Pension allowances impacting high earners

Introduction

When paying into your pension, you receive tax relief on any contributions that you make. This is at the highest rate of income tax that you pay, provided that the total gross pension contributions paid into your pension scheme, by you, your employer and anyone else do not exceed the lower of:

- Your annual earnings; and
- The annual allowance

Annual Allowance

The annual allowance is a limit to the total amount of contributions that can be paid to defined contribution pension schemes and the total amount of benefits that you can build up in defined benefit pension schemes each year, for tax relief purposes. The annual allowance is currently capped at £40,000 although a lower limit of £4,000 may apply if you have already started drawing a defined contribution pension. The annual allowance applies across all schemes you belong to, it's not a 'per scheme' limit and includes all of the contributions that you or your employer pay or anyone else who pays on your behalf.

With effect from 6 April 2016, a tapered reduction to the annual allowance was introduced for high earners who:

- had 'adjusted income', including the value of all income plus employer pension contributions, exceeding £150,000 **and**
- threshold (taxable) income, excluding pension contributions, of over £110,000

Where **both** the above limits are breached, the annual allowance was reduced by £1 for every £2 of 'adjusted income' in excess of £150,000, subject to a maximum reduction of £30,000, for each tax year affected between 2016/17 – 2019/20 inclusive.

Changes to the Tapered Annual Allowance effective 2020/21

It was announced by the Chancellor of the Exchequer in the March 2020 Budget that from 6 April 2020, the 'tapered annual allowance' for higher earners will continue to be linked to UK taxable income, however the income limits, before tapering applies, will be significantly increased. These changes mean that many people will no longer be affected by the tapering rules or will be affected to a lesser degree, and so have the ability to make increased pension savings.

With effect from 6 April 2020, 'adjusted income' (as detailed above) increases to £240,000 and threshold income increases to £200,000.

Where both the above limits are breached, the annual allowance will still reduce by £1 for every £2 of 'adjusted income' in excess of £240,000, however the maximum reduction has increased to £36,000, therefore it is possible for the annual allowance to be as low as £4,000 for some high earners (with adjusted income in excess of £312,000).

Carry Forward

Carry forward lets you take advantage of any unused allowance from the previous three tax years.

For those affected by tapering, carry forward of unused annual allowance will continue to be available for the past three years, but the amount available will be based on the unused tapered annual allowance.

Exceeding the Annual Allowance

The annual allowance charge is a tax charge on the individual. It arises where the total pension input amount for an individual, in Pension Input Period (PIP) which end in the tax year concerned, exceeds the amount of the annual allowance for that tax year and any unused annual allowance from the previous three years.

Anyone who has exceeded any of the annual allowances is required to report this to HMRC by completing a Self-Assessment return, even if they have not previously completed a return.

The amount of the annual allowance excess is treated like any other income and is added to the top part of the person’s taxable income. This could mean a tax charge of up to 45% depending on other earnings that tax year.

Lifetime Allowance

The lifetime allowance (LTA) is the overall limit of tax privileged pensions funds a member can accrue during their lifetime, before a Lifetime Allowance tax charge applies. The standard lifetime allowance is currently £1,073,100 (2020/21) this is expected to rise in line with increases in CPI each year based on current rules and subject to change.

The tax rate depends on whether the excess is paid as a lump sum - called a lifetime allowance excess lump sum and charged at 55% - or if retained to pay pension benefits, charged at 25% (tax is then payable on the income the member receives at their marginal rates).

Where an individual is likely to exceed the LTA, individuals have a number of strategies that can be considered. Analysis of your individual circumstances is required to establish how this can be best managed.

Planning

At Howe Maxted Group, we specialise in this type of planning and are able to help you understand your annual allowances, unused carry forward, as well as both the impact on your lifetime limits and how you might work with these rules to achieve your ultimate retirement goals through a robust financial plan.

The information provided in this document is correct as of 22 April 2020 and is intended for general information and illustrative purposes. It does not constitute advice.

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