Tapered Annual Allowance (TAA) from 2016/17 Important changes

Relevant from: 6 April 2016

Relevant to: Participating employers in the TPS
Employer and member representatives
Members concerned about the impact of the Annual Allowance (AA) changes

September 2017

Key points

- The Annual Allowance (AA) is being tapered for those people with a threshold income of more than £110,000 and an ‘adjusted income’ of over £150,000
- The Tapered Annual Allowance (TAA) works by reducing the person’s Annual Allowance by £1 for every £2 of adjusted income they accrue over the tax year
- Individuals may not know what their AA is until well after the end of the tax year in question
- As Teachers’ Pensions is not aware of income received in addition to the earnings their employer reports to us it will not know whether a member has TAA or not. It is for the member to inform Teachers’ Pensions if they are affected.
- Employers may want to communicate these changes with their senior employees.

Introduction

On 8 July 2015, the Government introduced plans to reduce Inheritance tax and to fund this tax change by restricting pension tax relief for high earners and other high-income individuals.

The reduced availability of tax relief for those with high income will take effect for all tax years from 6 April 2016. The method used to reduce pension tax relief is to reduce the person’s Annual Allowance, i.e. the maximum amount of pension savings in a UK registered pension scheme that will attract marginal rate tax relief.

Tapered Annual Allowance

The method chosen to reduce the Annual Allowance is called the Tapered Annual Allowance (TAA). It works by reducing the person’s normal Annual Allowance by £1 for every £2 of ‘adjusted income’ that the saver earns over £150,000 up to a maximum reduction of £30,000, leaving a minimum AA of £10,000. Therefore earners with an adjusted income of between £150,000 and £210,000 are affected by the taper from the 2016/17 tax year. Those with an adjusted income of over £210,000 know that their Annual Allowance is only £10,000.

The basis is derived from a formula that relies on the current Annual Allowance of £40,000 so the rate of reduction may vary for earners in the future if the AA is changed. Those affected by the Money Purchase Annual Allowance face added complications.

For these purposes ‘adjusted income’ is the total of all sources of taxable income falling in the tax year plus the value of any pension saving in that year.

Persons with a ‘threshold income’ of less than £110,000 are exempt.

TPS Briefing Note 6, Measuring Income, sets out what ‘adjusted income’ and ‘threshold income’ mean.

Maximum tax relievable contributions

If, in a tax year, an employee does not know what their final earnings and other income will be then they will not know where they fall within the taper range for the Annual Allowance (AA) (unless they are definitely above or below the range). Consequently they will not know during the tax year how much their maximum tax relievable pension contributions can be for that year. This uncertainty might be because a teacher receives a large pensionable or non pensionable payment at the end of the tax year or receives separate income e.g. buy to let income.

Reporting issues

Under current legislation where a member has exceeded the AA in the scheme and where we have the required information from employers, Teachers' Pensions are obliged to provide information about the AA and the Pension Input Amount (PIA) by the 6 October following the end of the tax year that gave rise to the charge together with the PIAs and AAs for the three previous tax years. However, pension schemes such as Teachers' Pensions will not be able to calculate a member's individual TAA as it relies on knowing the individual's adjusted income and this includes non-employment income which the employer and Teachers Pensions have no way of knowing for sure. Teachers' Pensions will not always know whether a member has exceeded the AA if the member is subject to the TAA.

The member then has an obligation to include the AA information on their tax return by the following 31 January and the scheme must include it on the scheme event report by that same date.

Option to Elect for Scheme Pays

A member has a right to ask Teachers' Pensions to pay the AA charge based on the amount of their pension savings that exceeded the standard Annual Allowance in the Teachers' Pension Scheme alone from the member's accrued pension benefits under the scheme (if the liability exceeds £2,000 and the AA is exceeded).

A tapered Annual Allowance is a reduction of the standard Annual Allowance. This will mean that the tax charge arising on the portion of pension savings between the lower tapered Annual Allowance and the higher standard Annual Allowance threshold will not meet the criteria, to require the Scheme to pay this part of the tax charge.

Therefore in order to assist members, Teachers Pensions are able to accept an additional Scheme Pays election made on a 'Voluntary' basis, to mitigate this element of the tax charge. Please see Briefing Note 4(b) for further details.

Teachers' Pensions must receive the Scheme Pays Election by 31st July in the calendar year following the end of the tax year in which the AA charge arose. Otherwise the right to ask Teachers' Pensions to pay the charge is lost. Please note that this is a statutory deadline over which Teachers' Pensions does not have any ability to amend to accommodate late elections.

The deadline for Scheme Pays Election is brought forward in cases of retirement (a Scheme Pays Election must be made and any tax due paid before benefits are put into payment).

In return for paying the tax charge, Teachers' Pensions will reduce the members' accrued benefits. The factors used to calculate the reduction in benefits are contained on the TP website on the link below.

https://www.teacherspensions.co.uk/members/resources/factors.aspx

The Scheme Pays Election can only be submitted by completing the following form, which must be received by TP by the 31st July, otherwise the election will not be allowed.

https://www.teacherspensions.co.uk/~/media/Documents/Member/Applications/AllowanceSchemePays%20v14.ashx

Member communications

As we noted above, under the TAA regime, Teachers' Pensions won't be able to calculate an individual member's AA.

Actions for the members

- Those members with high salaries should seek independent financial advice to determine whether their earnings exceed the 'threshold income'.
- High earners should then seek assistance in connection with the calculation of their 'adjusted income' taking account of earnings received from various sources, to identify whether their Annual Allowance is tapered and the level of AA tax charge which may apply from 2016/17

The information in this Briefing Note is based on our understanding of the tax and legal position and does not allow for any changes that may be communicated after the date of publication. For more information on how your particular circumstances may be affected, please contact us. This document is for reference purposes only and does not constitute financial advice. It is the member's responsibility to ensure that they pay any tax due to their pension savings. We recommend that you take independent financial advice from a registered individual, who can assess and quantify the extent of any tax liability that is due. You can find a list of independent financial advisers at www.unbiased.co.uk