CARTWRIGHT

The Annual Allowance (AA) and its effect on Pensions Savings Tax Year 2020/2021

The purpose of this briefing is to remind all individuals who are members of a pension scheme of the current limits on pension savings.

Annual Allowance ('AA')

The **Annual Allowance** ('AA') **is** the maximum amount of pension savings that can be made into all pension arrangements (whether by an individual scheme member, or an employer or anybody else on the member's behalf) each year before a tax charge arises.

The AA is currently **£40,000** unless an individual's taxable income is above £240,000 or they have flexibly accessed funds from a money purchase arrangement, when it could be lower. (Further information regarding this is provided below).

If an individual does not use all of their AA in a tax year, they can carry forward any unused AA from the previous three years.

The scheme administrator will automatically issue a Pensions Saving Statement (Annual Allowance Statement) if a member's pension savings in the scheme they administer has exceeded £40,000 and the member has no known unused AA in that scheme for the previous three years.

It is important to remember that it is possible for individuals to be members of several pension arrangements and the contributions paid to all arrangements need to be taken into account when calculating whether or not the AA limit has been exceeded.

For example, an individual could be a member of a pension arrangement offered by their employer such as a Defined Benefit scheme or a Group Personal Pension Plan, pay Additional Voluntary Contributions (AVCs) to a freestanding arrangement, and also pay pension contributions into an individual Personal Pension Plan.

All pension input from all pension schemes/arrangements of which individuals are a member /contribute will need to be added together, and it is their responsibility to check whether they have exceeded the £40,000 input level.

If a Pension Savings Statement in respect of a particular scheme/arrangement is required it should be requested from the administrator.

If an individual's AA in any tax year has been exceeded and the surplus also exceeds any unused AA from previous years, they will be subject to an **Annual Allowance Charge**.

It is the responsibility of the individual to report the amount by which they have exceeded the AA to HM Revenue & Customs.

CARTWRIGHT

Scheme Pays

In certain circumstances, if the AA is exceeded and the tax charge would be £2,000 or more, it is possible for a scheme to pay the tax charge on behalf of the individual in exchange for a reduction in their pension benefits.

Money Purchase Annual Allowance (MPAA)

If funds are flexibly accessed from a money purchase arrangement, that is, an Uncrystallised Funds Pension Lump Sum, a flexi-access drawdown or capped drawdown or income above the cap is taken, the amount that may be paid into a money purchase arrangement will be reduced to £4,000 (this is known as the (MPAA).

Taking money purchase funds may also affect the AA available in respect of other pension savings. This is known as an **Alternative Annual Allowance** e.g. £40,000 – £4,000 (MPAA) = £36,000 (Alternative AA for other Defined Benefit pension inputs).

Changes to the Annual Allowance that affect those with high taxable income – the Tapered Annual Allowance

From 6 April 2020 changes have been made to the operation of the tapered Annual Allowance; from the tax year 2020/2021 and all subsequent tax years, individuals who have **taxable income** plus pension savings greater than £240,000 (previously £150,000) in any tax year will have their Annual Allowance (AA) restricted. The minimum reduced Annual Allowance under the tapering rules has been reduced from £10,000 to **£4,000**.

Taxable income for this purpose will include the value of all pension savings/contributions paid and any other income received on top. For example, this can include:

- Earnings from employment, (including bonuses), earnings from self-employment/ partnerships, pensions income (State, occupational and personal pensions), interest on savings, income from shares (dividend income) and other investments, rental income, income received from a trust, after the deduction of tax relief

plus

- The value of any pension savings

(For Defined Contribution schemes the member and the employer contributions paid, and for Defined Benefit schemes the pension input amount, less any member contributions paid in that tax year)

less

- any lump sum death benefits received in the tax year (that is, taxable income)

This is known as "adjusted income"

Income tests for the Tapered Annual Allowance

There are two tests on income levels:

If an individual's **taxable income** is below £200,000 a year, (£240,000 - £40,000) (threshold income) (previously £110,000 i.e. £150,000 - £40,000) the AA will remain at £40,000.

If an individual's **taxable income** is higher than £240,000 a second test applies:

If an individual's taxable income plus the increase in their pension savings comes to £240,000 or more their AA will be tapered, that is, for each £2 of income over £240,000 the AA is reduced by £1 with a maximum reduction to the AA of £36,000. A minimum reduced AA of **£4,000**.

Examples:

Income	£290,000	Annual Allowance	£40,000
Less	£240,000	Less	£25,000
	£50,000 /2 = £25,000	Reduced Annual Allowance	**£15,000 ***
		*(known as the **Tapered Annual Allowance**)	

Therefore, any individuals with income of £312,000 or above will have their AA reduced to £4,000, plus any unused AA from the previous three tax years.

Income	£312,000	Annual Allowance	£40,000
Less	£240,000	Less	£36,000
	£72,000 /2 = £36,000	Reduced Annual Allowance	**£4,000 ****
		** (the **Minimum Tapered Annual Allowance**)	

Cartwright views

It is not possible for an employer, scheme trustees or administrators to know details of the total taxable income of any individual, or details of other benefits or pensions they may have in order to calculate accurately the level of an individual's Annual Allowance.

These are complicated matters and all members of pension arrangements should therefore carefully consider the implications of these limits on their pension savings. If anyone believes they may have exceeded the Annual Allowance, will be subject to an Annual Allowance Charge, wish to opt for Scheme Pays, have flexibly accessed money purchase funds, or are likely to be affected by "tapering" of the Annual Allowance, it is **strongly** recommend that they seek the advice of a tax expert or a FCA registered Independent Financial Adviser.

If you would like to discuss any of these matters further, please get in touch with your usual contact at Cartwright.

June 2020