

# Tapered annual pension allowance and how it works

Pension allowances are being cut for some high earners

The amount you can contribute to a pension each year and receive tax relief on is limited to the annual allowance. For most people this is usually £40,000 but for some high earners this may be reduced. The allowance will be 'tapered' according to your income, although everyone will retain an allowance of at least £4,000. This means the amount you could tax-efficiently invest to your pensions each year, could change from tax year to tax year.

## In this guide we cover:

- Why some high earners may have a reduced annual pension allowance
- How to calculate if you are affected or not
- How much your allowance will potentially drop by
- What happens if you exceed the allowance

## Will I be affected by the tapering of the annual allowance?

This depends on your annual income as defined by two measures. Your annual allowance will only be reduced if both of the following occur in a tax year:

- Your 'threshold income' is above £200,000 and
- Your 'adjusted income' is over £240,000

Working out your threshold and adjusted income is rather complicated but we have shown how you can calculate these figures on pages 1 and 2 of this guide. You will need to reassess your position on a yearly basis.

The first step is to calculate your threshold income because if this is £200,000 or below you will not be subject to the tapered annual allowance and you do not need to worry about your adjusted income.

## How does the tapered annual allowance work?

If you are affected, your £40,000 allowance will reduce by £1 for every £2 of adjusted income you receive over £240,000. However, the tapering of the allowance stops at £312,000 and so everyone will retain an allowance of at least £4,000. An illustration of how this may affect you is shown on the next page.

The tapered annual allowance took effect from the 2016/2017 tax year. The amount of tapering in any tax year will be dependent on your income. For tax year 2016/2017 through to tax year 2019/2020 the threshold income was £110,000 and the adjusted income was £150,000, the maximum annual allowance was £40,000 and the minimum was £10,000. Please keep a record of your tapered annual allowance for each year it impacts you to help you to determine carry forward amounts and if any annual allowance charge applies.

The value of tax benefits from a pension depends on individual circumstances and all tax rules may change in the future.

Adjusted income	Annual allowance
£240,000	£40,000
£250,000	£35,000
£260,000	£30,000
£270,000	£25,000
£280,000	£20,000
£290,000	£15,000
£300,000	£10,000
£310,000	£5,000
£312,000	£4,000

We show some examples of how this works in practice on page 3. The figures in the above table are for illustration purposes only. In practise the reduction in your annual allowance as a result tapering will not reduce by £5000 increments. We show some examples of how this works in practise on page 3.

## How is my threshold income calculated?

### Firstly, add up all the following:

- Your salary (do not include any pension contributions made through salary sacrifice)\*
- Any bonuses, commission and any benefits in kind
- Income from property
- Dividend payments and interest from saving
- Any self-employed earnings
- Any salary/bonus you have sacrificed for pension contributions if:
  - The arrangement started on or after 9 July 2015. This could apply where a decision to renew the arrangement is required from the member
  - Your contributions have increased since 9 July 2015 (this could be the whole amount or just the increase)

### You should then deduct:

- Any contributions you make to a pension (do not include any contributions made by your employer)
- Certain reliefs you may be entitled to such as those applying to charitable donations (these reliefs are outlined in Section 24 of the Income Tax Act 2007)

\*Some employers will have a different name for salary sacrifice and you should check if you are unsure.

**This will give you your threshold income. If it is £200,000 or less you will not be affected by the taper and your annual allowance will not be reduced. However, if it is above £200,000, you will be affected if your adjusted income is over £240,000.**

## How is my adjusted income calculated?

### Firstly, add up all the following:

- All your taxable income (as per your threshold income)
- Any contributions your employer has made to a pension (including any made by salary sacrifice)
- Benefits built up in a final salary (defined benefit) pension scheme, excluding the cost of your contributions (you should contact your scheme provider for more information on the 'pension input amount')
- Any contributions you have made to a workplace pension scheme where the contributions were taken from your full pay before tax was calculated (this is known as Net Pay and if you are not sure, you should check with your pension provider)

### Then deduct the following:

- Certain reliefs you may be entitled to such as those applying to charitable donations (these reliefs are outlined in Section 24 of the Income Tax Act 2007)

**This will give you your adjusted income. If it is less than £240,000, the tapered annual allowance will not apply. If it is more than £240,000 (and your threshold income is above £200,000) your annual allowance will be affected. It will reduce by £1 for every £2 of adjusted income you receive over £240,000 (the minimum allowance is £4,000).**

## What happens if I exceed the annual allowance?

If you exceed your annual allowance you should first determine if carry forward will reduce or eliminate the excess. If even after carrying forward there is still an excess amount, you will face a tax charge. In other words, your excess contribution, less any available carry forward amounts, will be added to your income and as a result will be subject to Income Tax at your highest marginal rate. The charge is normally declared and paid through the income tax self-assessment process (although it could be deducted directly from your pension savings if certain conditions are met – this is known as 'Scheme Pays' and you will have to make a formal request to your pension scheme provider) if you want to apply for this.

## What if I am already subject to the Money Purchase Annual Allowance?

If you have taken taxable money out of your pension pot using pension freedoms (i.e. more than the tax-free part), a lower money purchase annual allowance (MPAA) may apply to you. If you need to know more about these restrictions, you may find our MPAA guide useful.

However, you should note that if you also hold a defined benefit pension (which includes 'final salary' and 'career average' pension schemes), you can benefit from what is called the 'Alternative Annual Allowance' which is £36,000 for the 2018/19, 2019/20 and 2020/21 tax years. You should contact your defined benefit pension provider for details.

**If you have a question about money purchase annual allowance or annual allowance please speak to your financial adviser.**

## Can I still carry forward any unused annual allowances?

The carry forward rules will continue to operate as before but please note the taper can potentially affect the amount you carry forward to future years. This is because the amount you may be able to carry forward will be determined with reference to your tapered annual allowance in each of the tax years this applies. Please see our 'carry forward' guide for more information.

**If you want to discuss your retirement options please speak to your financial adviser.**

### Important information

The value of investments and the income from them can go down as well as up so you may get back less than you invest. Tax treatment depends on individual circumstances and all tax rules may change in the future. Withdrawals from a pension product will not normally be possible until you reach age 55.

This information is not a personal recommendation for any particular investment. If you are unsure about the suitability of an investment you should speak to your financial adviser.

## How the tapered annual allowance works in practice



### Example 1

Phoebe's salary is £210,000 and her employer contributes £20,000 to her pension.

**Phoebe's threshold income = £210,000**

- Salary of £210,000
- No additions or deductions

**Phoebe's adjusted income = £230,000**

- Salary of £210,000
- Employer's pension contribution of £20,000

Phoebe will not be affected by the tapered annual allowance. This is because, although her threshold income is above £200,000, Phoebe's adjusted income is below £240,000. She will therefore have an annual allowance of £40,000 for the 2020/21 tax year.



### Example 2

Ravi's salary is £235,000 and his employer contributes £30,000 to his pension.

**Ravi's threshold income = £235,000**

- Salary of £235,000
- No additions or deductions

**Ravi's adjusted income = £265,000**

- Salary of £235,000
- Employer's pension contribution of £30,000

Ravi will be affected by the tapered annual allowance because his threshold income is above £200,000 and his adjusted income is over £240,000. His annual allowance of £40,000 will be reduced by £12,500 (£25,000 divided by 2) and therefore will be £27,500 for the 2020/21 tax year. As his employer's contributions exceed his annual allowance, Ravi could be liable for a tax charge. This could be as much as £1,125 (£2,500 @ 45%) if Ravi is an additional rate UK tax payer. If Ravi is a Scottish Resident any tax charge payable will be based on the Income Tax rates for Scotland which differ from the rest of the UK.



### Example 3

Helen's salary is £200,000 and she receives a bonus of £10,000. She also receives £2,000 in interest from her savings and £7,500 in dividends from her investments. Helen makes a £14,000 payment into her group personal pension and her employer matches her contribution.

**Helen's threshold income = £225,500**

- Salary of £220,000
- Bonus of £10,000
- Interest and dividends of £9,500
- Less her pension contribution of £14,000

**Helen's adjusted income = £253,500**

- Salary of £220,000
- Bonus of £10,000
- Interest and dividends of £9,500
- Plus her employer's pension contribution of £14,000

Helen will be affected by the tapered annual allowance because her threshold income is above £200,000 and her adjusted income is over £240,000. Her annual allowance of £40,000 will be reduced by £6,750 (£13,500 divided by 2) and therefore will be £33,250 for the 2020/21 tax year. However, her total pension contributions (£28,000) are within her annual allowance and so there will be no tax to pay.

The information in this guide is correct as at 6 April 2020.



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