

## Finance Bill: Pension changes

(Lecture P1197 – 14.14 minutes)

### Pension annual allowance

The pension tax rules include a maximum annual contribution (called the annual allowance) and where payments are made above that maximum, an annual allowance charge arises. There is some limited ability to carry forward unused allowances. The annual allowance is currently £40,000. However, since 2016, the annual allowance has been tapered for those who have higher incomes.

The tapering applies to those who have threshold income above one figure and adjusted income above a second figure. The threshold income is broadly the net income before tax excluding employer pension inputs and the adjusted income is broadly the threshold income plus employer pension inputs.

The current threshold income limit is £110,000 but will increase to £200,000 from 6 April 2020. The adjusted income limit is currently £150,000 but will increase to £240,000 at the same time.

The annual allowance reduces by £1 for every £2 that the adjusted income exceeds the limit.

Tapering does not currently reduce the annual allowance below £10,000 but this is also changing so that the minimum will be £4,000, again to apply from 6 April 2020. (Clause 21).

Mathematically, this reduction in the minimum annual allowance will only affect taxpayers with threshold income above £200,000 and adjusted income above £300,000.

#### Example

Nikki has threshold income of £230,000 for 2020/21.

Her employer operates a defined benefit pension scheme and the calculated employer input for 2020/21 is £45,000, giving Nikki adjusted income of £275,000. Nikki contributed £6,000 to the scheme in 2020/21.

She has no unused annual allowance brought forward and her marginal tax rate is 45%.

As she is a high-income individual, the annual allowance of £40,000 is reduced by the following amount:

$$(\pounds275,000 - \pounds240,000) = \pounds35,000 / 2 = \pounds17,500$$

The annual allowance will therefore be £40,000 less £17,500 = £22,500.

Nikki's total pension inputs are (£6,000 + £45,000) £51,000. She will therefore suffer a special annual allowance charge of 45% x (£51,000 – £22,500), i.e. £12,825. She can elect for this to be paid out of her pension scheme, but this will reduce the benefits she is able to take from it.

Taxpayers need to be mindful of the impact a small amount of extra income can have on their tax position (as highlighted by the recent decision of NHS consultants not to take on more work which led to the increases in the income limits above).

### Example

Paul has taxable income of exactly £200,000 and his company makes pension contributions into a scheme on his behalf of £40,000. He has made contributions of £5,000 to the scheme.

At this stage, as Paul's taxable income is at the threshold limit, his annual allowance is not tapered.

If Paul generates additional income of £1,000, his taxable income now exceeds the threshold level. His adjusted income becomes £241,000 and therefore his annual allowance is tapered to

$(40,000 - 50\% \times [241,000 - 240,000])$ , i.e. £39,500.

He is charged marginal tax on this £1,000 of 45%, i.e. £450, and there is a special annual allowance charge of  $45\% \times (40,000 + 5,000 - 39,500)$ , i.e. £2,475.

As a result of earning extra income of £1,000, Paul has an extra tax liability of  $(450 + £2,475)$  £2,925.

### **Pensions lifetime allowance limit**

The pension lifetime allowance is not specifically mentioned in the Bill so will be increased by CPI from 6 April 2020 from £1,055,000 million to £1,073,100.