

Pension Annual Allowance

(Lecture P1164 – 16.23 minutes)

The pension annual allowance charge is causing some fun for accountants who act for high net worth individuals who are making significant pension contributions or who participate in final salary schemes (now mainly those within the public sector). There has been a lot of publicity in the normal press recently about doctors who are having problems with their pension contributions.

Contributions can be made up to the annual allowance each year, with both personal and employer contributions being taken into account.

Where a final salary scheme is involved, there is a mechanism for calculating the pension input and the pension fund trustees should supply this each year. Very broadly, you take the difference between the pension entitlement at the beginning and end of the tax year (after the value at the beginning has been updated by CPI for the previous September) with annual pension amounts being multiplied by 16 to get the valuation.

Example

Ahmed belongs to a pension scheme where he gets 1/80th of his final salary for each year of pensionable service and a separate lump sum of three times his pension. At the start of the year, his pay is £75,000 and he has been a member of the scheme for 20 years. He has a promotion during the year that sees his salary increase to £90,000. Assume CPI is 3%.

Opening value

$$\text{Amount of pension} = 20/80 \times £75,000 = £18,750 \times 16 = £300,000$$

$$\text{Lump sum} = 3 \times £18,750 = £56,250$$

$$\text{Total} = £356,250 \times 1.03 = \mathbf{£366,937}$$

Closing value

$$\text{Amount of pension} = 21/80 \times £90,000 = £23,625 \times 16 = £378,000$$

$$\text{Lump sum} = 3 \times £23,625 = £70,875$$

$$\text{Total} = \mathbf{£448,875}$$

Pension input amount

The difference between these amounts is £81,938.

The annual allowance is now tapered away but even that is not straightforward. Net income (basically the income after pension contributions have been deducted) has to be more than £110,000 and adjusted income (basically the income plus both employers and pension contributions) has to be more than £150,000 for the taper to apply. The annual allowance is then reduced by £1 for every £2 adjusted income exceeds £150,000 although it cannot go below £10,000.

Finally, you can carry forward unused contributions for up to three years. Current year allowance is used first then brought forward on a first in first out basis. Note also that 2015/16 was a strange year as the year was split although the impact of that year is not relevant for 2019/20 onwards other than determining use of brought forward amounts.

Example

An individual has contributions as follows:

2011/12	32,867
2012/13	35,048
2013/14	12,505
2014/15	68,152
6 April 2015 to 8 July 2015	17,644
9 July 2015 to 5 April 2016	48,476
2016/17	49,943
2017/18	42,404

Annual allowance for all years up to 2013/14 was £50,000 and then reduced to £40,000. In 2015/16 the annual allowance was £80,000 but only £40,000 could be made after 8th July.

The analysis for the above employee is as follows:

2011/12: within annual allowance, surplus of £17,133 (NB this is used in 2014/15)

2012/13: within annual allowance, surplus of £14,952 (NB £11,019 utilised in 2014/15 and then the balance lost)

2013/14: within annual allowance, surplus of £37,495 (NB £8,476 used in 2014/15 and £9,943 in 2016/17 with the balance lost)

2014/15: contributions in excess of annual allowance but £17,133 used from 2011/12 and £11,019 from 2012/13

2015/16: apparent surplus over £80,000 but total amounts after 8 July more than £40,000 so no surplus

2016/17: contributions in excess of annual allowance but utilise £9,943 from 2013/14

2017/18: contributions in excess of annual allowance and no brought forward amounts to cover the excess.

The above assumes that there is no tapering of the allowance. What if the income in 2017/18 was £125,000? In that case, the net income is more than £110,000 and the adjusted income is £167,404. The annual allowance therefore reduces by $(167,404 - 150,000)/2 = £8,702$ so the revised annual allowance is £31,298 and the problem is exacerbated.

One final point to note is that if the annual allowance charge is more than £2,000 the pension member can ask the pension fund to pay the charge. You have until July following the normal self-assessment filing date to do this.

The tax charge is the marginal rate of tax paid by the individual on their top slice of income.

Reduced annual allowance

It is also important to acknowledge that there are other situations where there is a reduced annual allowance. Since April 2015 it has been possible for those aged over 55 to get full access to their pensions but taking income from a pension can mean that the money purchase annual allowance kicks in so that the amount which can be saved reduces to £4,000 per year (£10,000 from 6 April 2015 to 5 April 2017). It should be noted that just taking a cash-free lump sum will not trigger the MPAA but anything more than the cash-free amount would also push someone into this regime.

This is largely a problem with defined contribution schemes since the receipt of a pension from a defined benefit (final salary) scheme would not trigger the MPAA. Carry forward also applies, albeit of a much-reduced figure.

If you trigger an event that brings the MPAA into play, the pension provider should send a 'flexible access' statement within 31 days but evidence suggests this letter is often ignored or misunderstood. Whilst pension provider issuing the letter may not allow higher premiums to continue to be paid but other pension providers (and it is increasingly common for individuals to have more than one pension pot) will not be aware of the issue at all. If you receive such a letter, the individual must inform all other money purchase pension plans within 91 days that they are subject to the MPAA with fines being levied on those who fail to do this, as well as the additional tax charges.

Contributed by Ros Martin