Tapered Annual Allowance (TAA) 2016/17 Measuring Income

Relevant from: 6 April 2016

Relevant to: Participating employers in the TPS
Employer and member representatives
High earners who may be impacted by the Tapered Annual Allowance (TAA)

December 2015

Key points

- The Tapered Annual Allowance (TAA) comes into effect on 6 April 2016.
- It applies to those earning more than £110,000, with an adjusted income is over £150,000 (counting all sources and not just earnings).
- The Annual Allowance (AA) will reduce by £1 for every £2 a member's adjusted income is over £150,000.
- Adjusted income is used to determine if the TAA applies.
- It includes the value of employer pension contributions.
- Threshold income has been introduced to protect lower-paid individuals.
- Where an individual has threshold income of £110,000 or less they cannot be subject to the taper regardless of the level of their employer's pension contributions.
- Anti-avoidance measures will apply.

Introduction

In the Summer Budget on 8 July 2015, the Government introduced a 'Tapered Annual Allowance' (TAA) from 6 April 2016 for those whose adjusted income is over £150,000 so that their Annual Allowance (AA) reduces by £1 for every £2 of 'adjusted income' over £150,000.

This Briefing Note will explain how income is assessed to determine if the TAA applies.

Adjusted income

The income definition for the TAA will not be the same as taxable income. It will include the value of pension savings and will be known as 'adjusted income'. This is to ensure that the restriction applies fairly and cannot be avoided, for example, through using salary sacrifice.

There are seven steps in calculating adjusted Income.

1. Identify the amounts of income on which the taxpayer is charged to income tax for the tax year. The main types of chargeable income are; employment income, trading income (income from trades and professions), property income, pension income, social security income (where it is taxable), savings income, dividend income, and miscellaneous income.

2. Deduct from total income the amount of any relief under a provision listed in the Income Tax Act 2007 to which the taxpayer is entitled for the tax year.

   There are two pension scheme related reliefs: excess relief where relief under a net pay arrangement is not sufficient, and relief on making a claim. There are numerous other reliefs set out in the Income Tax Act 2007 that may be deducted at this step.

3. Add back in the amount of any claim for excess relief under net pay and relief on making a claim (described in step 2 above).

4. Add in the amount of any pension contributions made from any employment income of the individual for the tax year under net pay (but not any elements already added back in under 3 above). This is to ensure fairness between those who have contributions deducted via net pay and those through relief at source.

5. Add in the amount of relief claimed where non-domiciled individuals make contributions to overseas pension schemes.

6. Add in the value of any employer contributions for the tax year. The normal calculation basis for the AA should be used. For defined benefit schemes such as the Teachers' Pension Scheme, this is the pension input amount for the tax year minus the amount of member contributions.

7. Deduct the amount of any lump sum death benefit accruing to the individual in the tax year from the death of a member over age 75/pre age 75 where not paid before end of relevant 2 year period. This will apply to those lump sums that are currently subject to the special lump sum death benefit charge (45%), but will, from 6 April 2016, be instead taxed at the recipient's marginal rate of tax.

Threshold income

To provide some certainty for scheme administrators and individuals over who may be affected, and to ensure that lower-paid individuals are not affected by the addition of pension savings, the taper restriction will be subject to an income floor. This will be £110,000 (being £150,000 less the Annual Allowance) of what is normally an individual's net income for the tax year and will be known as threshold income.

Where an individual has threshold income of £110,000 or less they cannot be subject to the TAA regardless of the level of their adjusted income.

To calculate 'threshold income' there is five steps.

- Steps 1 and 2 are the same as for 'adjusted income' above.
- Step 3 - Add in the amount of any employment income given up for pension provision as a result of any salary sacrifice made on or after 9 July 2015.
- Step 4 - Deduct the gross amount of any pension contribution made via the relief at source method.
- Step 5 - Deduct the amount of any lump sum death benefit accruing to the individual in the tax year from the death of a member over age 75/pre age 75 where not paid before end of relevant 2 year period.

Action Points

- Employers may wish to identify those individuals that potentially could be impacted by the TAA based on the data they hold and communicate accordingly.
- Those members affected by the TAA will need to calculate the value of the employer contribution in order to confirm their TAA.

Additional notes

The inclusion of all types of contributable income in the definition of adjusted pensionable earnings may make the identification of affected members difficult because only the individual or his/her accountant will hold the required information. In many cases this might not be possible until the relevant tax year has ended.

An anti-avoidance clause will be introduced to prevent avoidance of the taper.