

Annual Allowance - Frequently Asked Questions

Q1: What is annual allowance?

A1: The annual allowance is the maximum amount by which the value of your pensions savings may increase in any one year before a tax charge applies. This increase is known as the pension input amount (PIA).

Q2: What period is used for annual allowance?

A2: From 6 April 2016, the annual allowance will be measured over the period 6 April to 5 April the following year. This is known as the pension input period (PIP).

Q3: What is the value of the annual allowance?

A3: The annual allowance is currently £40,000; however, from April 2016, if you have a taxable income above £110,000, it may be reduced to a minimum of £10,000.

Q4: When is the annual allowance tested?

A4: The test for annual allowance is made each year. You will receive a pension savings statement in the October, showing the pension input amount if you have exceeded the annual allowance in that year.

Q5: How is the pension input amount calculated?

A5: The opening value is calculated as 16 multiplied by the annual pension plus the tax-free lump-sum at the start of the pension input period increased by the consumer prices index (CPI) as measured at September of the previous year. At the start of the period, the pension is £41,046 and the lump-sum is £92,436.

Opening value is:
 $16 \times \pounds 41,046 + \pounds 92,436 \times 2.7\% = \pounds 769,399.64$

The closing value is calculated as 16 multiplied by the annual pension plus the tax-free lump-sum at the end of the pension input period. At the end of the period, the pension is £46,162 and the lump-sum is £100,050.

Closing value is:
 $16 \times \pounds 46,162 + \pounds 100,050 = \pounds 838,642.00$

The pension input amount = closing value - opening value.
 $\pounds 838,642 - \pounds 769,399.64 = \pounds 69,242.36$

This exceeds £40,000 by £29,242.36 and therefore a tax charge may be payable.

Any AVC contributions paid in the year are then added to this value. If the pension input amount exceeds the annual allowance figure, then a tax charge may be payable.

Q6: What happens if I exceed the annual allowance?

A6: There is a carry forward rule which allows any unused annual allowance from the previous three years to be used, before the annual allowance tax charge is determined.

Q7: What is the amount of the annual allowance tax charge?

A7: The tax charge is calculated at your marginal rate of income tax.

Q8: How is the annual allowance tax charge paid?

A8: It is declared on your self-assessment form and the tax is paid directly to HMRC. If the charge is more than £2,000, you can ask the pension fund to pay the tax charge for you, in exchange for a permanent reduction to your annual pension. This is the 'Scheme Pays' option.

Q9: How does the 'Scheme Pays' option work?

A9: The 'Scheme Pays' option applies a permanent pension deduction which is applied to the pension when it becomes payable. The pension deduction will increase over the period it is applicable from the date the retirement benefits are paid.

Q10: What happens to the pension deduction if I die?

A10: No deduction will be applied to any survivor pension or children's pension.

Q11: What is tapered annual allowance?

A11: From April 2016 a tapered annual allowance will apply. If your "threshold income" is less than £110,000 you will not be affected by the tapered annual allowance. If you have an "adjusted income" of over £150,000, the annual allowance will reduce by £1 for every £2 of income over £150,000 to £10,000 once the adjusted income is £210,000 or more.

Q12: What is 'adjusted income'?

A12: Adjusted income is your net income for the year plus the value of your pension savings in the year.

Q13: What is 'threshold income'?

A13: Threshold income is your net income.

Q14: What is net income?

A14: Net income is all of your taxable income, including bonus and rental income, it does not include any pension contributions.

Q15: Where can I find more information?

A15: You can obtain further information on annual allowance by visiting the HMRC web site at:
www.gov.uk/tax-on-your-private-pension/annual-allowance

You may wish to seek independent financial advice if you think you are affected.