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## CHANGES TO THE ANNUAL ALLOWANCE

This fact sheet outlines the changes to the annual allowance announced by the Government on 14 October 2010.

**The Pensions Advisory Service is unable to give individual specific advice and you should seek alternative tax or independent financial advice.**

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### What is the annual allowance?

The Annual Allowance is an annual limit set by HM Revenue & Customs.

For money purchase schemes, it's the limit on how much can be paid by in total by you and someone else on your behalf—for example, your employer.

For final salary and career average schemes, the limit is on the value of the increase in your pension built up in a tax year.

### How is the annual allowance changing?

The annual allowance for the 2010/11 tax year is £255,000 but reduced to **£50,000** for the 2011/12 tax year. A tax year runs from 6 April to 5 April inclusive.

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### Useful Terms to Know

#### Pension input amount

For a defined contribution scheme, this is the contributions paid in the pension input period, and includes your own contributions as well as those from your employer.

For a defined benefit scheme, this is the increase in annual pension in the pension input period.

#### Pension input period

The interval over which the amount of saving (pension input amount) into a scheme is measured. The measurement works on the principle of how much was saved between the start and end of the interval. A pension input period is usually a year long, but does not necessarily coincide with tax years.

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### What does this mean for me?

You can contribute up to 100% of your earnings (or a gross contribution of £3,600, if less) in a tax year to a registered pension scheme and get tax relief on your contributions at your marginal rate of income tax. However, the annual allowance acts as the overall limit.

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The pension input amount paid in the pension input period is measured against the annual allowance. You will have to pay a tax charge on the amount in excess of the annual allowance.

The reduced £50,000 annual allowance will remain unchanged until at least 2015/16. If your pension savings exceed the £50,000 annual allowance in a tax year, you will be allowed to bring forward any unused annual allowances from the previous three tax years, if you have been a member of a registered pension scheme for the year in question. For the tax years 2008/09, 2009/10 and 2010/11, the annual allowance will be treated as if it had been £50,000. Therefore if your pension savings were £50,000 or more in any of those tax years, you will have no unused annual allowance to bring forward.

Please refer to 'Spotlight on how to test pension savings against the annual allowance' for further information on the pension input amount and the pension input period.

## How much is the annual allowance tax charge?

With effect from 6 April 2011, the tax charge on savings above the annual allowance changed from a flat rate of 40% to your marginal rate of income tax. This effectively means that any excess amount will be treated as income for tax purposes. It is possible that this could move you into a higher tax bracket.

## How is it calculated?

To see whether a tax charge is payable, contributions for defined contribution schemes and increases in annual pension for defined benefit schemes over the pension input period ending in a tax year is compared against the annual allowance for that same tax year. For example, if your pension input period starts in the 2009/10 tax year but ends in 2010/11 tax year, your savings are compared against the annual allowance for the 2010/11 tax year.

## Who pays the annual allowance charge?

Normally, you would pay the charge, and account for the payment by completing a self-assessment tax return.

You can also choose to have some or all of your annual allowance charge paid by your pension scheme, in return for a reduction in your benefits. You can do this if the following conditions are met:

- your annual allowance charge liability for the tax year has exceeded £2,000; and
- the total amount of your pension savings in the pension scheme for the same tax year has exceeded the annual allowance.

The maximum amount you can ask each pension scheme to pay is the total pension input amount in the scheme which exceeds the annual allowance. For example, if the total pension input amount in the scheme was £60,000 and you were entitled to an annual allowance of £50,000, you could only ask the scheme to pay the £10,000 excess as a maximum.

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There is no minimum amount that you can ask your pension scheme to pay but if the amount is £2,000 or less, you will need to confirm to your pension scheme that your annual allowance liability for the tax year in question is more than £2,000.

You must notify your pension scheme that you wish the scheme to pay the annual allowance charge by 31 July in the tax year following the tax year in which the annual allowance charge became due (i.e. if the annual allowance charge became due in the 2012/13 tax year, you must notify the pension scheme by 31 July 2013). Alternatively, if you are due to take your benefits then you would have to give the scheme notice before the benefits are taken.

A scheme will not have to pay the annual allowance charge, even if you satisfy the conditions, in the following circumstances:

- The scheme is being assessed by the Pension Protection Fund (PPF) at the time you give notice or, at the time the PPF assessment period begins, the scheme has not yet paid the annual allowance charge following an earlier notice from you.
- The scheme would be unable to make an adjustment to your benefits to take account of the annual allowance charge because this would encroach on your Guaranteed Minimum Pension (GMP) or protected rights.
- Your benefits have been transferred to another scheme (along with the rights of all the other scheme members).
- The deadline for you to ask the scheme to pay has passed.

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## Exemption to the annual allowance test

With effect from 6 April 2011 the annual allowance rules apply in the year of taking benefits.

- There is an exemption to the annual allowance test in the year of death.
- There is an exemption to the annual allowance test in the year in which you retire because of serious ill-health (i.e. if you have less than 12 months to live).
- There will also be an exemption if you are a deferred member of a defined benefit pension scheme, if you were a deferred member for the whole of the pension input period or a deferred member for part of the pension input period and a pensioner for the rest of it.

This is conditional on any increase in your benefits not being more than:

- is required by the pension scheme rules in force on 14 October 2010; or
- the increase in the Consumer Prices Index (CPI) over a twelve month period ending with a month that falls within the scheme's pension input period.

# Spotlight on: Changes to the Annual Allowance

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For this purpose, your right to a GMP do not have to be taken into account when considering the increase in your benefits. The rate of GMP increase may be ignored.

If you have left a pension scheme but your future benefits are linked to your final salary, you are **not** exempt from the annual allowance test. This is because you are still building up benefits due to the continued salary link.

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## About Us

The Pensions Advisory Service has been providing help and guidance to members of the public on pension matters since 1983 either by telephone or written advice. We can also help people who have a pension complaint or dispute.

Our service is free and sustained by a nationwide network of volunteer advisers, who are supported and augmented by technical and administrative staff based in our London office.

### Contacting us

#### The Pensions Advisory Service

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We regret that we are unable to accept visitors at our office.

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