TECHNICAL NOTE
PERSONAL ALLOWANCE AND PENSION CONTRIBUTIONS

Scottish Widows Platform

For Professional Advisers only

Individuals with 'adjusted net income' over £100,000 will have their personal allowance reduced by £1 for every £2 of excess income meaning that in the 2023/24 tax year those individuals with adjusted net income of £125,000 or more will have no personal allowance.

Adjusted net income

Adjusted net income is the measure of income that is used for the calculation of the income-related reductions to the personal allowance and is defined in section 58 of the Income Taxes Act 2007. Broadly, it is the total income on which an individual is liable for tax, less the gross amount of any personal pension and gift aid contributions.

However, remember that this is not the calculation for the actual payment of income tax and National Insurance (NI), and the full income before removal of the pension contribution will be subject to tax and NI.

Loss of personal allowance

The following examples demonstrate the impact of losing the personal allowance and assumes both John and Graham are not Scottish taxpayers.

John has income of £100,000 in the current tax year. With a basic personal allowance of £12,570, this leaves income of £87,430 subject to income tax as follows:

First £37,500 at 20% £7,500
Next £50,000 at 40% £20,000
Total income tax £27,500

Now let's look at Graham, who has income of £125,140 in the current tax year. Graham now has no personal allowance and so his total income is taxed as follows:

First £37,700 at 20% £7,540
Next £87,440 at 40% £34,976
Total income tax £42,516

The above examples demonstrate that an increase in income of £25,140, over the £100,000 threshold, gives an increase in income tax of £15,084. This results in an effective rate of income tax of 60% on every £1 over £100,000, i.e. £15,084/£25,140.

Restoring the personal allowance

As any personal, including third party (excluding employer), pension contributions reduce the adjusted net income figure, making such a contribution provides an individual with an opportunity to avoid this additional tax.

If Graham, from the previous example, pays a net personal pension contribution of £20,112 (£25,140 gross) his adjusted net income will reduce to £100,000. This restores his personal allowance of £12,570 making £112,570 subject to income tax as follows:

First £37,700 + £25,140 at 20% £12,568
Next £49,730 at 40% £19,892
Total income tax £32,460

By regaining his full personal allowance, Graham has reduced his tax liability by £10,056. Graham also receives 20% tax relief at source of £5,028 on his pension contribution. Therefore, overall, Graham's effective rate of tax relief on the £25,140 pension contribution is 60% (£15,084).

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For Scottish taxpayers, the Scottish Rate of Income Tax may produce a different result to the rest of the UK due to the different tax rates and bands.

For Welsh taxpayers, the overall rates of income tax payable will be the same as UK taxpayers (excluding Scotland).

Tapered Annual Allowance

'High-income' individuals also need to be aware that their annual allowance for pension contributions may fall from £60,000 to as little as £10,000. From 6 April 2023, a 'high-income' individual is someone whose "Adjusted Income" (broadly taxable income plus employer pension contributions) for the tax year exceeds £260,000 and whose "Threshold Income" (broadly taxable income less employer pension contributions) for the tax year exceeds £200,000. Note that between 6 April 2020 and 5 April 2023, the Adjusted Income threshold was £240,000.

Key point summary

For clients who are high earners and who currently lose their personal allowance, the opportunity to make a pension contribution and regain this allowance, with an effective rate of tax relief of up to 60%, is a key discussion point.

For more information on the Scottish Widows Platform, please contact your consultant.
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