

Bonuses and the annual allowance charge (Lecture P1438 – 20.22 minutes)

F(No2)A 2023, which took effect on 6 April 2023, included the following changes relating to pension contributions:

1. An increase from £40,000 to £60,000 in the maximum amount of tax-deductible pension savings which can be made on behalf of an individual in a tax year (S20 F(No2)A 2023);
2. A rise from £4,000 to £10,000 in the money purchase annual allowance for those individuals who have already flexibly accessed their pension savings (S21 F(No2)A 2023);
3. An uplift from £240,000 to £260,000 in the 'adjusted income' threshold after which the annual allowance starts to be tapered for high-income individuals (with the minimum tapered annual allowance being pushed up from £4,000 to £10,000) (S22 F(No2)A 2023). The 'threshold income' figure of £200,000 was unaltered for 2023/24.

This case study looks at how the third of these changes could affect individuals today where their income rises, maybe as a result of receiving a bonus.

Example 1

In 2023/24, Eden's taxable remuneration (including benefits in kind) from his employment amounts to £250,000. He has no other income.

Eden is planning to make a pension contribution under a 'relief at source' scheme of £48,000 (net). He has no unused pension relief from any of the three previous tax years.

Before considering Eden's 'adjusted income', it is customary to determine his 'threshold income' for 2023/24.

This will normally be his total income less the gross amount of any pension contribution for which he is entitled to be given relief under S192 FA 2004.

In Eden's case, this is:

	£
Total income	250,000
Less: Gross pension contribution (48,000 x 100/80)	<u>60,000</u>
	<u>190,000</u>

Provided that the individual's 'threshold income' comes to £200,000 or less, the taper rules do not apply and there is no need to calculate his 'adjusted income'.

Eden is therefore entitled to 45% tax relief on his pension contribution, being:

	£
Basic rate relief at source (20% x 60,000)	12,000
Higher and additional rate relief ((45 – 20)% x 60,000)	<u>15,000</u>
	<u>27,000</u>

However, if Eden's employer also paid him a bonus of £50,000, this would take his annual earnings for 2023/24 to £300,000. His 'threshold income' then becomes £300,000 – £60,000 = £240,000 and so the 'adjusted income' calculation has to be made.

Eden's 'adjusted income' is:

	£
Total income (250,000 + 50,000)	300,000
Add: Pension contribution	<u>60,000</u>
	<u>360,000</u>

As a result, Eden's annual allowance of £60,000 is reduced by one half of the excess of his 'adjusted income' over £260,000, i.e. by $\frac{1}{2} \times (360,000 - 260,000) = £50,000$.

In other words, Eden's annual allowance for 2023/24 is £10,000 (£60,000 – £50,000).

Eden's income tax position for 2023/24 is:

	£
Salary and benefits in kind	250,000
Bonus	<u>50,000</u>
Taxable income	<u>300,000</u>
	£
97,700 (37,700 + 60,000) @ 20%	19,540
87,440 (125,140 + 60,000 – 97,700) @ 40%	34,976
<u>114,860 @ 45%</u>	<u>51,687</u>
<u>300,000</u>	<u>106,203</u>

Note:

Eden is not entitled to a personal allowance, given that his income is too far in excess of the £100,000 limit.

By paying £48,000, Eden obtains basic rate relief for his pension contribution of £60,000.

He receives higher rate relief by having his basic rate band extended from £37,700 to £97,700. Similarly, his higher rate band is extended from £125,140 to £185,140 in order to provide him with additional rate relief.

However, Eden's tapered annual allowance for 2023/24 is £10,000 and his pension inputs were £60,000. He is therefore subject to an annual allowance charge at his marginal tax rate of 45% on the excess of £50,000 (£60,000 – £10,000). This further tax liability is:

45% x £50,000	£22,500
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The effect of this clawback is that Eden ends up with tax relief on only £10,000 of his pension contribution of £60,000.

Eden's total income tax liability is:

	£
Income tax	106,203
Add: Annual allowance charge	<u>22,500</u>
	<u>128,703</u>

On the other hand, if Eden had not received the bonus, his income tax position for 2023/24 would be:

Taxable income	<u>£250,000</u>
	£
97,700 (37,700 + 60,000) @ 20%	19,540
87,440 @ 40%	34,976
<u>64,860 @ 45%</u>	<u>29,187</u>
<u>250,000</u>	<u>83,703</u>

In other words, the receipt of the £50,000 bonus has increased Eden's income tax liability by £45,000 (£128,703 – £83,703).

Contributed by Robert Jamieson