The annual allowance charge

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The annual allowance was introduced with A day in the 2006/07 tax year. The essential principle of the allowance is to limit the amount of 'Tax privileged' pension savings an individual can accrue each tax year. The limit applies to all pension savings, including those made by the individual themselves, by their employer or any other third party. The annual allowance is not a restriction on the amount of tax relief given when the savings are made, but works by applying a tax charge when the allowance is exceeded.

The client will always be personally liable for this tax, regardless of whether the contribution was made by them, their employer or someone else. They may have to pay this directly to HMRC or, in some cases, it may be possible to pay it from their pension account – this is known as 'Scheme Pays'. All pension schemes must facilitate payment of the tax charge when requested to if certain conditions are met – this is known as 'Mandatory Scheme Pays'.*

Some providers, including ourselves, are more flexible and can facilitate payment of the charge when the mandatory conditions are not met. This is known as 'Voluntary Scheme Pays'.

The annual allowance charge – the basics

The annual allowance applies to savings in occupational and personal pension schemes made by an individual, their employer and on their behalf by someone else. If the person goes over an annual allowance once all their pension savings have been added together, they may have to pay an annual allowance tax charge. The amount of the charge will depend on the excess amount, how much the person has earned in the tax year and whether they have any unused annual allowance they can carry forward to reduce or potentially eliminate the charge.

A client's annual allowance will depend on certain factors. It will be a very personal figure for the client, as it will be based on the current tax year's annual allowance, plus the value of any unused allowances carried forward from the previous three tax years and the person's tax liability.

The current standard annual allowance is £60,000, but this could be lower, as shown by the table on the right.

Type of annual allowance	
The standard annual allowance	
From 6 April 2023, this applies to everyone who isn't affected by the tapered annual allowance or Money Purchase Annual Allowance (MPAA).	**£60,000**
The standard annual allowance, prior to 6 April 2023, for everyone who isn't affected by the tapered annual allowance or money purchase annual allowance.	**£40,000**
The tapered annual allowance	
From 6 April 2023 their annual allowance will be reduced by £1 for every £2 of 'adjusted income' above £260,000. This is subject to a minimum of £10,000 for those who had Adjusted income of £360,000 or more.	**A sliding scale from £60,000 down to the minima shown**
For those affected by the tapered annual allowance, from 6 April 2020 their annual allowance will be reduced by £1 for every £2 of 'adjusted income' above £240,000. This is subject to a minimum of £4,000 for those with Adjusted Income of £312,000 or more.	**A sliding scale from £40,000 down to the minima shown**
Please see our factsheet on tapered annual allowance for further details of how tapering works.	

Money purchase annual allowance (MPAA)

Clients that have triggered the MPAA will have an 'inner' restriction on the amount of pension savings that can be made to money purchase arrangements. This will not reduce the client's overall annual allowance but will limit the annual allowance available on pension savings to money purchase arrangements to £10,000. Any unused allowance cannot be carried forward to future tax years.

Please be aware that if a client triggers the MPAA during a tax year, the MPAA applies from that point onwards and for subsequent tax years and they may need to measure their contributions against two or three annual allowances.

*It may not always be possible, in certain situations, when entering the scheme or if the scheme is under Pension Protection Fund assessment.

Calculating the charge

If, after following the process below, either the annual allowance or money purchase annual allowance have been exceeded, then a tax charge will be calculated on the excess amount for the tax year in question. Broadly speaking, the charge will be calculated by notionally adding the excess amount to the client's taxable income for the year and charged at the client's marginal rate (or rates if an income tax threshold is crossed). The annual allowance excess will not have any effect on reducing or removing the client's personal income tax allowance.

Case Study 1 – calculating the charge

Scenario 1: Total annual earnings of £90,000

Mike's employer has contributed £80,000 to his pension arrangement during the 2023/24 tax year. He has the standard annual allowance of £60,000 available and has no unused allowances to carry forward from previous years. His total taxable income for the year is £90,000.

2023/24 £80,000 pension contribution → **£60,000 standard annual allowance** → **No unused allowances to carry forward** → £80,000 – £60,000 = **£20,000 of excess contribution** → Taxed at the higher rate (40%) → **Annual allowance charge** £20,000 x 40% = **£8,000**

Scenario 2: Total annual earnings of £115,140

Had Mike's taxable income before the charge been £115,140, half of the excess would be charged at the higher rate (40%) and half would be charged at the additional rate (45%). This is because the £20,000 excess contribution is notionally added to his total annual earnings of £115,140, taking him over the threshold for additional rate tax of £125,140.

2023/24 £80,000 pension contribution → **£60,000 standard annual allowance*** → **No unused allowances to carry forward** → £80,000 – £60,000 = **£20,000 of excess contribution** →

- Half the excess taxed at the higher rate (40%) → **Higher rate charge** £10,000 x 40% = **£4,000**
- Half the excess taxed at the additional rate (45%) → **Additional rate charge** £10,000 x 45% = **£4,500**

Annual allowance charge £4,000 + £4,500 = **£8,500**

The above examples are based on UK Income Tax rates. Rates for Scottish and Welsh residents differ.

* This is on the assumption that tapering does not apply.

Paying the charge

If a charge is due, then the next step is deciding how to pay it.

1. **Direct payment to HMRC** In some circumstances, the client may choose or have to pay the charge directly to HMRC themselves, typically through self-assessment.

2. **Scheme Pays** It may be possible for the client to pay some or all of the charge from their pension account. This is often more palatable for the client and may also offer a pecuniary tax advantage. This is particularly relevant where the lifetime allowance is also a consideration. However, the other side to this equation is that pension benefits will be reduced. This may be simple to understand and calculate for a money purchase arrangement, but may be very complex and sometimes quite punitive for a defined benefit arrangement.

Scheme Pays

There are two types of Scheme Pays. Depending on the amount of the charge, how the charge arose and the client's circumstances, they may have access to one, both or neither of them.

Mandatory Scheme Pays

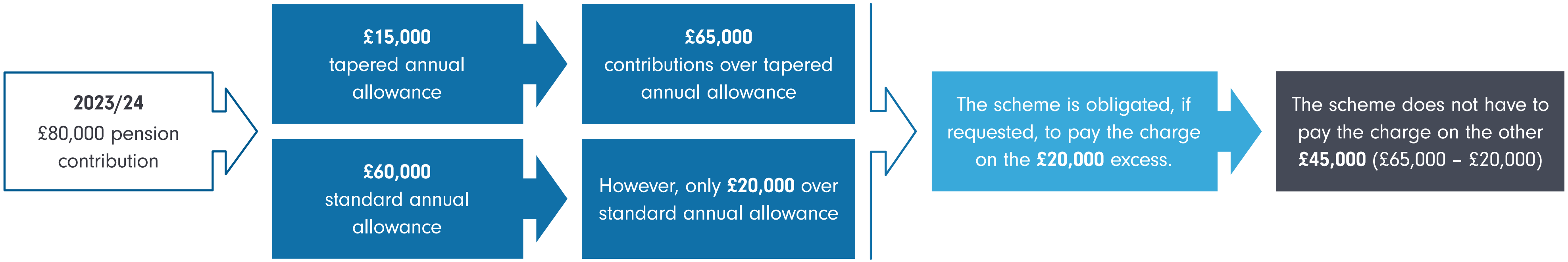
If certain conditions are met, the pension scheme must fulfil requests to pay the charge from the pension and it will become jointly and severally liable with the client for some or all of the tax charge. However, this option is available in a limited number of circumstances:

- When the person's total annual allowance charge is over £2,000* and
- The client has exceeded the standard annual allowance for the pension scheme in the same tax year (for this purpose the tapered annual allowance and MPAA are ignored).

* There is no minimum that the client can ask the scheme to pay but if this is less than £2,000 then they will need to confirm to the scheme that their total annual allowance tax charge liability is greater than £2,000.

Case Study 2 – Mandatory Scheme Pays

Sarita has put £80,000 into one of her pensions and has a tapered annual allowance (TAA) of £15,000.



The above example is based on UK Income Tax rates. Rates for Scottish and Welsh residents differ.

Mandatory Scheme Pays does not apply when:

- The client has an overall charge of less than £2,000 **and/or**
- The client has exceeded the tapered annual allowance and/or the MPAA, but the contributions paid into the pension scheme has not exceeded the £60,000 standard annual allowance.

It partially applies when:

- The client has exceeded the tapered annual allowance or the MPAA and has exceeded the £60,000 standard annual allowance. In this situation, it will only cover any charge on the excess contributions in the pension scheme over £60,000.

Voluntary Scheme Pays

Any pension scheme can offer Voluntary Scheme Payments but many do not. Where a scheme does offer this facility, there are no minimums and the scheme can pay any annual allowance tax charge even if the charge is not in relation to pension savings to that arrangement and will determine the criteria for acceptance. In fact, it may even be possible to transfer benefits to an arrangement in order to facilitate this. However, where Voluntary Scheme Pays is offered, the scheme will never become jointly and severally liable for the charge and it remains the sole liability of the client. As such, the reporting and payment deadlines for Voluntary Payments are different to Mandatory Payments.

Voluntary Scheme Payments are available with our pension.

Deadlines for Scheme Pays requests

If a client wants to use the Scheme Pays facility, the deadlines for the request must be adhered to. If the deadline is missed, then the option may not be available. The deadlines for Scheme Pays requests for our pension are shown below.

For Voluntary Scheme Pays, the deadline ensures there is enough time for the tax charge to be received by HMRC, by the deadline for personal tax of 31 January following the end of the tax year. The client should wait to receive confirmation that the scheme is prepared to and has paid the tax charge before they submit their self-assessment form (this is not necessary for Mandatory Scheme Pays as, if the conditions are met, the scheme is obliged to pay the tax charge).

Where the client does not have all of the relevant information to calculate the charge, it is possible to pay an estimated tax charge. This would need to be corrected when the information is received.

Scheme Pays deadlines

Mandatory Scheme Pays	Voluntary Scheme Pays
You must submit a request by 31 July in the year after the tax year when the charge became due. So, if you exceed the standard annual allowance in the 2023/24 tax year, you have until the 31 July 2025 for the transaction to be completed	You must submit a request by 31 August* in the same year when the charge becomes due. So, if you exceed an annual allowance in the 2023/24 tax year, you have until the 31 August 2024 to get in touch with us. This will allow us to take the money out of your pension and pay the charge (within the periods that pension schemes must abide to) before the deadline for self-assessment.

* Please note: this is a deadline specified by Fidelity not HMRC.

Next steps for Scheme Pays requests

If a client has a pension from which they wish to pay an annual allowance tax charge – and are within the relevant deadline – you can request a Scheme Pays form on their behalf.

- Once you have completed and returned the Scheme Pays form on behalf of your client, we will arrange for the charge to be paid to HMRC directly within 45 days of the end of the reporting quarter. Note that a form will be required for each scheme pays type for each specific charge amount.
- You or your client will need to complete the relevant sections of their self-assessment form or notify HMRC directly.

Notifying HM Revenue & Customs (HMRC)

The relevant excess amount (after deducting available carry forward of unused annual allowance if permissible) above an annual allowance needs to be input to section 10 of the ‘Pension Savings Tax Charges’ part of an individuals self-assessment. If your client does not complete a self-assessment, they will need to notify HMRC directly.

If scheme pays is used to pay some or all of the charge, individuals will need to compete sections 11 and 12.

Important information

This guide provides information and is only intended to provide an overview of the current law in this area and does not constitute financial advice, tax advice or legal advice, or provide any recommendations.

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