

# Tapered annual allowance

How the annual pension allowance works for those on higher incomes.

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here has always been an upper limit on the amount of tax relieved pension contributions that can be paid by or for you; this is called the annual allowance. Since 2016/17 this has been tapered for those on higher incomes.

The annual allowance applies to the total contributions paid by you and your employer. Since 2016/17, the general allowance of £40,000 has been tapered (i.e. reduced) for those on higher incomes. The general allowance is reduced by £1 for every £2 of income in excess of £150,000. For those with income of £210,000 or more, the allowance is capped at £10,000.

Income for this purpose is any income subject to UK tax, regardless of its source. It includes, for example, rental income from property, dividends and interest. It also includes the amount of any employer and personal pension contributions.

For members of 'final salary' or 'defined benefit' pension schemes the test for the annual allowance is more complicated in that it has nothing to do with the contributions *per se* paid to the scheme. Rather, the measure is the deemed value of increase in total scheme retirement benefits over the year. This can be a complex calculation so professional advice is recommended.

While it is incumbent on a pension scheme to write to a member if the £40,000 limit is exceeded (a so called 'pension savings statement'), there is no obligation to warn that a lower personal tapered allowance has been breached. Individuals or their advisors are left to assess this for themselves and, via a self-assessment tax return, account to HM Revenue & Customs (HMRC) for any tax due. It may be prudent for members of 'final salary' or 'defined benefit' pension schemes with income of £100,000 or more to ask the scheme administrator for a pension savings statement, just in case.

If you exceed the tapered or general annual allowance you are able to carry forward any unused annual allowance from the three previous tax years to reduce or eliminate the current year excess.

Where all available allowances are used up, the excess is subject to income tax, this is known as the annual allowance tax charge.

The general allowance is not tapered where total income after deducting personal pension contributions and ignoring employer contributions (except employer contributions resulting from salary sacrifice arrangements started after 8 July 2015) is less than £110,000.

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## Scheme pays

Where total contributions to a pension scheme exceed £40,000 and the tax charge is more than £2,000, it is possible to instruct the UK pension scheme to pay all or part of the tax charge for you out of your pension fund. This is known as scheme pays.

However, the pension scheme is not obliged to pay the extra tax resulting from you exceeding the tapered annual allowance, leaving you to pay this yourself. For example, a high earner with a tapered annual allowance of £10,000, who saves £25,000 over the year, incurring an annual allowance charge at 45% of £6,750 would not be eligible for scheme pays as their pension contributions do not exceed £40,000. If instead they saved £50,000, incurring an annual allowance charge of £18,000, they would be eligible for mandatory scheme pays - but only in respect of their pension contributions over £40,000 i.e. £4,500 (45% of their contributions above £40,000), leaving them with a personal liability of £13,500.

Even where the pension scheme agrees to scheme pays, there are strict deadlines for this and you need to arrange this with the pension scheme ahead of the tax due date (31 January following the tax year end).

## Money purchase annual allowance

Those who have 'flexibility accessed' a 'defined contribution' pension arrangement are, in any event, subject to the money purchase annual allowance, placing a £4,000 cap on tax relieved contributions to defined contribution pension arrangements. For those affected, earlier years' unused allowance cannot be carried forward and it is not possible for a pension scheme to pay the tax due.

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