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CHARTERED FINANCIAL PLANNERS
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# Annual Allowance Tapering for High Earners

Since April 2016, those considered 'high-income' individuals have faced a reduction in the amount of tax relievable Pension savings they can make per tax year. The restrictions were originally introduced by George Osborne in April 2016, the then Chancellor, and were then amended by Rishi Sunak with effect from April 2020. The differences are summarised as follows:

### From 6 April 2016:

If threshold income exceeds £110,000, and your adjusted income is above £150,000, then your Annual Allowance (AA) is subject to reduction. The standard AA of £40,000 is reduced by £1 for every £2 of adjusted income over £150,000 in a tax year, with the maximum reduction being £30,000. This means that anyone with adjusted income of £210,000 or more, would see their AA capped at £10,000.

### From 6 April 2020:

If threshold income exceeds £200,000, and your adjusted income is above £240,000, then your AA is subject to reduction. The standard AA is reduced by £1 for every £2 of adjusted income over £240,000 (a £90,000 increase in the threshold), with the maximum reduction being £36,000. This means that anyone with adjusted income of £312,000 or more would see their AA cut to £4,000.

## Am I affected?

From April 2020, HMRC stipulate that for the taper to apply, individuals must have threshold income over £200,000 and adjusted income over £240,000. Details of how these are tested, and the respective definitions, are detailed below:

| THRESHOLD INCOME | ADJUSTED INCOME |
|---|---|
| 1. Taxable Income from all sources – including earnings, bonuses, investment income, rental income etc. | 1. Taxable Income from all sources – including earnings, bonuses, investment income, rental income etc. |
| *PLUS* | *PLUS* |
| 2. Employment income given up through salary exchange set up on or after 9 July 2015 | 2. Employer Pension Contributions |
| *LESS* | *LESS* |
| 3. Gross member contributions paid (via relief at source or net pay) | 3. Any taxed lump sum death benefits received |
| *LESS* | |
| 4. Any taxed lump sum death benefits received | |
| = | = |
| If Threshold Income is above £200,000, then the Tapered Annual Allowance applies (the reduction is determined by the Adjusted Income calculation, see right.) | If Adjusted Income is above £240,000, then the excess is used to determine the reduction to the standard £40,000 AA, as demonstrated in the examples overleaf. |

**Threshold Income -** this test is expected to help protect those with spikes in earnings or pension contributions. If adjusted income is above £240,000, the taper will only take effect if threshold income is also above £200,000.

**Adjusted Income -** This is the sum of all income plus the value of employer contributions paid. Therefore, it is not possible to reduce an individual's adjusted income via salary sacrifice or bonus payments in exchange for increased employer pension contributions.

## Examples

### Example 1. No tapering

John has a salary of £150,000 and £20,000 of investment income in the 2020/21 tax year. His employer makes a contribution of £20,000, and he personally contributes £20,000.

**Threshold Income - £150,000**

| | |
|---|---|
| £150,000 | Salary |
| £20,000 | Investment Income |
| **£170,000** | **Taxable Income** |
| (£20,000) | Personal Contribution |
| **£150,000** | **Threshold Income** |

As John's threshold income is below £200,000, the tapered AA does not apply so there is no need to calculate his adjusted income. He has the full £40,000 AA for 2020/21.

### Example 2. Tapering applies

Janis has a salary of £140,000, plus bonus of £80,000 and investment income of £10,000 in the 2020/21 tax year. Her employer makes a £30,000 contribution and she personally contributes £10,000.

**Threshold Income - £220,000**

| | |
|---|---|
| £140,000 | Salary |
| £80,000 | Bonus |
| £10,000 | Investment Income |
| **£230,000** | **Taxable Income** |
| (£10,000) | Personal Contribution |
| **£220,000** | **Threshold Income** |

As Janis' threshold income is above £200,000, her adjusted income needs calculating to determine if she is subject to the taper.

| | |
|---|---|
| £140,000 | Salary |
| £80,000 | Bonus |
| £10,000 | Investment Income |
| £30,000 | Employer Contribution |
| **£260,000** | **Adjusted Income** |

As Janis' Adjusted income is £260,000, which exceeds the £240,000 threshold, her AA will be reduced as follows...

| | |
|---|---|
| Excess above £240,000 | £20,000 (£260,000 - £240,000) |
| Annual Allowance Reduction | £10,000 (£20,000 / 2) |
| **Annual Allowance** | **£30,000 (£40,000 - £10,000 reduction)** |

As Janis' total input into her Pension for 2020/21 is £40,000 (£10,000 personal plus £30,000 employer), which is £10,000 above her available £30,000 AA, she could face an AA tax charge on the excess unless she has unused AA to carry forward from the previous three tax years.

## Example 3. Using personal contributions to reduce threshold income

Howard has his own business and has income consisting of salary and dividends of £215,000 that is subject to Income Tax in 2020/21. He maximised his Pension contributions in 2017/18 and 2018/19 but made no contributions in 2019/20 due to reinvestment in the business. In 2020/21 he wants to maximise his contribution from the business, making use of his carry forward from 2019/20.

If the **employer** contributes the full £40,000 his situation is:

**Threshold Income - £215,000**

| | |
|---|---|
| £215,000 | Salary and Dividend |
| **£215,000** | **Threshold Income** |

As his threshold income is above £200,000 the tapered AA applies.

**Adjusted Income - £255,000**

| | |
|---|---|
| £215,000 | Salary and Dividend |
| £40,000 | Employer Contribution |
| **£255,000** | **Adjusted Income** |

As Howard's adjusted income is £255,000, which is over the £240,000 threshold, his AA will be reduced as follows:

| | |
|---|---|
| Excess above £240,000 | £15,000 (£255,000 - £240,000) |
| Annual Allowance Reduction | £7,500 (£15,000 / 2) |
| **Annual Allowance** | **£32,500 (£40,000 - £7,500 reduction)** |

Where Howard's employer has paid £40,000 into his pension, he will not face an AA tax charge as he has unused AA to carry forward from previous years. In fact, his company could pay £72,500. (£40,000 from 2019/20 and £32,500 for 2020/21).

**Alternatively**

Howard could make a personal contribution of £15,000 gross meaning his threshold income would be £200,000. He would therefore have the full AA available for both tax years and be able to contribute £80,000.

With available income tax relief at 45%, the net cost of the £15,000 contribution would be just £8,250. He would be required to pay £12,000 (net of Basic Rate tax) to his pension and reclaim £3,000 via Self-Assessment. Howard would however need to have a salary of £15,000 paid to him, as dividend income is non-pensionable.