Annual Allowance Factsheet

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.

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. This is in addition to any income tax you pay on your pension once it is in payment.

If the value of your pension savings in any one year (including pension savings outside of the LGPS (NI)) is in excess of the Annual Allowance limit, the excess will be taxed as income.

The Government reduced the AA limit 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 AA were made for higher earners from 6 April 2016.

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)

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 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 (NI) that was built up in the final salary section (built up before 1 April 2015 or you transferred in membership from another public sector pension scheme[1] 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.

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

- You transfer pension rights into the LGPS (NI) from a previous public sector pension scheme under the preferential Club transfer rules and your salary (full-time equivalent) on joining the LGPS (NI) is higher than the salary you earned when you left the previous scheme.
- You combine a previous LGPS (NI) pension benefit that was built up in the final salary section of the LGPS (NI) with your current pension account and your salary (full-time equivalent) has increased significantly since you left the Scheme.
- You have accessed flexible benefits on or after 6 April 2015.

If your LGPS (NI) pension savings exceed the standard AA in any year ending 5 April, NILGOSC will contact you by 6 October to let you know.

The 50/50 section of the LGPS (NI)

If you wish to slow down your pension build up, the 50/50 section of the LGPS (NI) allows you to pay half your normal contributions and build up half your normal pension, whilst still retaining full life and ill-health cover. Visit the NILGOSC website for more information on this 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 MoneyHelper website.

How is the Annual Allowance calculated?

The increase in the value of your pension savings in the LGPS (NI) 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
- 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 were aligned with the tax year – 6 April to 5 April. Before 2016/17 the PIP for the LGPS (NI) was 1 April to 31 March, except for the year 2015/16 when special transitional rules applied.

In the LGPS (NI) 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 need to pay a tax charge.

The assessment for the AA covers any pension benefits you may have where you have been an active member during the year, not just benefits in the LGPS (NI). For example, if the increase in the value of your LGPS (NI) benefits was calculated as £30,000 in 2020/21 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 for the amount you exceeded the AA by, even though you did not breach the AA in either scheme.

Carry Forward

You may be subject to an AA tax charge if the value of your pension savings for a year increased by more than the AA 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 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.

Example:

If the value of your pension savings in 2021/22 increased by £50,000 (£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 limit 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.

Changes to Annual Allowance

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

- An Annual Allowance taper for higher earners
- The ‘pension input period’ was aligned with the tax year

1. Tapered Annual Allowance for higher earners

From the tax year 2016/17 onwards, the AA is tapered for high earning members. 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, the AA is tapered down by £1. Your AA cannot be reduced below the minimum that applies. The limits changed from the 2020/21 year.

Table 2 on the following page shows the limits that apply.

Table 2 - Tapered annual allowance limits

	Definition	Limits 2016/19 - 2019/20	Limits for 2020/21 onwards
Threshold Income	Broadly your taxable income after the deduction of your pension contributions (including AVCs deducted under the net pay arrangement)	£110,000	£200,000
Adjusted Income	Broadly your threshold income plus pensions savings built up over the tax year	£150,000	£240,000
Minimum Annual Allowance (AA)	If your AA is tapered, the minimum AA that can apply	£10,000	£4,000

Threshold income includes income from all sources that are 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 6 April 2020, the taper reduces the AA by £1 for every £2 of adjusted income over £240,000, until a minimum AA of £4,000 is reached. This means that from 6 April 2020 the AA for higher earners will be as follows:

Table 3 - The tapered annual allowance 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 annual allowance 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

Example one (under limits for 2019/20)

Trevor has a gross salary in 2019/20 of £120,000 and his pension contributions are £12,600, 10.5% of his wage. Trevor's Threshold Income is £107,400 (£120,000 - £12,600), this is below the £110,000 limit so the AA will not be tapered for 2019/20. Trevor's pensions savings in the year are worth £39,184, which is less than the standard AA, so a tax charge does not apply.

Example two (over limits for 2019/20)

Sinead has a gross salary in 2019/20 of £130,000, and her pension contributions are £13,650, 10.5% of her wage. Sinead also has taxable income from property of £30,000. This gives Sinead a Threshold Income of £146,350. Sinead's pension savings are worth £42,449, so she has an Adjusted Income of £188,799 (£146,350 + £42,499). Sinead's Threshold Income is more than £110,000 and her Adjusted Income is more than £150,000.

Her AA is tapered for the 2019/20 year is:

(£188,799 - £150,000) / 2= £19,399.

Tapered AA: £40,000 less £19,399 = £20,601

Sinead has exceeded the annual allowance by £21,848 (Pension saving of £42,449 less tapered AA of £20,601). This means Sinead must pay an annual allowance tax charge at marginal rate (assumed to be 40%) of £8,739.20 (£21,848 x 40%).

Example three

Terry earns a gross salary for 2020/21 of £220,000 and his pension contributions are £23,100, 10.5% of his wage. Terry's threshold income for 2020/21 is (£220,000 - £23,100) = £196,900, this is below £240,000 so the AA will not be tapered for 2020/21 and remains at £40,000. His pension savings for the year are £39,184, this is less than £40,000, so no tax charge applies to Terry.

Example four

Emily earns a gross salary of £210,000 in 2020/21, and her pension contributions are £22,050, 10.5% of her wage. Emily also has taxable income from property of £30,000. Emily's threshold income of £217,950 is greater than £200,000. Her pension savings for the year are £68,571, is her adjusted income is £286,521. This is greater than £240,000 so AA will be tapered, this is calculated as follows:

(£286,521 - £240,000) / 2 = £23,260

Standard AA: £40,000 less £23,260 = £16,740

The pension savings of £68,571 less the tapered annual allowance of £16,740 is the amount that Emily has exceeded the AA: £68,571 - £16,740 = £51,831.

Emily will then have to pay an annual allowance tax charge at marginal rate (assumed to be 45%): £51,831 x 45% = £23,324.

Please note that these examples 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 Trevor, Sinead, Terry and Emily have no final salary benefits in the LGPS (NI) 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. Until 2014/15, the PIP in the LGPS (NI) 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 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 PIP exceed the MPAA.

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 (NI)) 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 please contact NILGOSC if you require more information on these rules.

If you access flexible benefits you will be provided with a flexible access statement; you should provide NILGOSC 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.

NILGOSC must notify you if your pension savings in the LGPS (NI) (plus the amount of any AVCs you have paid) exceed the standard AA in a year, or if we believe you have exceeded the MPAA in a year. We must inform you by no later than 6 October of the following tax year. NILGOSC is not obliged to tell you if you have exceeded the tapered AA.

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

If you want the LGPS (NI) to pay some or all of an AA tax charge on your behalf, you must notify NILGOSC 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 take all of your benefits from the LGPS (NI)) and you want the LGPS (NI) to pay some or all of the tax charge on your behalf from your benefits, you must tell us before you become entitled to those benefits.

NILGOSC, at its 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 (NI). You must contact NILGOSC before 31 December of the end of the year in which the tax charge arises if you wish to explore this option (i.e. if the tax charge relates to 2020/21 you must contact us before 31 December 2021).

Am I affected?

If you think you are affected by the AA, more information including an AA checking tool, is available on the Government's website - Tax on your private pension.

This factsheet provides an overview of the AA rules at July 2021. 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 MoneyHelper website.

More information

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

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Tel: 0345 3197 320 Email: info@nilgosc.org.uk