

## Pensions Taxation - Annual Allowance

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HM Revenue and Customs (HMRC) imposes two controls on the amount of pension savings you can make without having to pay extra tax. These controls are known as the Annual Allowance and Lifetime Allowance. This is in addition to any income tax you pay on your pension once it is being paid to you.

This factsheet looks at the Annual Allowance. The annual allowance is the amount by which the value of your pension benefits may increase in any one year without you having to pay a tax charge.

### What is the Annual Allowance?

The Annual Allowance (AA) is the amount by which the value of your pension benefits may increase in any one year without you having to pay a tax charge.

If the value of your pension savings in any one year (including pension savings outside of the LGPS) is more than the annual allowance, the excess will be taxed as income.

The Government reduced the AA from £255,000 to £50,000 from 6 April 2011 and then reduced it again to £40,000 from 6 April 2014. Further changes to the annual allowance were made for higher earners from 6 April 2016, which resulted in special transitional rules for the 2015/16 tax year. These changes are covered in more detail later in this factsheet.

**Table 1 - Annual allowance rates since 2011**

Pension Input Period	Annual Allowance
1 April 2011 to 31 March 2012	£50,000
1 April 2012 to 31 March 2013	£50,000
1 April 2013 to 31 March 2014	£50,000
1 April 2014 to 31 March 2015	£40,000
1 April 2015 to 5 April 2016	£80,000 (transitional rules apply)
6 April 2016 to 5 April 2017 onwards	£40,000 (unless tapering applies)

### Will I be affected by the Annual Allowance?

Most people will not be affected by the AA tax charge because the value of their pension savings will not increase in a year by more than £40,000, or, if it does they are likely to have unused allowance from previous years that can be carried forward.

You are most likely to be affected if one or more of the statements below applies to you:

- you have membership of the LGPS that was built up in the final salary section and you receive a significant pay increase. Final salary membership is membership built up before 1 April 2014 in England and Wales, or before 1 April 2015 in Scotland.
- You combine a previous LGPS pension benefit that was built up in the final salary section of the LGPS with your current pension account and your salary (full time equivalent) has increased significantly since you left the Scheme.

- You transfer pension rights into the LGPS from a previous public service pension scheme under the preferential Club transfer rules and your salary (full time equivalent) on joining the LGPS is higher than the salary you earned when you left the previous scheme. Public service pension schemes are schemes covering civil servants, any scheme in England, Wales or Scotland covering local government workers, teachers, health service workers, fire and rescue workers or members of the police force, or a new public body pension scheme.
- In the past you transferred in membership from another public service pension scheme which retains a final salary link and you receive a significant pay increase.
- You pay a high level of additional contributions.
- You are a higher earner.
- You have accessed flexible benefits on or after 6 April 2015.

If your LGPS pension savings exceed the standard AA in any year ending 5 April Avon Pension Fund will contact you by 6 October to let you know.

## **The 50/50 section of the LGPS**

If you wish to slow down your pension build up to avoid or reduce an AA tax charge, you may wish to consider joining the 50/50 section. In the 50/50 section of the LGPS you pay half your normal contributions and build up half your normal pension, but you retain full life and ill health cover. You can find out more about the 50/50 section at our website: <https://www.avonpensionfund.org.uk/can-i-pay-less-5050-option>

Before considering any action to reduce your tax liabilities you should always seek independent financial advice from an FCA registered adviser. For help in choosing an independent financial adviser visit the money advice website. <https://www.moneyadvice.service.org.uk/en/articles/choosing-a-financial-adviser>

## **How is the annual allowance calculated?**

The increase in the value of your pension savings in the LGPS in a year is calculated by:

- working out the value of your benefits immediately before the start of the 'pension input period'
- increasing that value by inflation, and
- comparing it with the value of your benefits at the end of the 'pension input period'.

The 'pension input period' (PIP) is the period over which your pension growth is measured. From 6 April 2016, PIPs for all pension schemes are aligned with the tax year – 6 April to 5 April. Before the 2016/17 year the PIP for the LGPS was 1 April to 31 March. Special transitional rules applied in the 2015/16 year.

In the LGPS the value of your pension benefits is calculated by:

- multiplying the amount of your annual pension by 16
- adding any lump sum you are automatically entitled to from the pension scheme, and
- adding any additional voluntary contributions (AVCs) you or your employer has paid during the year.

If the value of pension benefits at the end of the PIP less the value of your pension benefits immediately before the start of PIP (adjusted for inflation), is more than the AA then you may be liable to pay a tax charge.

The assessment for the AA covers any pension benefits you have where you have been an active member during the year, not just benefits in the LGPS. For example, if the increase in the value of your LGPS benefits was calculated as £30,000 in 2021/22 when the AA was £40,000, but you also had an increase in the value of other pension benefits of £15,000 in the same year, that would mean you had a total increase in pension benefits of £45,000. If you did not have any carry forward, you would be liable for a tax charge for the amount you exceeded the AA by, even though you did not breach the AA in either scheme. You can find out more about carry forward in the next section.

## **Carry forward**

You may be subject to an annual allowance tax charge if the value of your pension savings for a year increases by more than the annual allowance for that year. However, a three year carry forward rule allows

you to carry forward unused AA from the previous three years. This means that even if the value of your pension savings increases by more than the AA in a year, you may not be liable to the AA tax charge.

For example, if the value of your pension savings in 2021/22 increased by £50,000 (i.e. by £10,000 more than the AA) but in the three previous years had increased by £25,000, £28,000 and £30,000, then the amount by which the increase in your pension savings fell short of the AA for those three years would more than offset the £10,000 excess pension saving in the current year. You would not have to pay an AA tax charge.

To carry forward unused AA from an earlier year you must have been a member of a tax registered pension scheme in that year.

## Changes to the annual allowance

Two important changes to the AA were introduced from 6 April 2016:

1. An Annual Allowance taper for high earners
2. 'Pension input period' aligned with the tax year from 6 April 2016.

### 1. Tapered Annual Allowance for higher earners

From the tax year 2016/17 onwards, the AA is tapered for high earning individuals. The AA will be reduced if your 'Threshold Income' and 'Adjusted Income' exceed the limits in a year. For every £2 that your Adjusted Income exceeds the limit, your AA is tapered down by £1. Your AA cannot be reduced below the minimum that applies. The limits that apply changed for the 2020/21 year. Table 2 below shows the limits that apply.

**Table 2 – tapered annual allowance limits**

	Definition	Limit 2016/17 to 2019/20	Limit in 2020/21 onwards
<b>Threshold Income</b>	Broadly your taxable income after the deduction of your pension contributions (including AVCs deducted under the net pay arrangement)	£110,000	£200,000
<b>Adjusted Income</b>	Broadly your threshold income plus pensions savings built up over the tax year	£150,000	£240,000
<b>Minimum AA</b>	If your AA is tapered, the minimum AA that can apply	£10,000	£4,000

Threshold income includes income from all sources of that is taxable e.g. property income, savings income, dividend income, pension income, social security income (where taxable), state pension income etc.

You are not allowed to deduct from taxable income any amount of employment income given up for pension provision as a result of any salary sacrifice made on or after 9 July 2015.

### How does the taper work?

From the 2020/21 year, the taper reduces the AA by £1 for £2 of adjusted income received over £240,000, until a minimum AA of £4,000 is reached. This means that from 6 April 2020 the AA for high earners is as follows:

**Table 3 - The tapered AA from 2020/21 onwards**

Adjusted Income	Annual Allowance
£240,000 or below	£40,000
£250,000	£35,000
£260,000	£30,000
£270,000	£25,000
£280,000	£20,000
£290,000	£15,000

£300,000	£10,000
£312,000 or above	£4,000

Table 4 shows the effect of the tapered annual allowance in the years up to 2019/20.

**Table 4 – The tapered AA from 2016/17 to 2019/20**

Adjusted Income	Annual Allowance
£150,000 or below	£40,000
£160,000	£35,000
£170,000	£30,000
£180,000	£25,000
£190,000	£20,000
£200,000	£15,000
£210,000 or above	£10,000

## Examples

### Sanjay

Gross salary 2019/20	£130,000	
Less employee pension contributions	£14,820	11.4%
Plus taxable income from property	£30,000	
<b>Threshold Income 2019/20</b>	<b>£145,180</b>	
Plus pensions saving in the year	£42,449	
<b>Adjusted Income 2019/20</b>	<b>£187,629</b>	
Sanjay's Threshold income is more than £110,000 and his Adjusted Income is more than £150,000. His AA is tapered for the 2019/20 year.		
Tapered AA	£21,186*	
In excess of AA	£21,263	(£42,449 - £21,186)
<b>AA tax charge</b> at marginal rate	<b>£8,505.20</b>	(marginal rate of 40% assumed)
* Taper = £187,629 - £150,000 = £37,629 ÷ 2 = £18,814 (rounded down)		
Standard AA £40,000 - £18,814 = tapered AA £21,186		

### Cerys

Gross Salary 2020/21	£220,000	
Less employee pension contributions	£27,500	12.5%
<b>Threshold Income 2020/21</b>	<b>£192,500</b>	
Pensions saving in the year	£71,837	
Cerys's Threshold income is less than £200,000. Her AA will not be tapered in 2020/21. Cerys's pension savings will be measured against the standard AA of £40,000.		
Standard AA	£40,000	
Pension savings in excess of AA	£31,837	
<b>AA tax charge</b> at marginal rate	<b>£14,327</b>	(marginal rate of 45% assumed)

### Huang

Gross salary 2020/21	£210,000	
Less employee pension contributions	£26,250	12.5%
Plus taxable income from property	£30,000	
<b>Threshold Income 2020/21</b>	<b>£213,750</b>	
Plus pensions saving in the year	£68,571	
<b>Adjusted Income 2020/21</b>	<b>£282,321</b>	
Huang's Threshold income is more than £200,000 and her Adjusted income is more than £240,000. Her AA will be tapered for the 2020/21 year		
Tapered AA	£18,840*	
In excess of AA	£49,731	
<b>AA tax charge</b> at marginal rate	<b>£22,379</b>	(marginal rate of 45% assumed)
* Taper = £282,321 - £240,000 = £42,321 ÷ 2 = £21,160 (rounded down)		
Standard AA £40,000 - £21,160 = £18,840		

We have made no allowance for any carry forward in the examples above. In working out the pension savings in the year we have assumed:

- inflation adjustment of zero
- the members have no final salary benefits in the LGPS, and
- the members are not paying any additional contributions.

## 2. Aligning the 'Pension Input Period' with the tax year

The 'pension input period' (PIP) is the period over which your pension growth is measured. Until 2014/15, the PIP in the LGPS ran from 1 April to 31 March. From 6 April 2016, PIPs for all pension schemes are aligned with the tax year – 6 April to 5 April. Special transitional arrangements applied for 2015/16.

### Annual Allowance 'Flexible Benefit' access

If you have any benefits in a money purchase (defined contribution) pension arrangement which you have flexibly accessed on or after 6 April 2015, then the Money Purchase Annual Allowance (MPAA) rules may apply. The MPAA will only apply if your total contributions to a money purchase arrangement in a PIP exceed the MPAA.

Generally, if you have flexibly accessed any benefits in a money purchase arrangement on or after 6 April 2015, any further contributions you make to a money purchase scheme in subsequent tax years will be tested against the MPAA. If your contributions exceed the MPAA, your defined benefit pension (LGPS) savings will be tested against the alternative AA and you will pay a tax charge in respect of your money purchase saving in excess of the MPAA.

**Table 5: The Money Purchase Annual Allowance (MPAA)**

Tax Year	MPAA	Alternative annual allowance if MPAA is exceeded
2016/17	£10,000	£30,000
2017/18 onwards	£4,000	£36,000

Special transitional rules applied for the tax year 2015/16 – contact Avon Pension Fund for more information.

If you access flexible benefits you will be provided with a flexible access statement; you should provide your Avon Pension Fund with a copy of this statement.

Flexible access means:

- taking a cash amount over the tax-free lump sum from a flexi-access drawdown account
- taking an uncrystallised funds pension lump sum
- purchasing a flexible annuity
- taking a scheme pension from a defined contribution scheme with fewer than 12 pensioner members, or
- taking a stand-alone lump sum if you have primary but not enhanced protection. A stand-alone lump sum is a lump sum relating to pre 6 April 2006 where the whole amount can be taken as a lump sum without a connected pension.

### How would I pay an annual allowance tax charge?

If you exceed the AA in any year, you are responsible for reporting this to HMRC on your self-assessment tax return.

Avon Pension Fund must notify you if your pension savings in the LGPS (plus the amount of any Additional Voluntary Contributions (AVCs) you may have paid) exceed the standard AA in a year, or if they believe you have exceeded the MPAA in a year. They must inform you by no later than the 6 October which follows the end of the PIP. However, Avon Pension Fund is not obliged to inform you if you exceed the tapered annual allowance.

If you have an AA tax charge that is more than £2,000 and your pension savings in the LGPS alone have increased in the year by more than the standard AA, you may be able to opt for the LGPS to pay some or all of the tax charge on your behalf. The tax charge would then be recovered from your pension benefits.

If you want the LGPS to pay some or all of an AA tax charge on your behalf, you must notify Avon Pension Fund no later than 31 July in the year following the end of the year to which the standard AA charge relates. However, if you are retiring (and take all of your benefits from the LGPS) and you want the LGPS to pay some or all of the tax charge on your behalf from your benefits, you must tell your pension fund before you become entitled to those benefits.

Your pension fund, at their discretion, may also agree to pay some or all of an annual allowance charge on your behalf in other circumstances e.g. where your pension savings are not in excess of the standard AA but are in excess of the tapered or money purchase AA, or where part of the charge relates to pension savings outside of the LGPS. Contact Avon Pension Fund for more information.

### **Am I affected?**

If you think you are affected by the AA more information, is available on the Government's website - <https://www.gov.uk/tax-on-your-private-pension/annual-allowance>. If you are unsure if you will be affected by the AA use the AA quick check tool on the LGPS member website. <https://www.lgpsmember.org/more/aa-quick-check-tool.php>

This factsheet provides an overview of the AA rules and planned changes at June 2022. It should not be treated as a complete and authoritative statement of the law. The rules governing AA can be complex and are subject to change; if you are unsure how to proceed you are advised to obtain independent financial advice. For help in choosing an independent financial advisor visit the money advice website. <https://www.moneyadviceservice.org.uk/en/articles/choosing-a-financial-adviser>

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