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It is important to note that the Finance Bill 2015/16 has not yet received Royal Assent and as such is still subject to change, however, the Bill details that from April 2016 the government will introduce a taper to the Annual Allowance for those with:

“adjusted income” of over £150,000. For every £2 of adjusted income over £150,000, an individual’s Annual Allowance, the limit on the amount of tax relieved pension savings that can be made by an individual or their employer each year, will be reduced by £1, down to a minimum of £10,000.

AND

‘threshold income’ of over £110,000. Broadly, this is taxable income plus any salary sacrifice entered into post budget. More below!

It should be noted that although the member receives no tax relief on employer contributions these are still assessed against the members annual allowance.

Adjusted Income?

“Adjusted income” (£150,000) is broadly ‘the individual’s net income (all income charged to income tax- not just salary) plus the value of any pension savings for the tax year, but less the amount of certain lump sum death benefits paid to the individual during the tax year.’ As such, “Adjusted Income” is not the same as “Adjusted Net Income” which we usually use when we discuss using pension contributions to reduce/negate the various “tax traps”.

In more detail “Adjusted Income” is:

- The individuals net income for the year (step 1 and 2 of the calculation in section 23 of the ITA 2007),
  - Step 1
    - Identify the amounts of income on which the taxpayer is charged to income tax for the tax year. The sum of those amounts is “total income”. Each of those amounts is a “component” of total income.
  - Step 2
    - Deduct from the components the amount of any relief under a provision listed in relation to the taxpayer in section 24 to which the taxpayer is entitled for the tax year. See section 25 for further provision about the deduction of those reliefs. The sum of the amounts of the components left after this step is “net income”.

continued overleaf
Threshold Income?

To provide certainty for individuals with lower salaries who may have “one off” spikes in their employer pension contributions that mean they may temporarily exceed the adjusted income, the Chancellor has set a net income threshold of £110,000 before the taper will apply. Where an individual has a “threshold income” of £110,000 or less they cannot be subject to the tapered annual allowance.

“Threshold Income” is broadly defined as ‘the individual’s net income for the year, less the amount of any lump sum death benefits paid to the individual during the tax year that can be deducted from the adjusted income.’

In more detail “threshold income” is:

» Taxable income for the tax year
» less
» Any lump sum pension death benefits accruing in the tax year (ITEPA03 636A-4ZA)
» plus
» Employment income given up for pension contributions (i.e. salary sacrifice) on or after 9 July 2015 (to prevent post budget salary sacrifice to reduce threshold income to under £110,000)
» less
» The gross amount of any relief at source (to ensure that when calculating threshold income, there is parity between any contributions made under net pay, which are deducted arriving at taxable income, and relief at source).

Although the government have included anti-avoidance rules to prevent new salary sacrifice arrangements from reducing the level of someone’s threshold income, it appears that pension contributions can still be used to reduce the taxable income in the calculation of threshold income (unlike the calculation for “adjusted income”). As such, pension contributions could be used to reduce threshold income below the £110,000. Clearly, that is why the threshold income has been set £40,000 (standard Annual Allowance) below the level of adjusted income. However, individuals with sufficient relevant income and unused annual allowance from previous years (carry forward) could still use pension contributions to potentially avoid the application of the tapered annual allowance in some years.

We would suggest calculating threshold income first, it’s simpler and may prevent the need to calculate the much more complicated “adjusted income”.

Notes – Section 24 and 25 are accessible here. Further information on allowable deductions is also provided.

Plus

Amount of any of pension contributions:

» under Net pay arrangements
» gaining UK tax relief but made to overseas pension schemes
» using Excess relief under net pay provisions,
» using relief on making a claim provisions,

Plus

Value of employer contributions, which are:

» Money Purchase = value of contributions
» Defined Benefit = Pension Input Amount minus member contributions (technically you have to add in all pension input amounts and remove the member contributions but this amounts to the same thing and is simpler)

Less

» the amount of any lump sum pension death benefit accruing to the individual in that tax year
Outcome

Notwithstanding, the potential impact of the money purchase annual allowance for those having flexibly accessed their pension benefits the changes will result in an Annual Allowance of:

£40,000 for those with an adjusted income of less than £150,000; Between £10,000 and £40,000 for those with adjusted incomes between £150,000 and £210,000; and £10,000 for those with an adjusted income over £210,000.

The tapering of Annual Allowance significantly reduces the opportunity of pensions for higher earners. However, there is potential to add value through planning.

The use of carry forward to reduce an individual’s threshold income below £110,000 may help delay the impact of these changes. Also, as the changes are not due until April 2016, there is an opportunity for those that will be impacted to maximise their pension contributions in the interim period. The exchequer expects this to happen and has budgeted to pay an extra £70 million in pension’s tax relief to higher earners in 2015-16 as a result of these changes.

And finally, for those not yet members of a registered pension scheme joining a scheme this year will generate £40,000 of carry forward for adding to whatever their reduced allowance will be in future.

In a post freedom world and the undoubted attractiveness of the pension tax wrapper would it be foolhardy for higher earners not to plan to maximise their contributions? But time is of the essence!

Pelle moras; brevis est magni fortuna favoris. – translates as “away with delay; the chance of great fortune is short-lived”.

Silius Italicus, Punica, IV. 734.

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