

# Pension considerations at tax year end

## A step-by-step approach

With Paul Kennedy, Head of Tax and Trust Planning and Paul Squirrell, National Pension Sales Manager.

### VIDEO TRANSCRIPT

#### Paul Kennedy (PK)

Hello, I'm Paul Kennedy and with me is my colleague Paul Squirrell. With tax year end fast approaching we thought it would be a good idea, once again, to get ourselves together to cogitate one or two bits and pieces as regard to calculations and other things.

Paul, before we start looking at the calculations, is there anything changing in the next tax year 2019/20 of which we should be cognisant of before the end of this tax year?

#### Paul Squirrell (PS)

Well I suppose the main thing Paul is the lifetime allowance, which currently sits at £1.03 million from April; from the new tax year it will be £1.055 million.

**PK:** So, I guess that means, other income tax considerations aside, that might be a situation where it might actually make more sense, if you have an LTA issue, to crystallise things after the start of the new tax year.

**PS:** Yes.

**PK:** Anything else?

**PS:** The other thing to consider, as we go onto the new tax year, we will now be under the fourth year of tapering. So, for those who have been affected heavily by tapering over recent years, this may be the last chance to pick up some sizable carry forward contributions before the end of the tax year.



**PK:** Okay then, so here I am today, I now want to understand what I may be able to contribute to a pension before the tax year end or indeed understand my position as regard to contributions which have already been made. So where should we start?

**PS:** Well, my starting point is: before we think about making any contributions, is to think about the tax relief. I always take the tax relief first, so if I'm going to make a personal contribution, whatever that may be, I need the net relevant earnings to cover that. Otherwise, I'm not going to make a contribution, I won't get tax relief. If it's an employer contribution, then off course it's dealt with the 'wholly and exclusively' rules.

**PK:** And that's a critical starting point isn't it? Because it's really important to understand, should you become subject to the annual allowance tax charge, that has nothing to do with the tax relief that was given to you on the contribution or indeed that allowed the employer to treat it as an allowable expense. And the simple rule here is that once tax relief has been given, it is not going to be taken away. It may be that you become subject to a further tax charge, but it doesn't mean that the tax relief is being taken away. That's the underlying policy, but in practice the tax relief is not taken away.

So, we've ensured that we have sufficient net relevant earnings, or if it's an employer contribution that it meets that test. Now we need to look at the allowances and I guess the best starting place there is to look at this year's annual allowance. So, what is the annual allowance for this tax year?

**PS:** The annual allowance is £40,000.

**PK:** And would that be for everybody?

**PS:** Not necessarily, as we mentioned earlier, those who have been affected by tapering could have their annual allowance reduced to a minimum of £10,000.

**PK:** And you mentioned tapering there, so how does that work?

**PS:** In essence there are two tests. The threshold income of £110,000 and the adjusted income of £150,000, and it's whether you are over the £150,000 that you start having your allowance reduced.

**PK:** Do I have to be over both of them or just over one of them?

**PS:** Both of them.

**PK:** And how much does the allowance reduce by if, as you said, the adjusted income goes over £150,000?

**PS:** It's basically every bit of your adjusted income over £150,000. You'll lose £1 of your allowance for every £2 over, subject to a minimum of £10,000. So, once you're over £210,000 you're down to 10.

**PK:** So, the simple answer is the annual allowance this year for everybody is somewhere between £10,000 and £40,000.

**PK:** You mentioned the word income there. Adjusted income and threshold income. Are they both primarily the same test?

**PS:** No there are some subtle differences. The threshold income is their first test which is £110,000, which broadly speaking is your taxable income for the year, less any personal relief at source contributions.

The adjusted income test, however, does include the value of employer pension contributions

**PK:** And we have a factsheet on it that explains all of this if anybody needs any further information. One thing I think that has arisen on a few occasions over the past couple of years is sometimes clients will have what I'll call an income of a particular type, and people are not certain whether or not it falls within the adjusted or threshold income test. No simple rule there.

Just look at something that's a little bit atypical and then you'll just need to work through the legislation or consult somebody on it to see whether or not it's in there.

Okay. So that's got me to understanding what are my annual allowances for this year. What about previous year's annual allowances that I didn't fully use at that time?

**PS:** So for calculating what you can pay, as we know, you've got to first of all use this year's allowance, but then we can carry forward any unused contributions for the previous three years.

**PK:** So we can carry forward for the previous three years. Are there any fundamental rules that we have to abide by in order for that to happen?

**PS:** Yes, the first thing is that you need to be a member of a registered pension scheme. Not necessarily the one you're paying into but anything that's a registered pension scheme. And the other thing is that we always use them in order so that we use the oldest one first and then move back to the current year.

**PK:** So, this year's first then we go back further in time and follow it through.

In terms of being a member of a pension scheme, in each of the individual years we're looking at, do I need it to have contributed in that particular year?

**PS:** No. It can even be an arrangement that you can't pay into. It could be an annuity. It's still a registered pension scheme. It would qualify you for carry forward for that year.

**PK:** So, simply a member of a pension scheme. Right. Let's look at what the allowances were for each of the past three tax years. So for tax year 2017/18 the annual allowance was?

**PS:** The same as this year. So, it'd be somewhere between £10,000 and £40,000 depending on tapering.

**PK:** And the year before that 2016/17?

**PS:** Exactly the same. So, it's somewhere between £10,000 and £40,000 depending on tapering.

**PK:** Which leaves us with one final year the tax year 2015/16. What about that one?

**PS:** That was the fun year in a way. That was the year where we essentially had sort of a split year because of the Summer Budget.

**PK:** And when did that split?

**PS:** 8 July, which was this Summer Budget.

**PK:** And the period between the start of the tax year and 8 July is known as the pre-alignment year and the period from 9 July through to the end of the tax year is known as the post-alignment tax year.

That first bit, saw effectively the abolition of pension input periods when we got to the end of that. So, in terms of that first bit where pension input periods did still apply, I've got to look at the sum total of my contributions made in that chronological period, but relating to pension input periods that ended in that period, and the allowance for that period was?

**PS:** £80,000

**PK:** And the allowance for the post-alignment period?

**PS:** It was technically zero with the ability to carry forward up to £40,000 of unused allowances from the pre-alignment period.

**PK:** So, the maximum (if you didn't do any contributions in that year at all) that you'd be carrying forward is £40,000.

If you made contributions that counted in that pre-alignment year, then your allowance for that year is going to be very individual and very specific on what you did before that cut-off date of 8 July, and that would always need individual calculations. Again, we have a factsheet on it if anybody's interested in the detail.

So that should get me to understand what my annual allowance is for this tax year, I should now be able to understand what my carry forward allowances are, if any. And in essence, that's going to give me the total of all the contributions I could make this tax year without exceeding my available annual allowances. Now within that overall total, is there anything else I need to watch out for?

**PS:** Yes, the other thing probably just to check is that you haven't tripped the money purchase annual allowance.

**PK:** And if I trip the money purchase annual allowance what that will mean is I still have the same total available allowance but within that I will be restricted as to a maximum that can go into money purchase plans. The remainder could go elsewhere which is predominantly DB. So, in terms of that inner restriction what's the maximum that I'll be able to put into a money purchase plan?

**PS:** It's £4,000 from the point that you trip the money purchase annual allowance.

**PK:** So, from the point that it's tripped the maximum is £4,000. What about if I trip it halfway during a tax year? Does that mean I can only put £4,000 into a money purchase plan for the whole of that tax year?

**PS:** No, but from the point you've tripped it to the end of the tax year will be restricted to £4,000.

**PK:** And what trips this money purchase annual allowance?

**PS:** There's a whole list of things. As you know, often referred to as accessing your pension flexibly but as we know it's much wider than that.

**PK:** Because actually, there is no hard and fast rule. Sometimes, for example with PCLS tax-free cash, you can access all of that and it doesn't trip it. Sometimes, occasionally, you can be receiving an income in certain ways, and that doesn't trip it.

We don't have time to go through the long list of what does trip it. By inference you just look at what trips it and if it's not on the list of tripping then whatever you've done won't trip it. But, again we have a factsheet and you can look at what trips it and what doesn't trip it.

So that's going to give me the sum total of all my allowances, I'm then going to know if there's any restriction as to a maximum of £4,000 that I can put in.

If I didn't use it. Say I tripped that money purchase annual allowance two or three years ago and I hadn't actually put up to my £4,000 or £10,000 (as it used to be in the money purchase) does that carry forward?

**PS:** No, it's one allowance that you can't carry forward.

**PK:** So, the money purchase doesn't carry forward within my overall calculations. Right. So, I now know what the sum total of my total allowances is for this tax year and the carry forward. I know whether or not I'm subject to this inner restriction. My next question is: if I exceed either that overall allowance or I exceed the inner money purchase annual allowance, what happens next?

**PS:** You'll be subject to the annual allowance tax charge.

**PK:** And you want to tell us broadly what that is and how it works?

**PS:** Broadly speaking, the amounts of excess will be treated as income as though it was added to the rest of your salary, so it'll be taxable at your marginal rate.

**PK:** So, it's going to pick up a pretty hefty tax charge. 'My marginal rate' as you say. I mean given that it's a pretty hefty tax charge, that from a policy design perspective this is meant to negate the tax relief that's been given, albeit as we've said, it doesn't affect that. Is this a tax charge that one always wants to avoid?

**PS:** Not necessarily because I think it all depends on who's making the contributions. It may also depend on who's paying the tax charge.

**PK:** Tell me more on who's making the contribution. Say I'm making the contribution.

**PS:** If it's a personal contribution then there doesn't seem, at first glance, to be a lot of sense of tripping the annual tax charge. But if it's an employer-only contribution, then and especially if it's a take-it-or-leave-it scenario from the employer, then it might be better to take it.

**PK:** On the basis that if you don't take the pension contribution you will have nothing because no option was given, and something left, even after a tax charge, is better than nothing at all.

What about if it's part employer contribution and part personal contribution?

**PS:** You probably need to get your calculator out at this point.

**PK:** It's as simple as that. And what about if the employer is giving a choice: either take the contribution or maybe they're offering some sort of cash alternative?

**PS:** Yes, again there are calculations involved because, as we know, different employers will have different views on whether they did have National Insurance contributions et cetera. So, again you'll have to do the maths and work out what it's going to cost you either way.

**PK:** So, no simple rule.

**PS:** No.

**PK:** Generally speaking, it's always something you'll need to look at individually to work out whether or not this tax charge should be born. But it would be completely wrong to say it's something that should always be avoided depending upon the circumstances.

Okay, so I know what my allowance is and what my carry forward is and I would have got this inner money purchase annual allowance and I know what's going to happen if I go over the allowances? What about if I make a mistake?

What about if I...well let's say, first of all I make a contribution and I simply didn't have the net relevant earnings which means, as you said earlier, I can't get tax relief. Is there anything I can do about it?

**PS:** Yes. If it's a personal contribution and you've gone over your net relevant earnings meaning that you won't have tax relief, you can actually reclaim the contributions. You've got six tax years after the mistake has been made to reclaim that.

**PK:** What about if I've made a mistake with my allowances and thought I had a much bigger allowance than I actually did and I over contributed and I look back and I think 'Gosh, had I known that then, I wouldn't have put so much in. I don't want to pay the tax charge'. Anything I can do about it?

**PS:** Unfortunately not, because you are over the annual allowance. So the contribution was okay from tax relief but not because the annual allowance. There isn't anything you can do without it being an unauthorised payment if they pay the money back to you.

**PK:** So, I would face the tax charge which I guess just leaves us with one thing to answer on this tax charge should it arise. That is who pays it?

**PS:** That will depend. Subject to certain conditions you may be able to get the scheme to pay it. In other situations, the scheme may volunteer to pay it.

**PK:** Can you briefly tell us where I can compel the scheme? I mean it may be that I don't want to pay the tax charge myself, out of my own money. And as we've already said, with an employer contribution, something is something which is better than nothing. But I'd rather the tax charge came out of the pension pot. Can I compel the scheme to do it?

**PS:** Broadly speaking the rules say that you can if the tax charge will be more than £2,000 and that contributions that you've made to that particular scheme are more than the full annual allowance of £40,000.

**PK:** And again, this is all explained in one of our other factsheets if you want to have a look at the details. The voluntary scheme pays, I'm assuming, is how you suggest it's entirely down to the scheme if it wants to meet a voluntary tax bill.

**PS:** Yeah absolutely that could even be for another scheme. So, any scheme can pay a tax charge on a voluntary basis.

**PK:** Right. So, to summarize, I know what my allowances are and what the carry forward is. I know whether I've got this inner allowance. I know whether or not I'm going to trigger the annual tax charge and if I am, I now know who's going to pay it. Given all of that – and let's assume I don't want to exceed the annual allowance, but I do want to max out what I put in – does it always make sense to fully utilise your carry forward?

**PS:** I think that really depends on individual circumstances, because if by using all of my available allowances it means that I'm going to be suffering tax charges next year, because I've got no carry forward, then maybe that isn't the most advisable thing. But also, tax relief. Sometimes spreading a contribution will mean that you can get higher rates of relief depending on how you pay it.

**PK:** And I guess there's one other thing that we haven't really turned to, and another reason perhaps sometimes these days for not maxing out what you have available in terms of allowances, and that's of course going to be the lifetime allowance.

**PS:** Which is where we start.

**PK:** Yes, that ultimate cap on what you can save within an overall pension pot again without being subject to a tax charge. And just to reiterate this point, all these three things are completely independent.

So, if you really got it wrong you could end up:

- Getting no tax relief on the contribution going in,
- Still suffering an annual tax charge in that particular tax year on the contribution that's been made and then further down the road,
- Still suffering a lifetime allowance tax charge.

They are all independent.

**PS:** I think that's known as suboptimal

**PK:** Suboptimal pension planning. Well I think that's about it in terms of end of tax year and pensions isn't it? Just very quickly before we leave this video, don't forget with the end of the tax year there are other things that we ordinarily look at:

- **ISAs:** there you know the allowance has been frozen at £20,000.
- **Junior ISAs:** where the allowance has gone up by a little bit.
- **Capital Gains Tax allowances:** again a 'use it or lose it' allowance where again compared to last tax year it's also gone up by a little bit.

Well that's it from us; thanks very much for watching.

Happy tax year end planning.

## Important information

This video transcript provides information and is only intended to provide an overview of the current law in this area and does not constitute financial advice, tax advice or legal advice, or provide any recommendations. The value of benefits depends on individual circumstances. Withdrawals from a pension will not normally be possible until age 55. Different options may have different effects for tax purposes, different implications for pension provision and different impacts on other assets and financial planning.