CURTIS BANKS

CASE STUDY

# THIRD PARTY CONTRIBUTIONS AND ANNUAL ALLOWANCE CHARGES – PART 1

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***This case study is from Meet the Joneses - Series 1. Information about the family and further case studies can be found on our website, www.curtisbanks.co.uk. All characters in the Jones family are fictional and intended for demonstrative purposes only.***

## The Challenges

Julia Jones (47) has lived in the apartment above her boutique clothing store for many years. Her daughter Flo (24) recently moved back into the apartment after Julia ended her civil partnership with her ex-partner Sara. There was a financial advantage to the move, as Flo is starting out as a freelance illustrator and has a very unpredictable income; however, her main motivation was to be on hand to help Julia out around the apartment and shop as needed, as Julia suffers from osteoarthritis which has been gradually worsening.

Over coffee with her sister-in-law Karolina, Julia mentions how proud she is of her daughter for pursuing her dream job, and that she is even more grateful to Flo for wanting to help her at the same time. Julia tells Karolina that she would like to thank Flo by contributing to her pension. She hadn't been aware that it was possible to contribute to another person's pension until her ex Sara had helped Flo to start her first pension last year.

Julia's only concern is around inheritance tax, as she wonders if giving a significant sum to Flo's pension could be seen as some kind of avoidance exercise, particularly if she does it more than once as she's considering.

She wondered if Karolina knew anything about this from her time as a legal secretary or from her current job at a legal aid charity.

Karolina warns that this isn't her area of expertise, but she doesn't believe it poses a specific issue. Her understanding is that Julia's contribution to Flo's pension will be treated as any other gift for inheritance tax purposes, so it shouldn't be a problem as long as Julia survives seven years.

Reassured about her situation contributing to Flo's pension, Julia decides to go ahead with her plan. She pays £16,000 into Flo's pension, giving a total contribution of £20,000 with the tax relief.

## The Actions

Unfortunately, Julia hasn't considered that third party contributions count towards the annual allowance, and are only eligible for tax relief if they are within the recipient's earnings for the year, rather than the payer's.

Separately, Flo has been planning to use the £80,000 lump sum she received from her late grandmother to make larger pension contributions, based on how much tax relief she would be eligible to receive. Thanks to a couple of unexpectedly large commissions, Flo's total income this year is £30,000. She had therefore contributed £24,000, which would give a total gross contribution of £30,000 with tax relief.

When Julia surprises Flo with the news of her contribution, Flo is extremely grateful, but immediately realises the possible problem with the tax relief. Julia had assumed the contribution would be eligible for tax relief because it was within her earnings and she was the one paying the money, but Flo isn't so sure. She calls her provider and speaks to Danny, confirming her suspicions that the contributions need to be within her earnings in order to be eligible for tax relief. Danny reassures her that he can arrange to have the tax relief corrected. He adds that an easy way for Flo to remember the tax treatment, is that contributions made by anyone other than an employer are treated exactly the same as though Flo made them herself.

Flo's nervous again. Does this mean her mother's contribution will also count towards the annual allowance? Danny confirms that that is the case. Even without the tax relief on Julia's contribution, Flo's pension will have received £46,000 of contributions during the year. Flo is surprised to learn that her mother's contribution is tested against the annual allowance, even though it didn't receive tax relief. Danny confirms that unfortunately this is the case, because personal and third party contributions are tested against the annual allowance if they would be eligible to receive tax relief, even if the individual's earnings mean that they can't actually receive it.

Flo asks how she goes about paying the annual allowance charge she will incur. Danny explains that there are two methods; Flo can either pay the charge herself, or use a process called 'scheme pays' to pay the charge from her pension. He mentions that the provider offers scheme pays on a voluntary basis, which means that Flo doesn't have to meet certain criteria such as a minimum amount of charge to be paid.

## The Results

Flo decides to use scheme pays to pay her annual allowance charge. Her provider has a form for her to complete with all the required information for them to arrange to deduct the charge from her pension and pay it to HMRC.

Danny mentions that Flo will receive a letter from them later in the year stating that she has exceeded her annual allowance and prompting her to consider whether she needs to take action. Danny explains that it is a regulatory requirement for providers to send these letters, even though in this case Flo is already aware and has taken action. She won't need to worry about the letter.

Julia is very sorry for causing Flo these issues, although Flo remains very grateful to her mother for her generosity. Julia resolves to talk to Flo about these matters in the future rather than trying to surprise her.

***Read Part 2 of this case study to see the mistake Flo has made in her calculations and how she corrects it.***

### Contact details

If you'd like to speak to us about anything in this case study, please contact us on:

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