of these, it is the total of them that constitutes an individual's taxable income:

- earnings from employment
- earnings from self-employment/partnerships
- most pensions income (State, occupational and personal pensions)
- interest on most savings
- income from shares (dividend income)
- rental income
- income received by an individual from a trust.

Salary sacrifice

A relevant salary sacrifice arrangement is where:

- an individual gives up employment income in exchange for pension contributions by an employer, and
- the salary sacrifice arrangement was made on or after 9 July 2015 (whether before or after the start of the employment concerned).

Flexible remuneration

A relevant flexible remuneration arrangement is where:

- an individual and their employer agree that pension contributions will be made by the employer rather than the individual receive some employment income, and
- the flexible remuneration arrangement was made on or after 9 July 2015 (whether before or after the start of the employment concerned).

For the purpose of a relevant salary sacrifice or relevant flexible remuneration arrangement, 'a pension contribution by an employer' means an individual's employer or some other person

- paying contributions (or additional contributions) to a pension scheme in respect of the individual or otherwise
- to secure increased benefits under a pension scheme to which any of the following have an actual or prospective entitlement
- the individual
- a dependant of the individual, or
- any person connected with the individual.

Note that a variation after 9 July 2015 of an existing salary sacrifice arrangement will bring the salary sacrifice arrangement into the definitions highlighted above and within the calculations for the tapered annual allowance.

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