Quilter

Dealing with clients affected by the tapered Annual Allowance rules–case study

The tapered Annual Allowance was introduced in 6 April 2016 when it was stated the Annual Allowance would be potentially tapered to a minimum of £10,000 for those with **threshold income** exceeding £110,000 and **adjusted income** exceeding £150,000.

From 6 April 2020 the Annual Allowance taper figures were adjusted to give a higher threshold level of £200,000. The tapered Annual Allowance calculations would now not affect anyone with a **threshold income** level below £200,000. **Adjusted income** levels at which taper starts was also increased in 2020 to £240,000, this level again changed in April 2023 and was increased to £260,000 with the minimum taper level also increased to £10,000 (up from the minimum £4,000 level introduced in 2020).

Threshold income

Start with the net income from all sources as per ***http://www.legislation.gov.uk/ukpga/2007/3/section/23***. In broad terms this is the total income from all sources that is subject to income tax, for example: salary/bonus; dividends; taxable redundancy payments savings income; pension income; etc. To be clear, this amount will be after any type of salary sacrifice has been applied.

Deduct the gross amount of pension contributions made by the relief-at-source method and the amount of any taxable lump sum death benefit paid to the individual.

Add the value of any salary sacrifice (or flexible remuneration) arrangement for the tax year (only if the arrangement is in return for of pension contributions and started on/after 09/07/2015). The employer will be able to say when an arrangement started.

If the threshold income does not exceed or £200,000 (for tax years 2020/21 and after), there won't be a reduction to the Annual Allowance and the adjusted income does not need to be calculated.

Otherwise you must calculate adjusted income.

Threshold income is defined in full at ***https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm057100#Income***

Adjusted income

This has the same starting point as threshold income (i.e. total income from all sources that is subject to income tax).

Add the following:

- The amount of employer contributions
- The amount of any employee contributions paid via net pay arrangement
- The amount of any contributions paid gross with tax relief claimed by the individual (e.g. to a retirement annuity contract)

Deduct the amount of any taxable lump sum death benefit received in the tax year.

Adjusted income is defined in full at ***https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm057100#Income***

With adjusted and threshold income comprising so many different elements, it can make the advice process very difficult where a client wants to fund their pension to the maximum or has to decide whether to continue to receive an employer pension contribution. It may be very late in the tax year or even the following tax year before total adjusted/threshold income is known.

The table below shows a selection of adjusted income values and the corresponding reduced annual allowance for the 2023/24 tax year and after:

Adjusted income	Annual allowance
up to £260,000	**£60,000**
£270,000	**£55,000**
£280,000	**£50,000**
£290,000	**£45,000**
£300,000	**£40,000**
£320,000	**£30,000**
£340,000	**£20,000**
£360,000	**£10,000**

For financial advisers only

Example case study

Let's look at how you can manage the above dilemma by using an example.
Bob is 50 and a senior employee in a small engineering business. Although Bob has always been well paid he has had a good pay increase this tax year. He now has a basic salary of £210,000 plus taxable benefits, shares in the engineering business, a portfolio of shares in various companies, a portfolio of collectives, and a rental property he inherited from his father. He is eligible for an annual bonus on 31 March each year which can be anything up to 50% of basic salary at the discretion of his employer.

His employer has made contributions to Bob's Collective Retirement Account up to now. Bob has not made full use of the pension savings allowances in past years.

Key points:

- Bob's basic salary of £210,000 means he has threshold income in excess of £200,000 so adjusted income needs to be calculated.
- Bob has a range of income payments he will receive this tax year that are currently unknown.
- Based on known information it can be expected that Bob will have adjusted income in excess of £260,000 and will have a reduced Annual Allowance.
- Bob was still a high earner in these earlier years and was subject to the tapered Annual Allowance. In the years previous to 2023/24, the tapered Annual Allowance was based on adjusted income levels of £240,000 increasing to £260,000 in 2023/24. He has unused Annual Allowances of:

2021/22	**£30,000**
2022/23	**£20,000**
2023/24	**£15,000**

Advice requirements:

- Bob is keen to contribute as much as possible into his pension as he wishes to semi-retire at 55.
- He wishes to make the contribution into his existing Collective Retirement Account as it gives him the flexibility of drip-feed drawdown via tax-efficient retirement income options on reaching age 55.
- Bob does not want to over-contribute and have to pay an Annual Allowance excess charge. This would mean he pays income tax on the excess contribution over his Annual Allowance at his highest marginal rate of income tax.

Solution:

- Bob's adjusted income and Annual Allowance will not be known until very late in the tax year or even until tax year 2025/26. Because of the uncertainty of what his 2024/25 Annual Allowance will be, the immediate contribution in relation to tax year 2024/25 should be limited to £10,000. This is largely taken up with his employer's contribution.
- Bob can still use carry forward and look back to tax year 2021/22.
- Bob decides his contributions from all sources for the tax year will be £75,000 (he assumes his annual allowance for this tax year is £10,000, and adds his £65,000 carry forward).

Future actions

It will not be until Bob knows his full adjusted income for tax year 2024/25 that he'll know if he can pay more. By following this strategy of limiting contributions for 2024/25 to an assumed annual allowance of £10,000 plus his carry forward he is funding to the maximum but is not in danger of over-contributing in the current tax year.

Early in the tax year 2025/26 Bob's total adjusted income for 2024/25 becomes known and totals £340,000 meaning his actual Annual Allowance for 2024/25 was £20,000. To use carry forward you must first use your full Annual Allowance in the current tax year, before using any unused Annual Allowances from the three previous tax years.

Any unused Annual Allowance from the earliest tax year must be used first. This results in Bob's £75,000 contribution being allocated as follows:

Tax year	Unused Annual Allowance	Available Annual Allowance used
2024/25	£20,000	£20,000
2021/22	£30,000	£30,000
2022/23	£20,000	£20,000
2023/24	£15,000	£5,000 (£10,000 remaining)
Total paid		**£75,000**

As Bob wants to continue to maximum fund, and his income uncertainty has not changed, he can pay in £20,000 (he would assume his 2025/26 annual allowance is £10,000 and add the £10,000 carry forward from 2023/24 to it).

Summary

The rules are complex and many individuals will be in a similar position to Bob. They will have variable elements in their income which mean it will be very late in the tax year or the following tax year before they can accurately calculate their Annual Allowance.

Clients like Bob whose pension savings are building solely through defined contribution pension schemes can:

- assume their annual allowance for 2024/25 is the lowest it could be
- add their known carry forward from the three previous tax years to it.

In 2025/26 once the adjusted income and Annual Allowance is known you can adopt the same approach. This way, clients should not exceed the Annual Allowance, might even find they have unused Annual Allowance to use in later tax years.

Where a client is accruing benefits through a defined benefit scheme and wishes to top-up, any action should be deferred until later in the tax year. It will be important to be able to estimate the value of the accruing benefits in this tax year, in order to estimate how much of any unused Annual Allowance could safely be funded without risk of an Annual Allowance tax charge applying.

Helping you identify how much your clients can fund into their pensions

Working out the tapered annual allowance is as complicated as pensions can get. Our calculator represents a simple but essential tool to help you identify how much your clients can fund into their pensions this tax year. It takes into account:

- adjusted income
- threshold income
- any carry forward allowances available.

Download our Annual Allowance Calculator at ***https://www.quilter.com/help-and-support/technical-insights/technical-insights-articles/carry-forward-calculator-202425/***

We regularly update our literature; you can confirm that this **April 2024** version is the latest by checking the literature library on our website ***quilter.com***

Your clients' investment may fall or rise in value and they may not get back what they put in.

This document is based on Quilter's interpretation of the law and HM Revenue and Customs practice as at April 2024. We believe this interpretation is correct, but cannot guarantee it. Tax relief and the tax treatment of investment funds may change.

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