



North East Scotland Pension Fund
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GUIDE TO

Annual Allowance

There are 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 factsheet looks at Annual Allowance. For information on the lifetime allowance please refer to the Lifetime Allowance factsheet.

What is the Annual Allowance?

Annual Allowance (AA) is the amount your pension benefits may increase by 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) exceed the annual allowance limit, the excess will be taxed as income.

The AA limit for most members is £40,000 however from 6 April 2016 the AA limit will be reduced or tapered for higher earners. Tapering is covered in more detail later in this factsheet.

Am I likely to be affected by the Annual Allowance?

Most people will not be affected by the AA tax charge because the value of their pension saving 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:

- you have a lot of scheme membership and you receive a significant pay increase, and/or;
- you pay a high level of additional contributions, and/or;
- you are a higher earner, and/or;
- you transfer pension rights into the LGPS from a previous public sector pension scheme¹ under the preferential club transfer rules and your salary (full time equivalent) upon joining the LGPS is somewhat higher than the salary you earned when you left the previous scheme, and/or;
- 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 leaving and re-joining the scheme, and/or;
- you have accessed flexible benefits on or after 6 April 2015

The North East Scotland Pension Fund will inform you if your LGPS pension savings exceed the AA limit in any year by no later than 6 October of the following year.

¹ A public service pension scheme includes a pension scheme covering civil servants, the judiciary, the armed forces, any scheme in England, Wales or Scotland covering local government workers, or teachers, or health service workers, or fire and rescue workers or members of the police forces; or membership of a new public body pension scheme.

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, whilst still retaining full life and ill health cover. Visit the [LGPS member website](#) for more information on this option.

Before taking 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 [MoneyHelper](#) website.

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 the value by inflation and then 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 will be aligned with the tax year – 6 April to 5 April. Prior to the 2016/17 the PIP for the LGPS was 1 April to 31 March, except for 2015/16 when special transitional rules apply.

In the LGPS, the value of your pension benefits is calculated as such:

Annual Pension X 16 + any lump sum + any AVCs paid by you or your employer in the year

If the difference in 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 limit then you may have to pay a tax charge.

PLEASE NOTE: 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 when the AA limit 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 (see below for more information), you would be liable for a tax charge on the amount you exceeded the AA limit by, even though at face value you did not breach your AA limit in either scheme.

Carry forward

You would only be subject to an AA tax charge if the value of your total pension savings for a year increase by more than the AA limit 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 increase by more than the AA limit in a year, you may not have to pay an AA tax charge.

For example, if the value of your pension savings in 2019/20 increased by £50,000 (i.e. by £10,000 more than the AA limit) but in the three previous years had increased by £25,000, £28,000 and £30,000, then the amount by which each of the previous 3 years fell short of the AA limit would more than offset the £10,000 excess pension saving in the current year. There would be no AA tax charge to pay in this case.

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 Annual Allowance

Two important changes to the AA come into force from 6 April 2016.

1. **An annual allowance taper for high earners -this was further changed in April 2020**
2. **To adjust the 'pension input period' during 2015/16 so that it becomes aligned with the tax year**

1. Tapered Annual Allowance for higher earners

From the tax year 2016/17 onwards, the AA will be 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 (to a minimum of £4,000).

| | Definition | Limit 2016/17-2019/20 | Limit 2022/23 |
|-------------------------|---|--------------------------|------------------|
| Threshold Income | Broadly your taxable income after the deduction of your pension contributions (including AVCs deducted) | £110,000 | £200,000 |
| Adjusted Income | Broadly your threshold income plus pensions savings built up over the tax year | £150,000 | £240,000 |
| Minimum AA | If your AA is tapered, the minimum AA that can apply | £10,000 | £4,000 |

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

Please note, 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?

The taper reduces the AA by £1 for every “2 of adjusted income received over the £240,000, until a minimum AA of £4,000 is reached. This means that from 6 April 2016 the AA for high earners will be as follows:

| 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 |

Examples

JOHN

| | | |
|--|-----------------|--|
| Gross Salary 2019/20 | £130,000 | |
| Less employee pension contributions | £14,820 | Contribution Rate 11.4% |
| Plus taxable income from property | £30,000 | |
| Threshold Income 2019/20 | £145,180 | Above the £110,000 limit |
| Pension savings in the year | £42,449 | |
| Adjusted Income 2019/20 | £187,629 | Above the £150,000 limit so this AA will be tapered |
| Tapered AA | £21,186* | |
| In excess of AA | £21,263 | Calculated as £42,449 - £21,186 |
| AA Tax Charge (assumed at marginal rate of 40%) | £8,505 | |

*Taper = £187,629 - £150,000 = £37,629/2 = £18,814. Standard AA £40,000 - £18,814 = Tapered Allowance of £21,186

CERY'S

| | | |
|-------------------------------------|-----------------|-------------------------|
| Gross Salary 2020/21 | £220,000 | |
| Less employee pension contributions | £27,500 | Contribution Rate 12.5% |

| | | |
|--|-----------------|---|
| Threshold Income 2020/21 | £192,500 | Below the £200,000 limit, so AA will not be tapered and will be measured against the standard AA of £40,000 |
| Pensions saving in the year | £71,837 | |
| Standard AA | £40,000 | |
| Savings in excess of AA | £31,837 | Calculated as £71,837 - £40,000 |
| AA Tax charge at member's marginal rate (assumed 45%) | £14,327 | |

SARAH

| | | |
|--|-----------------|-------------------------------------|
| Gross Salary 2020/21 | £210,000 | |
| Less employee pension contributions | £26,250 | Contribution Rate 12.5% |
| Plus taxable income from property | £30,000 | |
| Threshold Income 2020/21 | £213,750 | Above £200,000 Threshold Limit |
| Plus pensions saving in the year | £68,571 | |
| Adjusted Income 2020/21 | £282,321 | Greater than £240,000 so AA tapered |
| Tapered AA | £18,840* | |
| Amount in Excess of AA | £49,731 | |
| AA Tax charge at member's marginal rate (assumed 45%) | £22,379 | |

*Taper = £282,321 - £240,000 = £42,321/2 = £21,160. Standard AA £40,000 - £21,160 = Tapered Allowance of £18,840

Please note, the examples above make no allowance for any carry forward and assume an inflation adjustment of zero. The pension savings in the year are based on the assumption that the members have no final salary benefits in the LGPS and that they 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. Up until 2014/15 the PIP in the LGPS ran from 1 April to 31 March. From 6 April 2016, PIPs for all pension schemes will be aligned with the tax year – 6 April to 5 April. Special transitional arrangements apply for 2015/16 meaning that there are 2 PIPs in 2015/16, as set out below:

Pre-alignment tax year: 1 April 2015 to 8 July 2015 - the revised AA limit during this period is £80,000

Post-alignment tax year: 9 July 2015 to 5 April 2016 - the AA limit for this period is the amount of the £80,000 not used up from the pre-alignment tax year (subject to a maximum of £40,000) together with any carry forward available from the three previous years.

If you have flexibly accessed any benefits in a money purchase pension arrangement on or after 6 April 2015 (see below) you should contact the Pension Fund for information about how the pre and post alignment tax years will work as it will be different to the above.

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. However, the MPAA will only apply if your total contributions to a money purchase arrangement in a Pension Input Period 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.

| 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 the Pension Fund for more information, if applicable.

If you access flexible benefits you will be provided with a flexible access statement; you should provide the 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 (UFPLS), 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 protection².

How would I pay an Annual Allowance tax charge?

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

The North East Scotland Pension Fund is obliged to notify you if your LGPS benefits (plus the amount of any Additional Voluntary Contributions (AVCs) you may have paid) exceed the AA limit or if we believe you have exceeded the MPAA in a year. We will notify you by 6 October of the following tax year. We are 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 AA limit 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 the Pension Fund no later than 31 July in the year following the end of the year to which the AA charge relates. However, if you are retiring (and draw 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 the 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 your 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>.

This factsheet provides an overview of the AA rules and planned changes at April 2022. It should not be treated as a complete and authoritative statement of the law. The rules governing AA can be complex and

² 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

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 [MoneyHelper](#) website.

More information

If you have any questions about your LGPS membership or benefits, please contact:

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Level 1, 2MSq
Marischal Square
Broad Street
Aberdeen
AB10 1LP

Helpdesk: (01224) 264 264
Email: pensions@nespf.org.uk
Website: www.nespf.org.uk

DISCLAIMER

The information in this guide is based on the Local Government Pension Scheme (Scotland) Regulations 2018 and other relevant legislation. It applies to people who were contributing members of the Local Government Pension Scheme on 1 April 2015 or who have since joined the Scheme. This guide was up-to-date at the time of publication in 2022. It is for general use and cannot cover every personal circumstance, nor does it cover specific protected rights that apply to a very limited number of employees. In the event of any dispute over your pension benefits, the appropriate legislation will prevail as this guide does not confer any contractual or statutory rights and is provided for information purposes only.