Edison
Wealth
Management

Pension Annual Allowance

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On the 6 April the start of the new tax year resets the yearly limit on pension contributions. The tax relief on pension contributions can be significant. But the rules on contribution limits are not straightforward, notably for those who have the most to gain, higher rate tax payers.

Those with taxable income (which for this purpose includes all pension contributions) over £150,000 pa and taxable income excluding pension contributions over £110,000 are subject to a tapering of their annual allowance. It is important to seek advice on how this affects contributions so as to avoid the risk of incurring unexpected charges.

What is the Annual Allowance?

The Annual Allowance is the annual total amount of personal and employer contributions that can be paid into a pension without suffering a tax charge. The current standard allowance is £40,000.

> "Individuals with income of £210,000 will see their annual allowance cut by £30,000."

The Annual Allowance is tapered for higher earners and those with high total taxable income; it is reduced by £1 for every £2 of 'adjusted income' over £150,000, until it drops to £10,000.

The Annual Allowance Charge

When an individual's total pension input amount exceeds the annual allowance applicable, a charge is triggered. This Annual Allowance charge is an income tax charge at up to the individual's highest marginal rate.

> "Where the excess [pension contribution] is caused by an employer, it's effectively an income tax charge on a non-cash benefit."

It doesn't matter whether the excess amount is caused by a member contribution, employer contribution, or an increase in pension benefit accrual as part of a final salary scheme.

So, for example, in certain circumstances the level of pension entitlement in dormant defined benefit schemes will continue to accrue annually. This accrual will count towards the Annual Allowance.

Hence it is important that individuals with current and past benefits seek advice regularly, regardless of whether they are actively contributing to pension plans.

Impact on individuals with income over £150,000

The annual allowance is tested against 'adjusted income' over £150,000.

If adjusted income exceeds £150,000, the annual allowance is reduced.

Total income before tax from all sources and all pension contributions (including employer) are included in the adjusted income figure.

It can catch out individuals who consider their actual income to be below £150,000, but who are failing to account for employer pension contributions.

There is therefore a second 'threshold income' test available for those who find themselves subject to an unexpected increase in their pension funding.

This test helps those caught out simply because their pension contribution takes them over the £150,000 limit even though their actual earnings might be lower. So, even if their adjusted income exceeds £150,000, their annual allowance won't be reduced if their 'threshold income' is £110,000 or less for the tax year.

If threshold income is £110,000 or less, the annual allowance is not adjusted.

Total income before tax from all sources including income given up under a salary sacrifice agreement made after 8 July 2015 are included in the threshold income figure. Meanwhile, the value of an individual's own pension contributions is deducted.

What can be done?

Individuals earning over £150,000 (or with total income including savings and investment income) and making pension contributions should be taking advice on:

- Whether their intended future contributions (incl. from an employer) will trigger a charge
- Carrying forward any unused annual allowance from the previous three tax years
- Whether they should be making other adjustments to their earnings to pass the allowance tests

How we can help

Pensions continue to be an attractive long-term investment vehicle, especially now they can, in many cases, be accessed more easily on retirement and passed on tax efficiently to beneficiaries. We can help individuals with planning the appropriate level of pension contributions in order to avoid charges.

Next briefing note: avoiding the annual allowance charge

With careful planning, individuals may be able to avoid or reduce the annual allowance charge by using unused allowance from previous tax years, using **Carry Forward.**

To contact us, do not hesitate to call on 0207 287 225 or by email (help@edisonwm.com).

You can read this Briefing Note on our website. To download it or view other updates please visit our Insights page.

Important Information

The above is a simplification of the legislation. It does not constitute advice. This piece was written based on the legislation applicable at the time. The views expressed above are subject to changes in legislation. The Financial Conduct Authority does not regulate tax advice.

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