

## The Annual Allowance

This factsheet outlines the annual allowance rules. The government reduced the annual allowance to £40,000 with effect from 6 April 2014. In the July 2015 further changes affecting high earners were announced which will come into effect from 6 April 2016. In the meantime, transitional arrangements will apply to pension input periods (PIPs) up to April 2016. Thereafter, all PIPs will be harmonised with the tax year (i.e. running to 5 April each year). See below for an explanation of the terms used.



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

### What is the annual allowance?

The annual allowance is a yearly limit set by HM Revenue & Customs on the amount of pension savings that benefit from tax relief.

For money purchase schemes, it's the limit on how much can be paid 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 the pension input period.

If you have more than one pension scheme the annual allowance applies to the contributions paid or increase in value across all of your pension schemes in total.

The annual allowance for the 2010/11 tax year was £255,000 but reduced to £50,000 for the 2011/12 tax year and £40,000 with effect from 6 April 2014 (the 2014/15 tax year). A tax year runs from 6 April to 5 April inclusive. Further reductions will apply to higher earners from 6 April 2016.

### What has changed from April 2015?

From 6 April 2015, once you have flexibly accessed your pension benefits by taking any income from it in excess of the tax free amount, you (and your employer) can only contribute up to £10,000 to all money purchase (defined contribution) pensions each year. It will also not be possible to make use of any unused contribution allowance from previous tax years to increase this amount, as you are able to do with the £40,000 annual allowance.

The overall £40,000 annual allowance still applies. If you also have a final salary (defined benefit) scheme you can continue to accrue benefits worth up to £40,000 a year in total, plus any unused allowance from the previous tax years, across all your pensions without facing tax charges. However, if you have flexibly accessed income from your money purchase benefits, the amount you contribute to your money purchase pensions cannot exceed £10,000. If you contribute the full £10,000 you would still have scope to accrue up to £30,000 in a defined benefit scheme if you are in one.

## When is the restricted allowance triggered?

You will be affected by this new allowance when you:

- take any income flexibly from your pension
- exceed your income limit in capped drawdown
- take an income payment after you have told your scheme administrator you want to move from capped drawdown to flexi-access drawdown
- purchase a flexible annuity that allows income to decrease
- have previously been taking flexible drawdown (before 6 April 2015)
- have taken up an Uncrystallised Fund Pension Lump Sum (UFPLS) arrangement

You will not be affected by this new allowance if you:

- do not touch any of your pension pot
- take a tax-free lump sum but no other income
- cash in up to three small pots of £10,000 or more
- continue to take income below your annual limit in capped drawdown
- purchase a lifetime annuity
- take a lump sum or income as a beneficiary of someone else's pension

## 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 paid by someone else, for example 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 pension savings (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, and at present does not necessarily coincide with tax years, although this will change from 6 April 2016 (see section above). If you have different pension plans you may currently have different pension input periods. Please refer to the Spotlight on 'How to test pension savings against the annual allowance' for further information on the pension input amount and the pension input period.

## 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.

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.

If your pension savings exceed the £40,000 annual allowance in a tax year, you will be allowed to bring forward any unused annual allowances from the previous three tax years (called carry forward), if you have been a member of a registered pension scheme for the year in question. For tax years prior to 6 April 2011 the annual allowance is treated as if it had been £50,000, even though for these years it was much higher. From 2014/15 the annual allowance has been reduced to £40,000 but the previous three tax years (2011/12, 2012/13 and 2013/14) will still be £50,000 for carry forward. Even if you can carry forward, the maximum amount for tax relief purposes is still 100% of your total earnings in the tax year in which you make the contributions. You should also note the restriction of £10,000 to money purchase arrangements once benefits have been accessed that has been highlighted above. This allowance cannot be carried forward from previous years if any of it is unused.

## I have received a pension savings statement about the annual allowance

You may have received a pension savings statement informing you that your pension savings in one particular pension scheme alone have exceeded the annual allowance for the year. An annual allowance charge is due if you have exceeded the annual allowance in any tax year and do not have enough unused annual allowance to carry forward from previous years.

You will have to complete a self-assessment tax return declaring an annual allowance charge. If you think that you might need to declare an annual allowance charge but you don't normally submit a self-assessment tax return, you will need to register with HMRC. Further information can be found here: [www.hmrc.gov.uk/sa/need-tax-return.htm](http://www.hmrc.gov.uk/sa/need-tax-return.htm). HMRC's HS345 note sets out more details on how you should complete your tax return to allow for the annual allowance.

## How much is the annual allowance tax charge?

The tax charge on savings above the annual allowance is 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.

A scheme must provide you with a pension savings statement if your savings in the scheme exceed the annual allowance for a year.

### 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 2014/15 tax year but ends in 2015/16 tax year, your savings are compared against the annual allowance for the 2015/16 tax year.

### Who pays the annual allowance charge?

You are responsible for paying 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 £50,000 and you were entitled to an annual allowance of £40,000, you could only ask the scheme to pay the £10,000 excess as a maximum.

You must notify your pension scheme that you wish the scheme to pay the annual allowance charge by 31 July in the year following the tax year in which the annual allowance charge became due (i.e. if the annual allowance charge became due in the 2014/15 tax year, you must notify the pension scheme by 31 July 2016). 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)**.
- 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.

## 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 if a person becomes entitled to a serious ill-health lump sum under a pension arrangement (a serious ill-health lump sum can only be paid where a person has less than 12 months to live).
- There is also 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.

For this purpose, your rights 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.

## About Us

The Pensions Advisory Service (TPAS) works to make pensions accessible and understandable for everyone. We provide independent and impartial information and guidance about pensions, free of charge, to members of the public.

We help with all pension matters covering workplace, personal and stakeholder schemes and also the State Pension. We answer general questions, help with specific queries and offer guidance for people with complaints about their private pension scheme.

### Contacting us



Pensions Helpline  
(Monday- Friday 9:00am- 5:00pm)

**0300 123 1047**



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