The Annual Allowance

This factsheet outlines the annual allowance rules. The annual allowance has remained unchanged at £40,000 with effect from 6 April 2014. Further changes affecting high earners came into effect from 6 April 2016. In addition, individuals that have flexibly accessed their defined contribution pension pots will have a reduced annual allowance for certain pension savings.

The Pensions Advisory Service is unable to give individual specific advice and you should seek alternative tax or regulated 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 defined contribution or 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 defined benefit schemes such as 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 has been £40,000 since 6 April 2014 (the 2014/15 tax year). A tax year runs from 6 April to 5 April inclusive. Reductions to the annual allowance apply when defined contribution pots have been accessed flexibly (see below) and for higher earners from 6 April 2016.

Money Purchase Annual Allowance (MPAA)

Once you have flexibly accessed your defined contribution pension by taking any income from it in excess of the tax free amount, you (and your employer) can only contribute up to £4,000 to all money purchase (defined contribution) pensions each year. This is known as the Money Purchase Annual Allowance (MPAA). 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.

If you are subject to the MPAA and you make no contributions to a defined contribution pension scheme you can still save the standard £40,000 annual allowance into a defined benefit scheme, if you are in one. Equally, if you were to contribute the maximum £4,000 p.a. into a defined contribution scheme the maximum tax relievable savings you can make in a defined benefit scheme would be £36,000, giving a combined pensions savings total of £40,000.
When is the restricted MPAA 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 personal pension pots of £10,000 or less
- 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

Tapered Annual Allowance

The tapered annual allowance came into force as of 6 April 2016 for high earners. For every £2 of income above £150,000 per annum, £1 of annual allowance will be lost. The maximum reduction will be £30,000 meaning that anyone earning over £210,000 will have their annual allowance capped at £10,000.

An income floor will mean the taper will not apply unless the individual’s income excluding pension contributions exceeds £110,000 (referred to as the “threshold income”). We have more detail on this in our Spotlight on End of Tax Year Planning.

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. Since 6 April 2016 pension input periods have coincided with tax years.

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

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. 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 £4,000 to money purchase arrangements if the MPAA applies to you as highlighted above. This allowance cannot be carried forward from previous years if any of it is unused.

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.

The tax charge on savings above the annual allowance is at 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.

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 covers the 2018/19 tax year, your savings are compared against the annual allowance for the 2018/19 tax year.

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 2018/19 tax year, you must notify the pension scheme by 31 July 2020). 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.

The Pensions Advisory Service is provided by

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