ANNUAL ALLOWANCE AND CARRY FORWARD OF UNUSED RELIEFS

What are the 'annual allowance' and the 'money purchase annual allowance' for pensions?

Annual allowance

The annual allowance (AA) is a limit on the amount of tax relief available for pension provision made by or in respect of someone to registered pension schemes for a tax year.

The standard AA is currently £60,000 for those with taxable income less that £200,000.

Money purchase annual allowance

Since 6 April 2015, individuals of pension age can take as much as they want from their money purchase pension pot, when they want it - if the scheme allows it. However, once they take benefits in excess of the tax-free cash this might trigger the money purchase annual allowance (MPAA) of £10,000, which was increased from 6th April 2023.

- They'll still have an overall AA of £60,000
- but no more than £10,000 can be paid to money purchase schemes
- and it won't be possible to carry forward any unused MPAA.

How are pension savings tested against the annual allowance?

To test whether someone's pension savings for a tax year exceeds their AA and if applicable their MPAA, they have to be valued.

What is tested is the total pension input amount - this is the sum of all pension input amounts made within the tax year.

The calculation of the pension input amount depends on the type of scheme:

It is possible, in certain circumstances, to carry forward from the previous three tax years.

What are the annual allowance carry forward rules?

Since tax year 2011/12 it has been possible, subject to certain conditions, to carry forward unused annual allowance from three earlier tax years to the current tax year. This can allow pension provision valued above the standard AA to be made in a tax year without triggering a tax charge.

So, it is necessary to look back at the three years immediately before the 'overpayment' to establish if the excess was covered by a previous carry forward exercise. And, if so, did it use up any unused AA from the earlier year(s) within the current carry forward exercise.

What is the tax charge if the annual allowance is exceeded and how is it paid?

The annual allowance (AA) tax charge is on the excess amount.

The tax charge also applies to those who have accessed their private pension funds by using flexi access and who then exceed their money purchase annual allowance, currently £10,000.

The precise tax rate depends on the rate of income tax someone pays if the 'excess amount' is included in their taxable income for the tax year and treated as the top slice of that income. The appropriate rate is:

- 45% on any of the 'excess amount' that falls into the additional 45% income tax band
- 40% on any of the 'excess amount' that falls into the higher 40% income tax band
- 20% on any of the 'excess amount' that falls into the basic 20% income tax band.

Paying the charge

The AA tax charge is normally collected through the self-assessment process. If someone hasn't been sent a personal tax return but they have a liability to pay the charge, they should notify their tax office. The charge is payable even if the member is not UK resident.

It's sometimes possible for AA tax charges to be paid from pension benefits. This could save them from having to find the money to pay the tax charge during self-assessment. This wasn't possible for tax years before 2011/12.

July 2024