ADVISER FACTSHEET

JAMES HAY PARTNERSHIP

Tech Talk

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Tapered annual allowance and planning considerations

Where high net worth individuals have spare resources due to a redundancy payment or bonus payment for example, then using these resources to boost their retirement pot will likely be an option for consideration. This Tech Talk examines the implications for such individuals looking to increase their pension funding. In particular, the impact of the tapering of the annual allowance (AA) where the increase comes on top of already healthy pension funding. This needs to be understood if pension funding is to remain tax efficient.

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For professional advisers only

Introduction

The tapered AA and the associated threshold and adjusted income definitions have been covered in a previous Tech Talk. In the table below the impact on these incomes is set out where the events listed in the first column occur in isolation.

Event	Threshold income	Adjusted income
Employer contribution to other money purchase arrangement	No change	Increases
Contribution made by member	Reduces	No change
Benefit enhancement under defined benefit or cash balance arrangement	No change	Increases
Increase in member's salary	Increases	Increases

In order to understand the pension planning issues please consider the following case studies.

CASE STUDY 1

Nicola is a major shareholding director in a company she started from scratch 20 years ago. Income and pension savings estimates for the 2016/17 tax year are summarised in the table below:

Threshold income	£122,000
Adjusted income	£162,000
AA	£34,000
Pension input amount (PIA)	£40,000
Unused AA from 2015/16	£10,000
Unused AA from 2014/15	£14,000
Unused AA from 2013/14	£6,000

Based on these figures, £6,000 unused AA from 2013/14 would cover the £6,000 excess in 2016/17. This would leave £24,000 unused AA available for 2017/18.

What would the impact be if Nicola makes the following additional personal contributions to her SIPP in 2016/17?

A – £10,000 gross
B – £12,000 gross
C – £30,000 gross

See the table below:

	A	B	C
Threshold income	£112,000	£110,000	£92,000
Adjusted income	£162,000	£162,000	£162,000
AA	£34,000	£40,000	£40,000
PIA	£50,000	£52,000	£70,000
Unused AA available for 2017/18	£14,000	£18,000	Nil

As mentioned above an additional personal contribution reduces threshold income while having no effect on adjusted income.

Looking at B in more detail, if Nicola makes an additional contribution of £12,000 before the end of 2016/17 her threshold income would reduce to £110,000 and no tapering of the AA would apply. Her PIA for 2016/17 would increase to £52,000 compared to her AA of £40,000. The £12,000 excess would be covered by £6,000 unused AA from 2013/14 and the remainder from 2014/15 leaving £18,000 unused AA (£8,000 from 2014/15, £10,000 from 2015/16 and nil from 2016/17) available for 2017/18.

CASE STUDY 1 (CONTINUED)

What if the additional contributions were made by the employer to Nicola's SIPP?

E – £10,000
F – £12,000
G – £30,000

See the table below:

	E	F	G
Threshold income	£122,000	£122,000	£122,000
Adjusted income	£172,000	£174,000	£192,000
AA	£29,000	£28,000	£19,000
PIA	£50,000	£52,000	£70,000
Unused AA available for 2017/18	£9,000	£6,000	Nil

Additional employer contributions to the SIPP would have no impact on threshold income but would increase adjusted income.

Looking at G in more detail, if an additional employer contribution of £30,000 is made before the end of 2016/17 Nicola's adjusted income would increase to £192,000 and as her threshold income exceeds £110,000 her AA for that year would be tapered further. Her PIA for 2016/17 would increase to £70,000 compared to her AA of £19,000. There would not be enough unused AA from previous tax years to cover the £51,000 excess meaning that she would be liable for an AA charge for 2016/17 on a surplus of £21,000 (£51,000 – £30,000) and there would be no unused AA available for 2017/18.

No increase in Nicola's salary or other taxable benefits will be forthcoming. The additional pension funding will be through the SIPP and her pension fund will increase by the same amount regardless of where the funding comes from (personal or employer).

From an AA perspective the personal contribution route is best. However personal contributions, subject to the appropriate level of tax relief, will come from Nicola's own income/savings which is not the case if funding comes from the employer. Also, subject to the wholly and exclusively criteria being met the employer contributions would attract corporation tax relief.

Therefore, support from Nicola's accountant will be needed as further number crunching is required in order to ascertain the best route for her.

CASE STUDY 2

Angus is a high net worth individual and has been offered additional employer pension funding (including the employer NI saving) through a SIPP instead of a bonus he is due to receive before the end of the 2016/17 tax year. He has unused annual allowance from the 3 previous tax years and the thought of augmenting his pension savings is appealing to him. Taking account of his current pension funding and before receipt of the bonus or additional pension funding it is estimated that his threshold income for the tax year will be £153,000 and his adjusted income will be £182,000. Therefore, the AA applicable to him in 2016/17 will be £24,000. The SIPP is the only pension he has and gross contributions for the tax year are expected to total £21,750 (Employer) and £7,250 (Personal).

The choice is between a bonus of £10,000, the net amount which he then uses to make personal contributions to the SIPP, or an employer contribution of £11,380 to the SIPP. Looking at each option in turn:

Employer contribution of £11,380	
Threshold income	£153,000
Adjusted income	£193,380
AA	£18,310
PIA	£40,380
PIA – AA	£22,070

Under the bonus option Angus will receive after tax at 45% and NI at 2%, £5,300. Assuming a gross contribution of £9,636 (£5,300/0.55) is made to the SIPP:

Personal contribution of £9,636 gross	
Threshold income	£153,364
Adjusted income	£192,000
AA	£19,000
PIA	£38,636
PIA – AA	£19,636

Under both options his net income for the tax year stays the same, but with the employer contribution more is added to his SIPP. The PIA exceeds the AA available in both cases and to complete the analysis account has to be taken of the additional tax, if any, Angus would be liable for.

Any additional tax would come in the form of an AA charge and given Angus's income for the tax year this would be levied at 45%. To factor this in, consideration needs to be given as to the merits of the contribution against the tax charge payable. Therefore, the amount of unused AA available from the 3 previous tax years is important. The relationship between the contribution and the charge is termed "relief" in the table overleaf.

CASE STUDY 2 (CONTINUED)

Unused AA	Employer	Personal
Nil	AA charge = £22,070 x 0.45 = £9,931.50 (relief = 12.73%)	AA charge = £19,636 x 0.45 = £8,836.20 (relief = 8.3%)
£5,000	AA charge = (£22,070 – £5,000) x 0.45 = £7,681.50 (relief = 32.5%)	AA charge = (£19,636 – £5,000) x 0.45 = £6,586.20 (relief = 31.65%)
£19,636	AA charge = (£22,070 – £19,636) x 0.45 = £1,095.30 (relief = 90.38%)	AA charge = Nil (relief = 100%)

The relief shown in the table represents the increase in the pension fund relative to the AA charge across six scenarios. For example, under the employer option where Angus has £5,000 of unused AA, the tax charge is £7,681.50 and his pension fund is increased by £11,380. In relief terms this equates to:

(1 – 7,681.50/11,380)% = 32.5%

The higher the relief the more effective the pension funding is likely to be. The table below summarises the position given different amounts of unused AA available from the 3 previous tax years:

Unused AA	Most tax efficient option
Less than £19,636	Employer contribution
Less than £22,070, but more than £19,635	Personal contribution
More than £22,069	See below

Where the unused AA from the 3 previous tax years is more than £22,069 there would be no AA charge for 2016/17 under either option. The SIPP fund would increase by more under the employer contribution option. However, if the unused AA from 2013/14 does not exceed £19,636 the employer contribution option would reduce the unused AA available for carry forward to 2017/18 and maybe 2018/19, as unused AA from either 2014/15 or 2015/16 or both would be required to cover the PIA excess in 2016/17.

Comment

Completing the tax return of a high income individual is normally a daunting task at the best of times. Where the individual is subject to tapering of the AA then a detailed knowledge of its impact is required if an accurate return is to be submitted as well as being necessary in determining how tax efficient pension planning is.

Hopefully advisers will find the case studies in this Tech Talk useful as they strive to get their heads around yet another piece of complicated pension tax legislation.

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Further information

Visit the Technical Hub for further information:

www.jameshay.co.uk/technicalhub

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