

Personal allowance and pension contributions

Introduction

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 2025/26 tax year those individuals with adjusted net income of £125,140 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.

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.

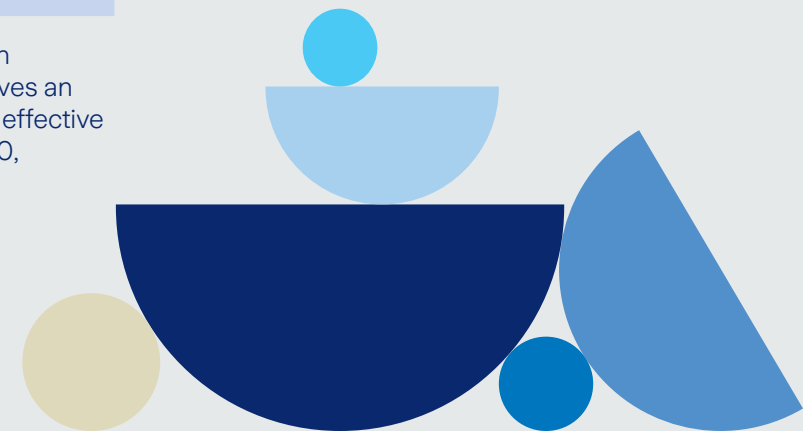
John has income of £100,000 in the current tax year. With a basic personal allowance of £12,570, this leaves income of £87,430 subject to income tax as follows:

First £37,700 at 20%	£7,540
Next £49,730 at 40%	£19,892
Total income tax	£27,432

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 (tax saving)/£25,140 (income increase).



Restoring the personal allowance

As any personal, including third party (excluding employer), pension contributions reduce adjusted net income, 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 and, together with claiming higher rate tax relief on his contribution, leaves the remaining £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 and being able to claim higher rate tax relief on his contribution, 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).

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.

This represents Zurich's understanding of HMRC regulations governing the personal allowance and pension contributions. This is subject to change and Zurich does not accept responsibility for any action taken or refrained from, by any person relying on this information.

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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 need to be aware that there is a reduction in the standard Annual Allowance where their "Adjusted Income" exceeds £260,000 and their "Threshold Income" exceeds £200,000. Both limits need to be breached for tapering to apply.

The Annual Allowance reduction is £1 for every £2 of Adjusted Income over £260,000, subject to a minimum £10,000 Annual Allowance applying.

The definitions of Adjusted Income and Threshold Income aren't straightforward but, broadly, "Adjusted Income" refers to all taxable income plus employer pension contributions for the tax year, and "Threshold Income" to all taxable income less personal contributions for the same period.

Please note that the Adjusted Income and Threshold Income amounts have previously been:

- between 6 April 2016 and 5 April 2020, £150,000 and £110,000 respectively, subject to a minimum £10,000 Annual Allowance applying, and
- between 6 April 2020 and 5 April 2023, £240,000 and £200,000 respectively, subject to a minimum £4,000 Annual Allowance applying.

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.