

Pension Tapered Annual Allowance and potential tax charge

The tapered annual allowance which was introduced in April 2016 impacted several taxpayers in 2016/17, resulting in large, often unexpected tax charges becoming due and there is potential for the same in 2017/18 and later years.

Since April 2016/17, if your 'threshold income' exceeds £110,000 and your 'adjusted income' exceeds £150,000, you are subject to the tapered annual allowance, which could see your annual allowance reduced from £40,000 to £10,000.

The standard allowance is reduced by £1 for every £2 of adjusted income in excess of £150,000.

'Threshold income' is: your taxable income, less gross member contributions paid, less any lump sum benefits received, plus any reduction of employment income for pension provisions via salary sacrifice or flexible remuneration arrangements.

'Adjusted income' is: your taxable income, plus any employer contributions (for defined benefit schemes this is the pension input amount less employee contributions), less lump sum death benefits received.



The impact of the potential reduction of the annual allowance to £10,000 for high earners has seen an increase in the number of individuals being subject to a tax charge, at their highest rate of tax, being 45% in most cases, on the excess pension growth/contributions.

In addition to the annual allowance, you may also have unutilised annual allowances brought forward from the previous three tax years to offset against any potential pension charge.

In previous years it has been possible to elect for scheme pays in respect of the tax charge arising, so the charge is paid from your pension pot, rather than making the payment personally via self-assessment in the January following the tax year of charge. However, since 2016/17, it is only possible to elect for the scheme to pay any tax charge which falls outside of the tapered allowance, i.e. contributions exceeding the standard allowance.

Any tax due relating to the tapered allowance (i.e. between £40,000 and £10,000) is payable via self-assessment and there is no option for the scheme to pay this.

As an example:

Scenario:

- Pension growth – £70,000
- Tapered annual allowance – £10,000
- Brought forward unused annual allowances – £nil

Tax consequences:

- You have exceeded your tapered allowance by £60,000
- Tax charge due at 45% of £27,000

Of this charge, you could elect for the scheme to pay £13,500, being the growth exceeding the standard annual allowance (£30,000@45%), however, the amount relating to the tapered allowance, i.e. £40,000-£10,000@45% = £13,500 has to be paid personally via self-assessment. In addition to the payment of this by 31 January following the tax year of charge, there is also a knock on effect on your payments on account due for the following tax year, resulting in an additional 50% of this being payable by 31 January, i.e. £20,250.

Pensions are a complex area. We are unable to provide pensions advice as we are not regulated to do so, however, if you are concerned about the above and require advice in connection with your pension/(s) we would advise you to consult a financial advisor. If you do not currently have an advisor, JW Hinks have links with independent financial advisors who we can put you in touch with.