Beware the "Taper Trap"

With the introduction of the new Annual Allowance tapering rules in 2016/17, higher earners and their advisers may not fully appreciate the impact the new "adjusted income" rules may have in relation to ongoing, or planned, pension contributions.

Although it is commonly believed that as long as an individual's income is less than £150,000, the tapered Annual Allowance calculation will not apply, in fact anyone with income at or above £110,000 may still be caught in this "taper trap". This may lead to an unwelcome Annual Allowance tax charge payable by the individual.

Let us look at two examples to see how this might arise;

Example 1

Denise is an active member of her employer's final salary scheme. In 2016/17 she earned £92,000 as salary/benefits and received a £15,000 bonus. During the tax year she also decided to exercise some executive unapproved share options to help fund her son's university expenditure, taking £35,000 which was treated as taxable income.

In September 2017, her scheme administrator subsequently confirmed to her that the Annual Allowance usage for the 2016/17 tax year was £32,000.

However, as her total income during 16/17 exceeded £110,000 the "adjusted income" rules come into play which dictate that employer pension contributions must be added to her other sources of income.

Accordingly, her total "adjusted income" for 2016/17 was in fact £174,000.

This exceeds the "taper" threshold of £150,000 by £24,000, meaning the taper applied to her 2016/17 Annual Allowance is £24,000/2 = £12,000.

Therefore, her tapered Annual Allowance for 2016/17 was £40,000 - £12,000 = £28,000.

As her final salary scheme Annual Allowance usage for 2016/17 has exceeded this by £4,000 so she may incur a tax charge of £1,600 unless she has sufficient unused "carry forward" relief to offset this excess contribution.

Example 2

John is sole managing director of a consultancy firm and has taken a salary of £10,000 as well as dividends of £100,000 each year for the past several years.

In February 2017, John spoke to his accountant about making an employer pension contribution to his SIPP to help reduce taxable profits, as he had done previously.

Relying on figures provided to him for his available unused Annual Allowance for 2016/17 and the previous three tax years, John made an employer pension contribution of £55,000 to his SIPP using up all unused carry forward relief.

However, as his total income was £110,000 we must look at his "adjusted income" for the 16/17 tax year, which was £10,000 + £100,000 + £55,000 = £165,000.

The taper applied for his 2016/17 Annual Allowance was (£165,000 - £150,000)/2 = £7,500. Unfortunately, John will now incur an Annual Allowance tax charge as he has no unused "carry forward" relief.

How can this "taper trap" be avoided?

For many, timely financial planning will be the key to address any tax planning as early as possible to help avoid the "adjusted income" rules for the tapered Annual Allowance.

There are several financial planning approaches to consider that may help an individual, with timely advice before the end of the tax year, to help avoid any unwanted tax charges arising by falling into this "taper trap".

Further Information

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How Can Save & Invest Help?	We aim to provide a full financial planning service to clients and build long term relationships with them and their other professional advisers. We can provide a retirement planning review including Annual Allowance considerations to ensure clients do not fall foul of the new "taper trap".
Who to Contact?	If you are interested in finding out more about how we can help you or your clients, please contact: **Jeffrey Deans, Managing Director, on 0800 132 740.**

The Small Print