



TAYLOR PATTERSON

PART OF MATTIOLI WOODS PLC



## TAPERED ANNUAL ALLOWANCE FOR HIGHER EARNERS

From 6 April 2016, individuals who have income for a tax year of greater than £150,000, will have their annual allowance for that year restricted. For every £2 of income that exceeds £150,000, £1 of the annual allowance is lost. There will be a cap on the reduction (or tapering) of £30,000, so that anyone with adjusted income of or above £210,000 will have a minimum annual allowance of £10,000.

Tapering is applied in each tax year. As such, an individual may have a tapered annual allowance in one tax year and a full annual allowance in the following tax year, dependent on their income.

It will still be possible to carry forward any unused annual allowance from the three previous tax years and add it to the individual's annual allowance. Where this annual allowance is reduced by the taper, the carry forward will be the balance of the tapered amount.

The income definition will not be the same as taxable income, but will include the value of pension savings. This is known as adjusted income; a full definition is detailed below. The definition of adjusted income does include the value of employer contributions. This is to ensure that any new salary exchange arrangements set up after 9 July 2015 are not used to reduce income below £150,000.

However, there will also be an income floor of £110,000. This will be known as the threshold income. A full definition is below.

The intention of the two definitions was to provide consistency between employed and self-employed individuals, as well as creating a safety net for members in defined benefit schemes and lower earners who may have been affected as a result of a large pension contribution.

Where an individual has threshold income of £110,000 or less, they will not be subject to tapering regardless of the level of their adjusted income.

One of the major complexities of the new system is that a member's annual allowance for any given tax year will depend on their adjusted income for that tax year. Individuals who may have separate self-employed earnings or receive significant bonuses or commissions may not know at the start of the tax year whether or not they are affected until the end of the tax year.

This means that Taylor Patterson cannot confirm what your annual allowance is, and we would recommend liaising with your financial adviser and/or accountant to help assist you.

If you feel this will affect you, please contact either your financial adviser, or contact Taylor Patterson using the contact details below to discuss this further, as there are some planning techniques that you may wish to explore.

### Adjusted income (£150,000)

**For this purpose the adjusted income definition will be:**

- The total amount of income in the tax year on which an individual is subject to income tax. This will include earned salary, bonus, dividends, self-employed profits, benefits-in-kind, pension income, property income, savings, and taxable lump sum death benefits (post-5 April 2016) (step 1 of section 23 of the Income Tax Act 2007)
  - less certain allowances and reliefs, i.e. excess tax relief under net pay pension schemes (where full tax relief is not available through payroll), pension scheme tax relief upon making a claim (RACs), gifts to charities and trade losses (step 2 of section 23 of the Income Tax Act 2007)
  - plus any pension scheme tax relief deducted in the previous bullet point
  - plus any employee pension contributions deducted from gross salary (net pay arrangements) in the tax year the payment is made
  - plus the value of any employer contributions. For defined benefits and cash balance arrangements, this will require working out the actual pension input amount for the arrangement for the tax year, using the normal annual allowance rules, and then subtracting from this figure the total of any member contributions to that arrangement paid in the tax year. This also includes any employer contributions as a result of a salary exchange arrangement for the tax year
  - less any lump sum death benefits paid to individuals in the tax year which were taxable at the individuals marginal rate (i.e. taxable lump sum death benefits received on or after 6 April 2016)

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### Threshold income (£110,000)

**For this purpose, the threshold income definition will be:**

- the total amount of income in the tax year on which an individual is subject to income tax. This will include earned salary, bonus, dividends, self-employed profits, benefits-in-kind, pension income, property income, savings, and taxable lump sum death benefits (post-5 April 2016) (step 1 of section 23 of the Income Tax Act 2007)
  - Less certain allowances and reliefs, i.e. excess tax relief under net pay pension schemes (where full tax relief is not available through payroll), pension scheme tax relief upon making a claim (RACs) (step 2 of section 23 of the Income Tax Act 2007).
  - less any contribution made by an individual to a relief at source pension (e.g. the gross amount of a contribution to a personal pension)
  - less any lump sum death benefits received in the tax year which were taxable at the individual's marginal rate (i.e. taxable lump sum death benefits received on or after 6 April 2016)
  - plus the amount of any employment income given up for pension provision as a result of any salary exchange, but only if the arrangement was made on or after 9 July 2015
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**The threshold income will be important for many. For example if an individual's total income amount less deductions is £100,000 (including an employee pension contribution to a net pay arrangement scheme of £100,000) it would mean that the £150,000 adjusted income is breached, but because the threshold income of £110,000 is not breached, the tapered annual allowance will not apply.**

**We would recommend liaising with your accountant to calculate your income under the relevant definitions.**

#### Example

David has a total salary of £130,000 p.a. and no other income. His employer pays 20% pension contribution and David contributes 10% via relief at source.

David's 'threshold income' is £117,000 (£130,000 income less the personal contribution of £13,000 made by relief at source). This is over £110,000, so he now needs to include his employer contributions to see if his 'adjusted income' exceeds £150,000, and if so, whether the annual allowance will need to be tapered.

To calculate adjusted income, the employer contribution is added to his income.

£130,000 plus the £26,000 employer contribution gives David an adjusted income of £156,000; as this is over £150,000 his annual allowance would be reduced. David's tapered annual allowance would be £37,000 (£1 reduction for every £2 over adjusted income).

David's total pension contributions of £39,000 would have been within the standard annual allowance of £40,000, but as this will be over his tapered annual allowance of £37,000, he would be subject to an annual allowance charge on the £2,000 excess (unless carry forward is available).