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## THE ANNUAL ALLOWANCE TRANSITIONAL RULES

When the government announced that the annual allowance for pension savings would be reduced from £255,000 to £50,000 from 6 April 2011, some people were already in the midst of their pension input period ending in the 2011/12 tax year. The government announced a two stage annual allowance test for people in this situation.

This fact sheet outlines who is affected by the annual allowance transitional rules, and the effect of those rules.

### Useful Terms

#### 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.

**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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### Do the rules apply to me?

#### My pension input period ended before 6 April 2011. Do the transitional rules apply to me?

No. Where a pension input period ends before 6 April 2011, the old rules apply in full (i.e. the increase in pension savings are tested against an annual allowance of £255,000 and the factor for valuing the increase in defined benefits is 10).

The transitional rules only apply to pension arrangements:-

- which started their pension input period before the 14 October 2010; **and**
- where the pension input period ends in the 2011/12 tax year; **and**
- where pension savings in the **total** 'pension input period' (i.e. both pre and post 14 October 2010) are going to exceed £50,000.

# Spotlight on: Annual Allowance Transitional Rules

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## **My pension input period started on or after 14 October 2010 and will end in the 2011/12 tax year. Do the transitional rules apply to me?**

No. Increases in pension savings (the pension input amount) will be tested against an annual allowance of £50,000 and the factor for valuing the increase is 16. Your pension at the start of the pension input period may be increased in value by any rise in the Consumer Price Index (CPI) for the twelve month period to September 2010.

You will be allowed to bring forward any unused annual allowances from the previous three tax years. For the tax years 2008/09, 2009/10 and 2010/11, the annual allowance will be treated as if it were £50,000 for those tax years. The carry-forward rules are complex, and we recommend that you refer to HM Revenue & Customs' guidance notes, which can be found at the following location:

<http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM06108030.htm>

## **My pension input period started before 14 October 2010, will end in the tax year 2011/12 and the pension savings in the total pension input period will be more than £50,000. Do the transitional rules apply to me?**

Yes. The pension input periods are split and effectively treated as two separate periods, with one covering pension savings before 14 October 2010 and the other, savings from 14 October 2010. The first calculation is for pension savings from 14 October 2010 followed by the calculation for pension savings before 14 October 2010.

### **Pension savings from 14 October 2010 calculation**

The increase in pension savings is calculated as your annual pension at the end of the pension input period (i.e. the period ending in the 2011/12 tax year) less your annual pension at 14 October 2010. You should increase the starting pension by the rise in CPI for the twelve month period to September 2010. The resulting is multiplied by 16. For example, if your pension had increased by £2,000 over this period, its value for the annual allowance test is £32,000 (i.e. £2,000 multiplied by 16).

From this figure, deduct £50,000 (i.e. annual allowance for the 2011/12 tax year), which gives your 'post-announcement period' amount. If this gives a negative amount, the post-announcement period amount is taken as zero. For example, deducting £50,000 from £32,000 will give a negative amount.

**You will need to contact your scheme administrator for details of your annual pension during this period.**

### **Pension Savings before 14 October 2010 calculation**

The increase in pension savings is calculated as your annual pension at 13 October 2010 less your annual pension at the start of the pension input period. You should increase the starting pension by the rise in CPI for the twelve month period to September 2010. You should multiply the resulting figure by 10. For example if your pension had increased by £5,000 over this period, its value for the annual allowance test is £50,000 (i.e. £5,000 multiplied by 10).

From this figure, deduct the difference between £255,000 (i.e. annual allowance for the 2010/11 tax year) and the lower of either £50,000 (i.e. annual allowance from 2011/12 tax year), or the post 13 October benefit. If this gives a negative amount, the pre-announcement period' amount is taken as zero.

For example, if the post 13 October benefit is more than £50,000, you deduct £50,000 from £255,000 and then deduct £205,000 from the pre 14 October benefit. If the post 13 October benefit is say £20,000, you deduct £20,000 from £255,000 and then deduct £235,000 from the pre 14 October benefit.

**You will need to contact your scheme administrator for details of your annual pension during this period.**

# Spotlight on: Annual Allowance Transitional Rules

The final pre- and post-benefit amounts are added together and if this gives a negative amount (i.e. zero) there is no annual allowance charge. Where there is an annual allowance charge, you will be allowed to bring forward any unused annual allowances from the previous three tax years. For the tax years 2008/09, 2009/10 and 2010/11, the annual allowance will be treated as if it were £50,000 for those tax years. The carry-forward rules are complex, and we recommend that you refer to HM Revenue & Customs' guidance notes, which can be found at the following location:

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## Worked Example where the annual allowance is exceeded

The increase in your post 13 October benefit is £150,000. Deduct £50,000 from this. The post 13 October amount is therefore £100,000.

The increase in your pre 14 October benefit is £120,000. Deduct from the £120,000 an amount representing £255,000 less the lower of the post 13 October benefit, or £50,000, which in this example is £50,000 (because this figure is lower than the post 13 October benefit of £150,000).

The difference between £255,000 and £50,000 is £205,000 and so £205,000 is deducted from the pre 14 October benefit of £120,000. As £205,000 is greater than £120,000, the pre 14 October amount is negative and so the pre 14 October amount is £Nil.

Add together the 'pre and post benefit amounts of £Nil and £100,000.

You have exceeded your annual allowance limit by £100,000, which is subject to income tax at your marginal rate of tax in the 2011/12 tax year. If you have unused annual allowances from the previous three tax years, you could bring these forward to reduce the annual allowance tax charge in the 2011/12 tax year. The carry-forward rules are complex, and we recommend that you refer to HM Revenue & Customs' guidance notes, which can be found at the following location:

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## Defined Contribution Schemes

For defined contribution scheme members the annual allowance transitional rules are simpler.

If your pension input period ends in the 2011/12 tax year and your pension input period started before 14 October 2010, the annual allowance is tested against the contributions paid in the pre 14 October and post 13 October period i.e. the same test as a defined benefit scheme without the 10 and 16 factor used for defined benefit schemes.

### About Us

The Pensions Advisory Service has been providing free 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.

*Please note that this guide is for information only. The Pensions Advisory Service cannot be held responsible in law for any opinion expressed, nor should any such opinion be regarded as grounds for legal action.*

### Contacting us

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