

Annual allowance (AA) – Pension contributions under a defined benefit scheme

The allowance sets the annual contribution an individual can make in any one tax year and receive tax relief at their marginal rate.

The annual allowance is now set at £60,000 gross a year from 6th April 2023, an increase from the previous AA of £40,000. For all individuals whose taxable income, from all sources is less than £200,000, the AA can be claimed in full where their taxable earnings at least match it. However, where taxable income exceeds £200,000 HMRC require further calculations to be made to determine if the allowance remains in full or if it needs to be adjusted down.

Where an individual has more than £200,000 of taxable income, they must add the pension input amount to this figure and if the total exceeds £260,000 your annual allowance will be tapered.

The standard £60,000 annual allowance (AA) will be reduced by £1 for every £2 of 'adjusted income' more than £260,000 until the AA drops to the minimum allowance of £10,000. So, someone with taxable income of £360,000 would see their AA reduced to £10,000.

This lower tapered allowance was previously set at £4,000.

This is relevant if the person is a member of a defined benefit pension scheme, where their pension input amount is not their personal contributions but rather the increase in their benefits, over the course of a year, after allowing for inflation as measured by CPI.

Carry forward – pension contributions

Where individuals have not used their annual allowance in the past three tax years, they can carry forward the unused relief once they have fully used the annual allowance in the current tax year.

The basis for calculating the “contribution” for members of a defined benefit scheme, such as the NHS, is to calculate the increase in the benefits from the start of the tax year (opening value) which is then increased by CPI and compared to the value at the end of the tax year (closing value). The difference is referred to as the **pension input**.

At the same time the different annual allowances are applied to each relevant tax year.

What happens if the annual allowance is exceeded after allowing for carry forward?

If you exceed the maximum contribution allowable you will be liable to a tax charge based on the excess amount.

If the amount is more than £2,000 you have the option to set the charge against your scheme benefits, for defined benefit schemes such as the NHS – Scheme pays – but if it is less than £2,000 you will be required to pay the charge through your tax return.

The tax charge will be based on your marginal rate of income tax rate.

If the payment is to be via Scheme Pays, the deadline for the election is 31st July in the year following the end of the tax year to which the charge relates.

It is important that the annual allowance is presented to your accountant to ensure that any excess is shown on your tax return and that the election for scheme pays is made before the end of the deadline.

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