# FINANCE UPDATES
## JANUARY 2020

# HIGH EARNERS & THE TAPERED ALLOWANCE

Controversial taper rules explained.

High earners will be familiar with the tapered annual allowance. After all, it spent most of 2019 mired in controversy after medical professionals in England snubbed overtime shifts amid fears of being clobbered with unexpectedly high tax bills.

In December 2018, the number of senior doctors and GPs leaving the NHS pension scheme was five times higher than from other public pension funds.

Prior to last month's general election, ministers signed off a temporary plan to cover the pension bills of senior physicians in a bid to get them back to work and head off a potential winter crisis in A&E departments up and down the country.

That was closely followed by a call to extend the temporary fix to the armed forces, specifically around taxation of final-salary pensions, and for it to extend to other people in public service.

While doctors and consultants have been offered a temporary resolution, the tax-free amount anyone can put into pension schemes each year has significantly reduced in the last decade.

In 2010/11, you could put £255,000 a year into your pension free from tax, but that was cut to £40,000 in April 2016 – and drops further for the highest earners through the controversial taper.

These changes tend to affect those earning more than £110,000 a year. How pensions work outside of England slightly differ, although tax-free allowances have been reduced in each of the UK's other nations.

## HOW THE TAPER WORKS

The £40,000 annual pensions allowance is the 2019/20 maximum you can put into, or accrue benefits towards, a pension and receive tax relief at your marginal rate.

High earners with a taxable adjusted income of more than £150,000 have this annual allowance restricted by the taper.

For every £2 of income you have over £150,000, your annual allowance is reduced by £1. The maximum reduction is £30,000, so if your income exceeds £210,000 you will have a tapered annual allowance of £10,000.

Anyone whose total annual pension contributions exceed their tapered annual allowance will be taxed at their marginal rate, making high earners most likely to be caught.

For example, additional-rate taxpayers face a 45% tax charge if they put more than their tapered annual allowance into their pension in 2019/20.

Working out whether the taper applies is not straightforward, however, as the taper does not apply if your threshold income is £110,000 or less.

## WHEN THE TAPER APPLIES

Whether or not the taper applies to you and affects what you can put into your pension each year depends on your adjusted income and threshold income.

Adjusted income includes all pension contributions, while threshold income excludes pension contributions.

To work out if the taper applies, your total income needs to be worked out. This takes into account all of your taxable income, not just your earnings, and certain deductions.

For example, Mark is a senior consultant with an adjusted income of £170,000 in 2018/19, which includes a £145,000-a-year salary and pension benefits of £25,000.

His salary is below the £150,000 allowance at which the taper kicks in, but the pension benefits take him above the threshold for the taper rules to apply.

Under those rules, Mark's annual pensions allowance reduces by £1 for every £2 his adjusted income exceeds £150,000.

As he is £20,000 over the threshold, the taper reduces his 2018/19 allowance by £10,000 to £30,000.

## PENSION CARRY FORWARD

Carry forward enables you to take any unused pension allowance from the previous three years. That's up to £40,000 a year.

With the 2018/19 deadline for tax returns and payments on account fast approaching, you can carry forward any unused allowance from the last three years.

That means you could be able to make a pension contribution of up to £160,000 in 2018/19 and receive tax relief.

Here's how someone could use the carry-forward method on their 2018/19 tax return, due by midnight on 31 January 2020:

| Tax year | Annual allowance | Contributions | Unused |
|---|---|---|---|
| 2018/19 | £40,000 | £40,000 | £0 |
| 2017/18 | £40,000 | £20,000 | £20,000 |
| 2016/17 | £40,000 | £10,000 | £30,000 |
| Total allowance to carry forward in 2018/19: | | | £50,000 |

You must be a member of a registered pension scheme and have used up your allowance for the current tax year before using the carry-forward method.

Assuming you did not maximise pension contributions in those tax years, you can use the carry-forward allowance.

How much you can utilise is the difference between the annual allowance for the carry-forward year and your pension contributions in that year.

Any amount left can be carried forward and added to this year's allowance to help avoid the tapered reduction.

## MONEY PURCHASE ANNUAL ALLOWANCE

Since April 2015, people over the age of 55 have benefited from more choice when it comes to flexibly accessing their pension.

If you have accessed your pension benefits, you will be subject to the £4,000 money purchase annual allowance (MPAA).

This applies to payments into defined contribution schemes. Those in final-salary schemes are affected differently.

If you are subject to the MPAA and belong to a final-salary pension scheme then the alternative annual allowance will apply.

To arrive at this figure, the MPAA is deducted from the standard annual allowance to give an alternative allowance of £36,000.

If you are a high earner and are caught by the taper rules, these will apply to your alternative annual allowance.

## PLANNING STRATEGIES

If you earn anywhere near £130,000 or received a big pay rise, you need to take action – urgently if the pay rise was in 2018/19.

Request a savings statement from your provider to see how much you have put into your pension over previous years.

If you have exceeded the annual pensions allowance, it will need to be declared on your tax return before midnight on 31 January.

We can look at your pension contributions and your investment returns to calculate your adjusted income for the tax year.

You can provide these figures to your accountant, who should be able to take it from there to calculate and submit your tax return.

From a planning perspective, it would be wise to have an easily accessible cash reserve to cover any unexpected tax charges.

The penalty for breaching the allowance is charged at your marginal rate, typically at 40% for those in the higher-rate tax band and 45% for additional-rate taxpayers.

**Speak to us for strategic financial advice.**