# How to work out the new tapered annual allowance

A guide to working out whether your client is affected by the taper

In the 2020 Budget, chancellor Rishi Sunak announced some changes to the tapered annual allowance, including increasing the threshold income and adjusted income limits at which the taper kicks in.

On 6 April 2020, the adjusted income limit rose to £240,000 (up from £150,000) and the threshold income limit rose to £200,000 (up from £110,000).

The chancellor also lowered the minimum reduced annual allowance from £10,000 to £4,000.

The annual allowance is still £40,000. It is possible to carry forward any unused annual allowance from the previous three years if the taper applies.

We've put together a guide to help you work out if your clients will be hit by the new tapering rules.

### HOW DO I WORK OUT IF I AM AFFECTED?

To check whether the tapered annual allowance applies to your client, you need to work out their threshold income and adjusted income. To calculate threshold and adjusted incomes, you will also need to work out your client's:

- total income in a tax year;
- net income in a tax year;
- pension savings in a tax year;
- the amount of any lump sum death benefits received in a tax year.

To work out their threshold income, you first need to work out their total income and their net income. Net income is total income, less a series of reliefs.

Threshold income is net income minus any pension savings and any lump sum death benefits you received from registered pension schemes.

Adjusted income is net income plus all pension contributions.

If your client's threshold income is less than £200,000, they will not be affected by the taper.

If their threshold income is over £200,000, you should work out your client's adjusted income.

If your client's adjusted income is over £240,000 and their threshold income is over £200,000, their annual allowance will be subject to tapering rules.

### STEP 1: TOTAL INCOME

The first thing you need to work out is your client's total income for the tax year.

This includes all forms of income that are taxable, including (but not exclusively) the following:

- employment income;
- pension income (state, occupational and personal);
- employment bonuses;
- self-employment or trading income;
- property/rental income;
- income from investments and savings accounts;
- income from shares (dividend income);
- income received by an individual from a trust;
- other sources of taxable income not specified.

Foreign earnings do not count towards income as they are not taxed in the UK.

### STEP 2: TOTAL PENSION SAVINGS

For defined contribution schemes, total pension savings are usually the amount of pensions contributions made by an indiviudal, or someone on your behalf, and your employer during the pension input period.

For defined benefit schemes, it is slightly more complicated. Pension savings are calculated by deducting the opening value from the closing value for the pension input period.

Prudential has a calculator that can be used to work this out here. A guide to using the calculator can be found here. To calculate the opening period:

- take your annual pension built up at the end of the previous pension input period;
- multiply this figure by 16;
- add any separate lump sum built up at the end of the previous pension input period;
- increase this by the Consumer Price Index for the previous September.

To calculate the closing period:

- take your annual pension built up so far at the end of the pension input period;
- multiply this amount by 16;
- add the value of any separate lump sum you would receive - this is your closing value.

### STEP 3: NET INCOME

Once you have calculated your client's total income, you need to work out their net income by applying any relevant deductions / tax reliefs.

These deductions are extensive - a full list can be viewed here from the Income Tax Act 2007. But some key deductions include:

- member contributions paid to money purchase and defined benefit pension schemes under the net pay arrangement (where the sponsoring employer of the pension scheme deducts employee contributions before tax under PAYE);
- qualifying interest payments, including interest on loans for the purpose of: acquiring a share in a closed company; acquiring a share in an employee-controlled company; acquiring an interest in a partnership; payment of inheritance tax;

- business losses in the early years of trade;
- property loss relief';
- trade loss relief against business income;
- gifts of shares and securities to charities.

**STEP 4: THRESHOLD INCOME**

The threshold income measure helps to ensure individuals with lower salaries who may have one-off spikes in the value of their employer pension contributions are not unfairly subjected to tapering.

To work out your client's threshold income for the tax year, start with their net income for the tax year.

Then deduct:

- the gross amount of any member contributions to UK registered pension schemes made via the relief at source method. These are contributions made by your client or someone else on their behalf, but exclude contributions made by their employer;
- the amount of any taxable lump sum death benefits they received from registered pension schemes.

Then add:

- any employment income given up for pension contributions through a salary sacrifice arrangement made on or after 9 July 2015.

If this total comes to less than £200,000, you do not need to do anything else. If it comes to £200,000 or more, you need to work out your client's adjusted income.

**STEP 5: ADJUSTED INCOME**

To work out your client's adjusted income, you need to add the value of all their pension contributions (including from their employer) to their net income.

This prevents individuals from avoiding the restriction by exchanging salary for employer contributions.

Start with their net income. Then add:

- all employer contributions made to their pension;
- all individual contributions made by the net pay arrangement (non relief at source);
- any claim for excess relief (eg. where the amount of a contribution paid by an individual under a net pay arrangement exceeds the employment income from the individual's employment);

Then deduct:

- the amount of any lump sum death benefits they received from registered pension schemes.

If their threshold income was £200,000 or more, and their adjusted income is £240,000 or more, then their annual allowance may be subject to tapering.

**IF YOUR ANNUAL ALLOWANCE IS TAPERED**

If your client's annual allowance is subject to tapering rules, for every £2 their adjusted income goes over the £240,000 threshold, their annual allowance for that year will reduce by £1.

As of 6 April 2020, the minimum that this can reduce to is £4,000, meaning the maximum reduction to their annual allowance is £36,000 (see graph below).

Carry forward is a potential way of increasing a member's annual allowance in the tax year. Your client can use carry forward when their total pension input for a tax year exceeds your annual allowance limit, if they have unused annual allowance from earlier tax years (up to three years). ■ **LAURA PURKESS**

**CASE STUDIES**

*Example 1*

Alex is a company director and sole shareholder of his own company. His taxable income is £190,000 and he decides to pay an employer contribution of £60,000. He uses carry forward to avoid an annual allowance charge.

His adjusted income is therefore £250,000, which should trigger a reduction of £5,000 in his annual allowance - half of the £10,000 excess over £240,000.

However, his threshold income is only £190,000, so the taper does not apply.

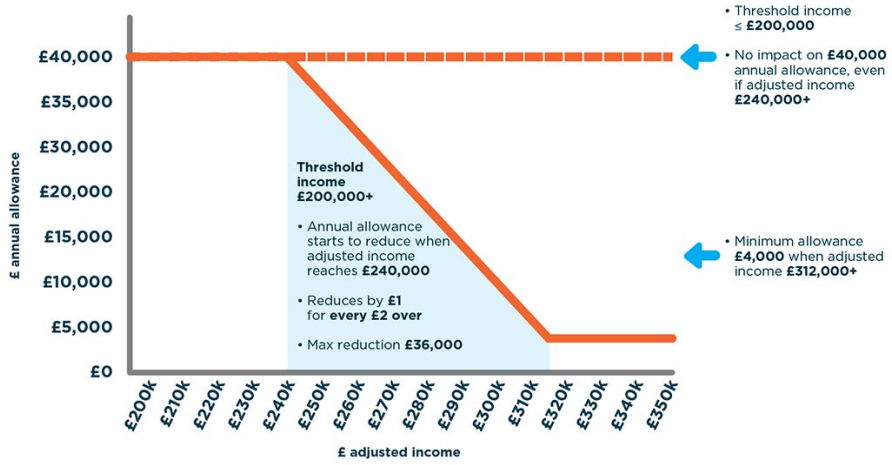
*Example 2*

Jack has an adjusted income of £300,000, so will exceed the adjusted income limit by £60,000.

His annual allowance would be reduced by half of this – so by £30,000 – leaving him with a tapered annual allowance of £10,000.

This is the standard annual allowance of £40,000, less the £30,000 reduction under the tapering rules.

## Annual allowance tapering




Source: James Hay