Withdrawal of Guernsey's Personal Allowances

"tax relief on pension contributions for very high earners is all but removed."

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The Quarter 4 - 2018 edition of Bandwagon provided a high level overview of the 2019 budget changes and illustrated the impact, for different levels of taxable income, of the changes in the phasing out of personal allowances between 2018 and 2019. These changes come into effect from the 2019 tax year and anyone with taxable income of £100,000 pa or more will be affected, to some extent, by the tapering of the tax relief.

In this article we take a more detailed look at the interaction of the withdrawal of tax relief on pension contributions and the carry forward provisions in Guernsey. The actual impact on an individual will depend on their personal circumstances. However, in the worst case scenario (ie no other allowances other than the £11,000 personal allowance), someone with taxable income over £155,000 pa will begin to see their tax relief on pension contributions eroded, potentially down to relief limited to contributions of just £1,000pa.

Carry forward provisions

Since 2011, individuals have been able to carry forward any unused pension tax relief, for up to 6 years, if they have made a pension contribution which had not utilised their full tax-free allowance in any particular tax year. The tax-free allowance is 100% of taxable income, subject to a monetary cap. This cap was £50,000 up until 31 December 2017, but reduced to £35,000 from 1 January 2018.

Interaction of carry forward and withdrawal of allowances

The Income Tax Office has clarified that it is the **total pension contribution paid** that is subject to the withdrawal of allowances.

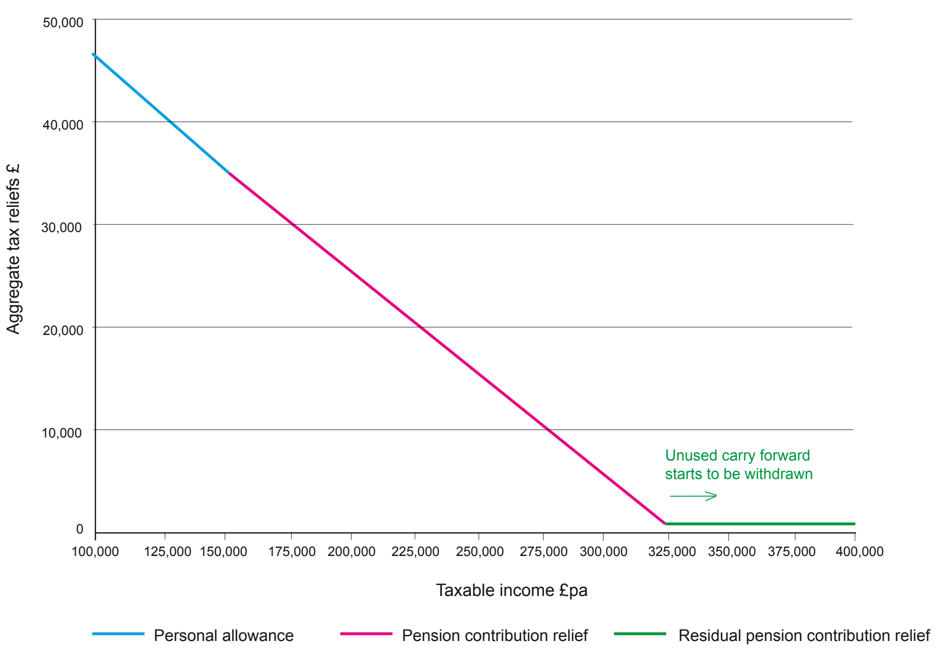
The practical application of this is quite complicated and we have illustrated this with some examples. However, in summary, it means that:

- an individual who is subject to tapering on pension contributions (ie taxable income of at least £155,000 pa in 2019, but possibly more depending on circumstances) will never be able to receive the full 20% tax relief on their pension contributions. This is because the first contributions paid are deemed to be those which are not tax relieved. In order to benefit from any tax relief an individual would need to make contributions over and above those which do not qualify for any relief.

- unused carry forward relief from the previous six tax years cannot be used to offset the withdrawal of tax relief on the current year's pension contributions; and

- unused carry forward is also withdrawn for very high earners (ie potentially those with taxable income in excess of £330,000 pa in 2019, but possibly higher depending on their circumstances). In 2018 a contribution needed to be made (and the individual's taxable earnings sufficiently high) for the carry forward to be withdrawn. From 2019 onwards carry forward will be withdrawn, regardless of whether a contribution is made, if the individual's taxable earnings are sufficiently high that the carry forward would have been withdrawn had a contribution been made.

Tapering of tax allowances based on £35,000 pension contribution and no other allowances (eg no mortgage interest relief)



Withdrawal of Personal Allowances	
Example 1 Partial withdrawal of tax-relief, carry forward unaffected	An individual has: - £100,000 unused carry forward from 2015 to 2017 inclusive - earnings in 2018 such that £15,000 of pension contribution tax relief is withdrawn (ie taxable income of at least £230,000) If this individual made a pension contribution of £80,000 in 2018 then that total contribution is subject to the withdrawal of allowances. Therefore the £80,000 is subject to the £15,000 withdrawal of allowances and the individual receives tax relief on £65,000 of their £80,000 contribution (£20,000* from 2019 relief and £45,000 from carry forward). * £35,000-£15,000
Example 2 Carry forward withdrawn by contribution	An individual has: - very high taxable income such that all allowances are always withdrawn, except for the £1,000 pension contribution allowance that can never be withdrawn - carry forward of £25,000 from unused allowances in 2016 If this individual made a pension contribution of £35,000 in 2018 then, due to the withdrawal of allowances they could only claim tax relief on £1,000 of this pension contribution. They would continue to retain their £25,000 carry forward. If the individual were to make a contribution of £80,000 in 2019 then the first step would be to assess the level of allowances before tapering. This would be £35,000 from the 2019 allowance plus the £25,000 carry forward leading to a total of £60,000. It is this £60,000 that is then subject to the withdrawal of allowances. Given this individual's very high earnings, all of the £60,000 would be tapered down to £1,000 and the individual would not have any residual carry forward.
Example 3 Carry forward withdrawn without contribution	An individual has: - very high taxable income in 2018 and 2019 such that all allowances are always withdrawn, except for the £1,000 pension contribution allowance that can never be withdrawn - £45,000 unused carry forward from unused allowances in 2015 and 2016 Given the level of this individual's taxable income, all of their carry forward would be withdrawn regardless of whether or not they were to make a pension contribution in 2019. They decide not to make a pension contribution in 2019 (since only £1,000 of it would benefit from any tax relief) and there is nothing to carry forward to 2020.

Conclusions

The examples highlight the degree of complexity that has been introduced to the taxation of pension contributions for higher earners. The way that the withdrawal of allowances is being phased for pension contributions means that the tax relief on pension contributions for very high earners is all but removed.

For those saving on an individual basis, either into a personal pension or a RATS, they will still benefit from the tax-free roll up of pension savings and potentially the tax-free element of the lump sum when they take their benefits (dependent on the level of pension savings to date since there is a monetary cap on the level of tax-free lump sum). However, those affected by the tapering will need to consider whether they are prepared to suffer tax on the contributions paid into the pension plan from 2019 onwards, as well as tax on the majority of the income it provides in retirement.

As well as the impact on individuals, employers may want to consider if a contributory pension scheme is an appropriate part of the remuneration package going forward for higher earners; a non- contributory scheme may be more attractive. However, individuals should be aware that the Guernsey Income Tax Office has highlighted that if individuals ask their employer to make additional contributions in lieu of a pay rise (to limit the withdrawal of their allowances) then the employer contributions may be considered part of their employment income and taxed accordingly.

Please note that we are not tax advisers. This article only provides our current understanding of the position. We recommend that pensions tax advice is sought by any high earners considering making substantial pension contributions.