The Tapered Annual Allowance

Tech-Bites

A look at what the tapered annual allowance is, how it operates and how it impacts on an individual's annual allowance.

Key points

The tapered annual allowance reduces the annual allowance for those with incomes over £240,000.

There are two tests 1) the threshold income test set at £200,000 and 2) the adjusted income test set as £240,000

For incomes over £240,000, the annual allowance will reduce by £1 for every £2 over this limit, with a maximum reduction of £36,000 for those of income £312,000 or less. Therefore for incomes over £312,000 the annual allowance will be £4,000.

The two tests include all taxable income (so not just earnings), less any taxable lump sum death benefits paid to the individual.

What is the tapered annual allowance?

The tapered annual allowance:

- Impacts those individuals with adjusted incomes over £240,000.
- Reduces by £1 for every £2 of income above £240,000.
- Has a maximum reduction of £36,000, reducing the annual allowance down to £4,000 for individuals with an income of £312,000 or more.
- For those individuals with adjusted income greater than £312,000, the annual allowance is £4,000

There are two income tests used to measure whether the tapered annual allowance will apply:

1. The threshold income limit - set at £200,000. If an individual's income is above this amount then they will be subject to the adjusted income test
2. The adjusted income tested - set at £240,000. If an individual's income is above this amount then the tapered annual allowance will apply.

What counts as taxable income?

It is important to understand which types of income are considered when looking at the threshold income and adjusted income.

Examples of taxable income:

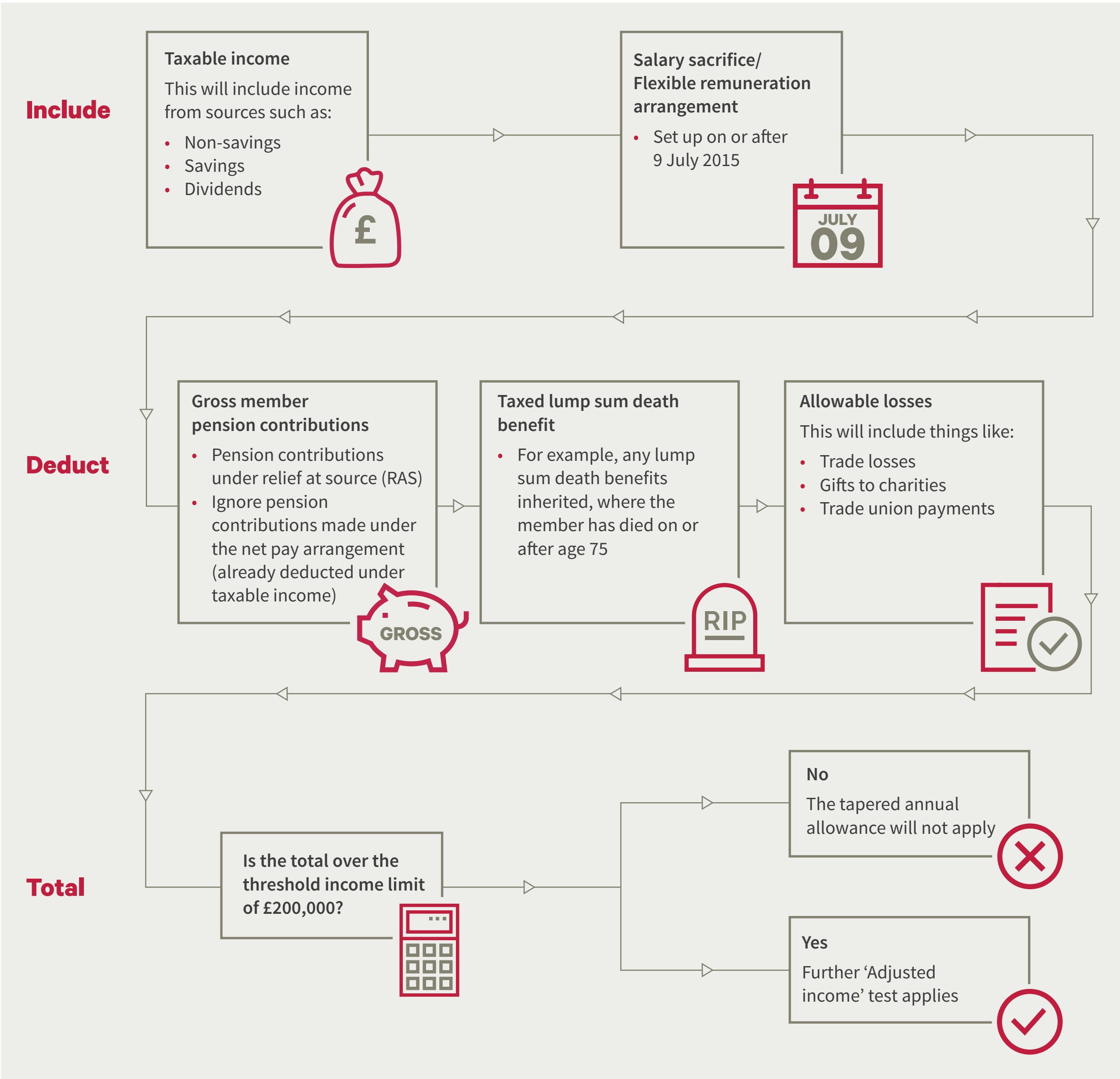
- Earnings from employment
- Earnings from self-employment/partnerships
- Pensions income
- Interest on most savings
- Dividend income (e.g. from shares)
- Rental income
- Trust income (e.g. where the member is a beneficiary)

When should you include a salary sacrifice or flexible remuneration arrangement?

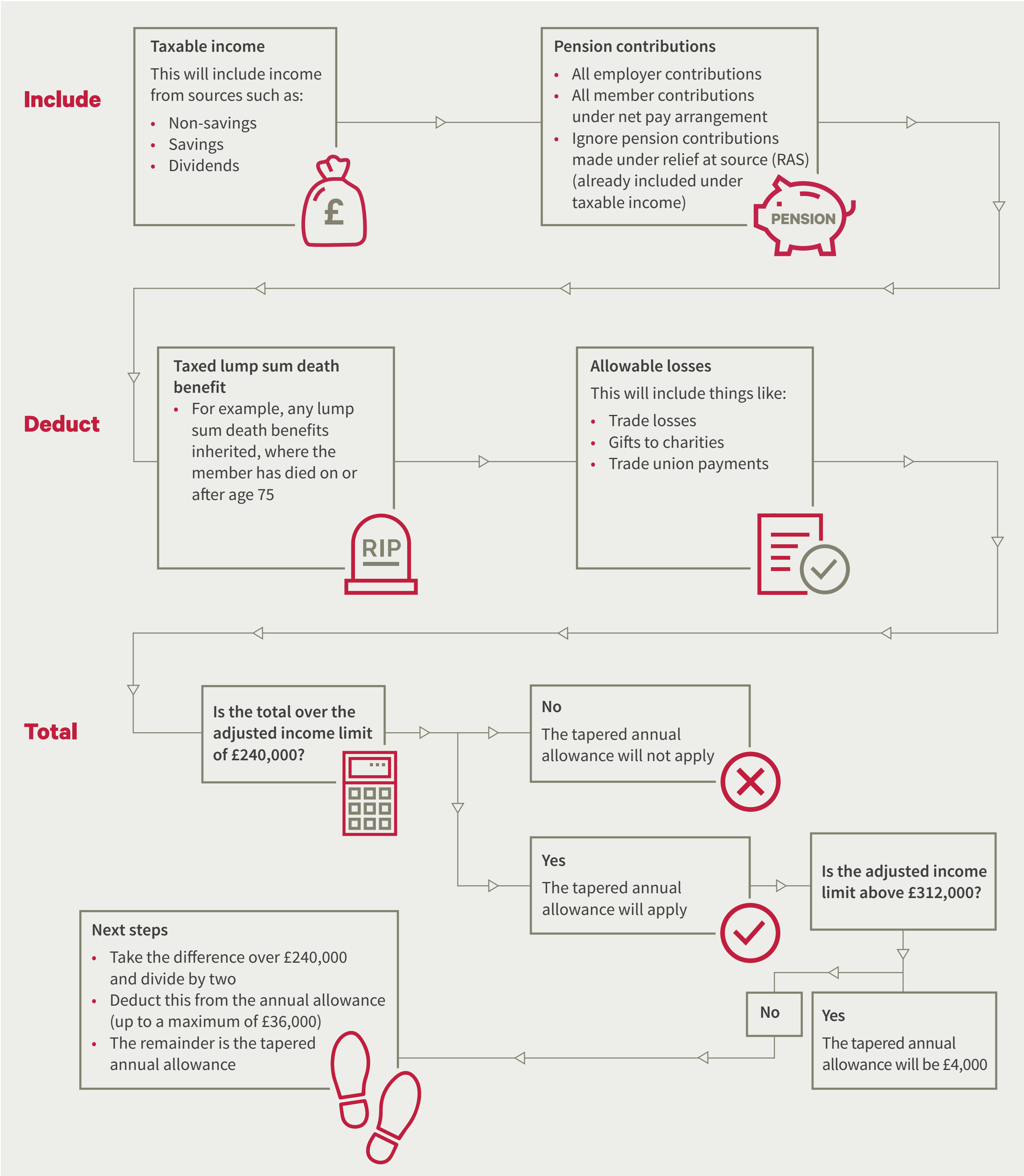
These should be included as income in respect of the threshold income test where:

- Either arrangement was made on or after 9 July 2015; and
- Regardless of whether or not this date is before or after the start of the employment concerned.
- Include where a existing arrangement has been amended (increased)

How does the Threshold Income test work?



How does the Adjusted Income test work?



Threshold Income Test – example

Caroline

- Is employed on a salary of £100,000
- Is a member of her employer's Group Personal Pension (GPP) scheme
- Contributions are paid using a salary sacrifice arrangement (set up after 9 July 2016)

In 2020/2021:

- Caroline sacrifices £10,000 into her GPP (pre-sacrificed salary is £110,000)
- Her employer makes an additional contribution of £10,000
- She also receives £1,000 gross savings interest and £2,000 gross dividend income (above any available allowances)

Therefore, Caroline's threshold income will be:

- (Gross income from all sources) + (any pre-sacrificed salary)
- (£100,000 + £1,000 + £2,000) + (£10,000) = £113,000
- Caroline's threshold income is below £200,000
- Therefore no adjusted income calculation is required

Caroline's Threshold Income → **£113,000**

Below Threshold Limit → **£200,000**

No Adjusted Income Test Required

If Caroline's threshold income had been £200,000 or over, then she would have been subject to the adjusted net income test and her employer's pension contribution would have been factored into the calculation.

Adjusted income – example

Nathan

- Is employed on a salary of £230,000
- Is a member of his employer's occupational money purchase scheme
- Contributions are paid using the net pay arrangement

In 2020/2021:

- He contributes £20,000 to his pension scheme
- His employer matches his contribution of £20,000
- He also receives £2,000 gross savings interest and £10,000 gross dividend income (above any available allowances).

Therefore, Nathan's adjusted income will be:

- (Gross income from all sources) + (employers' + employees' pension contributions)
- (£230,000 + £2,000 + £10,000) + (£20,000 + £20,000) = £282,000

Nathan's annual allowance will be reduced by £21,000:

- (£282,000 - £240,000) / £2 = £21,000

Therefore Nathan will have an annual allowance of £19,000:

- (£40,000 less £21,000) = £19,000

Nathan's Adjusted Income → **£282,000**

Above Adjusted Income Limit → **£240,000**

Tapered Annual Allowance will apply

Nathan's £42,000 above the Adjusted income limit, which will result in a reduction of £21,000 to his annual allowance. Therefore his annual allowance will be £19,000.

What if both the tapered annual allowance and the money purchase annual allowance apply?

If both the tapered annual allowance and the money purchase annual allowance apply, an individual's allowance can be determined as follows:

- The tapered annual allowance will be their actual annual allowance.
- The MPAA will still apply to the level of contributions that can be made to a defined contribution scheme.

Example:

If an individual's tapered annual allowance is £15,000, you would deduct the MPAA of £4,000 leaving £11,000 available as the alternative annual allowance.

How much applies to the MPAA and how much to the alternative annual allowance?

- Minus the MPAA from the available tapered annual allowance
- Whatever remains is the available alternative annual allowance, if nothing remains then the alternative annual allowance is nil

Can carry forward still be used with the tapered annual allowance?

Individuals will still be able to carry forward unused allowance from the previous three tax years providing:

- They have unused annual allowance available for those tax years
- They were a member of a pension scheme over those tax years
- They have relevant UK earnings (where it's a personal contribution) in the tax year the contribution is made to cover the size of any contribution being proposed.

Can 'scheme pays' be used if there's an annual allowance charge?

Individuals affected by the tapered annual allowance can still elect for their schemes to pay any annual allowance charge providing that:

- The charge exceeds £2,000
- The total pension savings within that scheme exceed the annual allowance (e.g. £40,000).

So for the scheme to pay the charge, in addition to the charge exceeding £2,000, the member will have to have exceeded the annual allowance limit and not the tapered annual allowance limit that may apply to them.

Planning considerations

- Maximise contributions where possible
- Make use of any carry forward of unused annual allowance
- Consider alternatives to pensions where restrictions apply
- Make pension contributions to bring total income below the threshold limit which in turn will allow employer contributions to be made without being included in any test.

MAXIMISING CONTRIBUTIONS

This document is based on Canada Life's understanding of applicable UK tax legislation and current HM Revenue & Custom's practice, as at March 2020 and could be subject to change in the future. It is provided for professional advisers only. Any recommendations are the adviser's sole responsibility

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