# TAPERED ANNUAL ALLOWANCE EXPLAINED

## WHAT IS THE TAPERED ANNUAL ALLOWANCE?

There's a limit on how much you can save into your pension each year and still receive tax relief on the contributions. This is known as the Annual Allowance and it's set at £40,000 for the 2020/21 tax year. For high earners, a lower limit called the Tapered Annual Allowance (TAA) may apply.

*All the figures that appear below have been updated for 2020/21 tax year

## KEY POINTS

- The Annual Allowance – £40,000 provides tax relief on pension contributions up to this amount.
- If your adjusted annual income is over £240,000, and your threshold income is over £200,000, the Tapered Annual Allowance may apply instead. Between 2016/17 and 2019/20, the adjusted income limit was £150,000 and the threshold income limit was £110,000.
- The TAA reduces the Annual Allowance by £1 for every £2 of income above £240,000 to a minimum of £4,000. The minimum TAA was £10,000 between 2016/17 and 2019/20.
- You can 'carry forward' any unused Annual Allowance from previous tax years to use alongside the TAA.
- Whether the TAA applies to you for a particular tax year depends on your Adjusted Income and Threshold Income just for that tax year. You may be able to benefit from the full £40,000 Annual Allowance in later tax years, depending on your Adjusted Income and Threshold Income in those tax years. This assumes that you haven't triggered the Money Purchase Annual Allowance.

# WHAT DOES THIS MEAN FOR YOU?

All pension contributions that you make or which are made on your behalf count towards your Annual Allowance. The TAA may apply, however, if your annual income – including earnings from employment and savings income, plus employer pension contributions – adds up to more than £240,000.

Two income measures are considered:

- **ADJUSTED INCOME** – your taxable income plus any employer contributions to your workplace pension
- **THRESHOLD INCOME** – your taxable income minus any pension contributions that you make.

The TAA will apply for any tax year in which your Adjusted Income is more than £240,000 and your Threshold Income is also over £200,000. As its name suggests, it 'tapers' the tax relief granted by the Annual Allowance.

If the tapered annual allowance applies, the standard £40,000 annual allowance is reduced by £1 for every £2 that adjusted income exceeds £240,000. The minimum tapered annual allowance is £4,000 which applies once adjusted income reaches £312,000.

Other factors may affect the Adjusted and Threshold Income. A financial adviser can confirm if any of these apply to you.

## TAXABLE INCOME

Your taxable income for the year includes any:

- salary, bonuses, commission and taxable job-related benefits
- earnings from self-employment
- bank and building society interest
- dividends
- rental and other taxable income such as pension payments.

A tax adviser will also take into account any adjustments such as contributions to occupational pension schemes and deductible losses.

# WHAT DO YOU NEED TO DO?

You can 'carry forward' any Annual Allowance left over from the previous three tax years to use alongside the TAA.

Any pension contributions over and above the TAA (plus any carried forward Annual Allowance) will be treated as income and subject to tax.

You may not know your actual income until the end of the tax year. Rather than risk a tax charge, you may decide to limit your pension contributions in the current year. You can make additional contributions another year.

The Annual Allowance will be restored in full if your adjusted income falls below £240,000 in a future tax year – unless you trigger the Money Purchase Annual Allowance.

You may also wish to discuss with your employer the possibility of adjusting your pension contributions or alternative forms of remuneration.

# EXAMPLE CALCULATION

In the 2020/21 tax year, Joe receives a salary of £200,000 from his employer plus a bonus of £50,000. He also receives dividends of £4,000 and savings interest of £1,000. He pays 5% of his basic salary into a group personal pension plan, which is matched by his employer.

| Salary | Bonus | Dividends | Savings interest | **Taxable income** |
|---|---|---|---|---|
| £200,000 | £50,000 | £4,000 | £1,000 | **£255,000** |

## ADJUSTED INCOME

£255,000 + £10,000* = £265,000

*employer pension contribution

## THRESHOLD INCOME

£255,000 - £10,000# = £245,000

#personal pension contribution

The TAA is applied as Joe's Adjusted Income is above £240,000 and his Threshold Income is over £200,000. The Annual Allowance of £40,000 is reduced as follows:

## ADJUSTED INCOME EXCESS

£265,000 - £240,000 = £25,000

## ANNUAL ALLOWANCE REDUCTION

£25,000 ÷ 2 = £12,500

£40,000 - £12,500 = £27,500

In our example, the £20,000 combined employer and employee contributions are comfortably within the TAA.

Tax treatment depends on your individual circumstances.
Your circumstances and tax rules may change in the future.

You can find out more about the Tapered Annual Allowance at
**www.gov.uk/tax-on-your-private-pension**
or by contacting a financial adviser.

SCOTTISH WIDOWS



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