Tapered Annual Allowance – what you need to know

Some people with higher incomes have their pension annual allowance tapered, reducing how much they can pay into their pensions tax-efficiently.

This factsheet explains who's affected and how to calculate your allowance.

WHAT IS THE ANNUAL ALLOWANCE?

The annual allowance is a cap on the amount you can contribute to pensions each tax year without incurring a tax charge. It includes contributions made by you and your employer and benefits built up in a final salary scheme.

For most people, the annual allowance is £40,000. The current tax year runs from 6 April 2017 to 5 April 2018.

WHAT'S THE TAPER?

Put simply, the annual allowance is reduced for some people with higher incomes. This measure was first introduced on 6 April 2016.

AM I AFFECTED?

You are affected if your Threshold Income is more than £110,000 and your Adjusted Income is more than £150,000. Your annual allowance will then depend on your Adjusted Income.

Follow these three steps to work out how you are affected.

IMPORTANT INFORMATION

This factsheet is for your information only and is not personal advice. It is based on our understanding of current legislation which can change and is correct at 6 April 2017. If you are unsure a particular course of action is suitable for your circumstances, you should seek personal financial advice.

If you have flexibly accessed a pension since 6 April 2015, a £4,000 annual allowance for contributions to money purchase pensions may apply – see our annual allowance factsheet. Tax rules can change and any benefits depend on individual circumstances. The value of investments can fall as well as rise, so you may get back less than you invest. If you are unsure any reliefs are applicable to you, you should consult your accountant or HMRC.

STEP 1 – CALCULATE YOUR THRESHOLD INCOME

Broadly, Threshold Income is your total taxable income plus any salary/bonus sacrificed for pension contributions, minus any personal pension contributions you make.

To calculate your Threshold Income:

A. ADD together your taxable income and some pension contributions

- All taxable income received this tax year, for example:
  - Taxable earnings such as salary, bonus and commission (this is the figure after any income sacrificed, for example in exchange for a pension contribution)
  - Most rental income from property
  - Dividend payments
  - Interest on savings
  - Self-employed earnings

- Any salary/bonus sacrificed for pension contributions made this tax year if:
  - The arrangement started, or in some cases is renewed, on or after 9 July 2015; or
  - Contributions are increased on or after 9 July 2015 (this could be the whole amount or just the increase depending on the exact wording of your salary sacrifice agreement)

B. DEDUCT some reliefs and pension contributions you make this tax year

- Any personal or employee contributions you make to a pension (not employer contributions)
- Any reliefs listed in Section 24 of the Income Tax Act 2007. You may need to speak with an accountant to determine if this is relevant

If your Threshold Income is £110,000 or less your annual allowance will not be reduced this tax year. If your Threshold Income is more than £110,000 you might be affected and must next calculate your Adjusted Income – see page 2.

HARGREAVES LANSDOWN

One College Square South,
Anchor Road, Bristol, BS1 5HL
www.hl.co.uk

EXAMPLE 1: Harry

Harry's salary is £120,000.

He makes a £12,000 personal pension contribution. His employer also contributes £12,000.

Harry owns a buy-to-let property and receives a taxable rental income of £10,000 each year.

Threshold Income = £118,000
(salary + rental income – personal pension contributions)

Adjusted Income = £142,000
(salary + rental income + employer pension contributions)

As his Adjusted Income is below £150,000, he will not be subject to the taper. This means Harry will have an annual allowance of £40,000.

EXAMPLE 2: Diane

Diane's salary is £150,000.

After contributing £15,000 to her company pension (via 'Salary Sacrifice' unchanged since 8 July 2015) her actual salary is £135,000. Her employer contributes a further £18,000.

Diane also holds shares which pay her a dividend income of £6,000 a year.

Threshold Income = £141,000
(salary after salary sacrifice + dividend income)

Adjusted Income = £174,000
(salary after salary sacrifice + dividend income + employer pension contributions including those made by salary sacrifice)

This means Diane's annual allowance will be tapered to £28,000, meaning she has already exceeded this year's annual allowance.

EXAMPLE 3: Olivia

Olivia's salary is £120,000.

She receives a £60,000 bonus and makes a £75,000 personal pension contribution (using Carry Forward). Her employer also contributes £6,000 to the pension.

Threshold Income = £105,000
(total taxable income – personal pension contributions)

Adjusted Income = £186,000
(salary + bonus + employer contributions)

Olivia will have a £40,000 annual allowance. This is because, although her Adjusted Income is above £150,000, her Threshold Income is below £110,000. She will not be subject to the taper.

STEP 2 – CALCULATE YOUR ADJUSTED INCOME

Broadly, Adjusted Income is your total taxable income after any reliefs, plus any employer pension contributions.

To calculate your Adjusted Income, add together the following from this tax year:

- All taxable income (the same measure used in step 1A)
- Contributions your employer has made to a pension, including any made by salary sacrifice (whenever this was arranged)
- Benefits built up in a defined benefit (e.g. final salary) scheme, excluding the cost of employee contributions
- Contributions you make to occupational/trust-based pension schemes through a net pay arrangement (which would otherwise reduce taxable income)

Then deduct certain reliefs from this tax year (the same reliefs used in step 1B). Do not deduct personal or employee pension contributions.

If your Adjusted Income is more than £150,000 your annual allowance will be 'tapered'.

STEP 3 – CALCULATE YOUR NEW ANNUAL ALLOWANCE

For every £2 of Adjusted Income over £150,000, your annual allowance this tax year will be reduced by £1. There are some examples below.

For Adjusted Income over £210,000, your annual allowance will be £10,000 – there is no further reduction.

Adjusted Income	Annual Allowance
£150,000 or less	£40,000
£170,000	£30,000
£190,000	£20,000
£210,000 or more	£10,000

WHAT HAPPENS IF I EXCEED THE ANNUAL ALLOWANCE?

If you exceed your annual allowance, the total excess will be added to your income for the relevant tax year, and taxed at your highest rate. This charge should be declared and paid through income tax self-assessment. If the charge is over £2,000 and you have exceeded £40,000 in a single pension, you could instead choose to have it deducted directly from your pension pot. It may be possible for you to reduce or eliminate the excess by using Carry Forward. Our Annual Allowance & Carry Forward Factsheet explains more.

All figures and scenarios relate to the 2017/18 tax year and assume no pension withdrawals have been made.

ANY QUESTIONS?

Call our Pensions Helpdesk on 0117 980 9926. We can answer your questions, or put you in touch with a financial adviser if you are unsure a course of action is suitable for your circumstances.