

How does the annual allowance work?

LET'S TALK HOW.

ANNUAL ALLOWANCE

Pensions are a tax-efficient way to save for your retirement but the amount of tax relief you receive on your contributions each year is generally restricted to your earnings and the annual allowance.

IN THIS GUIDE WE COVER:

- What the annual allowance is and how it works
- How to check your contributions towards the allowance
- What happens if you exceed it
- How you may be able to make higher tax efficient pension contributions in this tax year



The annual allowance and how it works

There is no limit on the amount you can save into your pension each year, but there is a limit on the amount of tax relief you can receive on your contributions. This is known as the annual allowance (AA) and contributions can be from yourself, your employer or made on your behalf by somebody else. In the tax year 2018-19, the annual allowance is £40,000 for most people and this amount includes the value of any tax relief that is added to the contributions (we explain this in more detail on page 4). Tax treatment depends on individual circumstances and all tax rules may change in the future. Normally, you cannot take money out of a pension until you are 55.

If you have already taken money from your pension pot using the pension freedoms or have income of more than £110,000 per year, your annual allowance may be reduced. See our [**money purchase annual allowance**](#) (MPAA) and [**tapered annual allowance**](#) (TAA) guides for more details. You can find them at: [**fidelity.co.uk/allowances**](https://www.fidelity.co.uk/allowances).

The annual allowance applies across all of the pension schemes you are a member of.

- This includes any personal pensions you may have and any work-place schemes you may be a member of (not forgetting any salary related schemes - often referred to as defined benefit/final salary schemes).
- It doesn't include any state pension.

Tax relief can only be given if you have relevant earnings that match or are more than the size of your total contributions. For example:

Jaymini has earnings of £35,000. She pays in a gross amount of £37,500 to a pension she has in a single tax year. Although this is still below the annual allowance of £40,000 it is above the amount of her earnings and so she is only eligible to receive tax relief on £35,000.

If the contributions to your pensions exceed the annual allowance, a tax charge ('the annual allowance charge') may become payable which effectively claws back any excess tax relief that was given. If your taxable earnings in the relevant tax year are below the annual allowance then tax relief on all the contributions made to your pension, including any from an employer, are limited to 100% of your earnings. However, if you have low or no earnings, you can still pay in up to £2,880 and benefit from tax relief (this will become £3,600 after tax relief is claimed by the provider).

It may also be possible to pay in more than the annual allowance (but **not** your earnings for the tax year) and still **not** be subject to a tax charge by making use of something called 'carry forward'. We explain this below in the section on page 6, titled '**Is there a way to invest more than the annual allowance and still receive tax relief?**'

Checking your contributions towards the annual allowance

The period that contributions are now checked against is the tax year (06 April to 05 April) for all schemes. You need to include contributions made by you, an employer or somebody else (including increases in benefits to defined benefit schemes) to any pension plan registered in your name. **Make sure you account for the value of any tax relief that is added by your pension provider** (which will depend on the type of scheme that you are in). The two main types are:

- Money purchase (defined contribution - such as personal and workplace) pensions and
- Salary related (defined benefit/final salary) pensions.



Money purchase (defined contribution) pensions

In a money purchase (defined contribution) pension you build up a pension pot to provide retirement income based on contributions from you and/or your employer.

In these types of schemes you need to total up the gross value of all of the payments made by you, an employer or anybody else on your behalf. This sounds simple, but is not quite as straightforward as it seems. **This is because you need to be mindful of how your pension scheme applies tax relief.** There are two ways this can be done and usually the method used will be determined by the type of pensions you have.

Personal Pensions

Personal pensions, including self invested personal pensions (SIPPs) and stakeholder pensions and those provided through the workplace like a group personal pension must use the 'relief at source' method. Here basic rate tax relief (currently 20%) is always applied to contributions that you or anybody other than an employer, pay on your behalf. The annual allowance is based on the gross contribution amount. You can calculate the gross contribution amount you intend to pay by dividing the net contribution amount by 0.80 (100% - 20%). This is the amount that will appear in your account shortly after the contribution has been paid.

For example: if you made personal contributions of £800 to a personal pension such as a SIPP, tax relief of 20% (currently) is applied automatically (though not necessarily immediately), so the gross contribution in this example is £1,000. This is the relief at source method and for these, it is the date the contribution is paid, not invested that counts.



Employer contributions however are always paid gross. So in this scenario £800 paid in from an employer would equate to £800 for annual allowance purposes. This includes any contributions paid under a salary sacrifice arrangement you may have with your employer.

In this example, your total for annual allowance purposes would be £1,800 when adding the personal contributions and employer contributions together.



If you pay more than the basic rate of tax, any extra tax relief that might be available to you may be claimed directly with HM Revenue & Customs and **does not count** for annual allowance purposes.

Workplace Pensions

Some other workplace pensions, which are known as trust based plans are usually dealt with slightly differently. They will typically use the 'net pay' method. In these schemes the pension contributions are taken from your gross pay before income tax is calculated. This means any tax relief is given straightaway and does not need to be claimed back from HMRC.

So, if we use the same figures from the previous example, we get a slightly different outcome. In this case, if you make a personal contribution of £800 to a workplace pension, there will be no tax

relief automatically added. The total pension contribution for annual allowance purposes would therefore be £800. When added to the employer contribution this will be £1,600 instead of £1,800.

For example:



We provide more detail on how tax relief is given in our [tax relief guide](#).

Salary related schemes (defined benefit/final salary schemes)

The calculations for salary related schemes are different. These pensions usually provide a retirement income based on your salary and how long you have worked for your employer. Defined benefit pensions include 'final salary' and 'career average' pension schemes. Nowadays these are generally only available from public sector or older workplace pension schemes. In this type of pension, it is the value of any increases to the annual benefits you may be expected to receive at retirement that count as contributions for annual allowance purposes. If you are a member of one of these schemes, you should speak with your pension provider for details of the 'pension input amounts' for the current and three former tax-years.

What doesn't count as a contribution?

Transferring your contribution from one pension to another is not usually considered as a contribution towards your annual allowance. However, the contributions made into the pension before it was transferred would still need to be counted for annual allowance purposes.

Building up benefits in the state pension scheme does not count towards annual allowance.

Reduced annual allowances

As of 06 April 2016, and for subsequent tax years, the annual allowance was reduced for some high earners (this could affect you if you earn £110,000 or more). If this applies to you, your annual allowance across all your pension schemes could be less for that year. Please read our [Tapered annual allowance factsheet](#) for more details.

In addition, if you have already taken benefits from a money purchase pension scheme, a lower money purchase annual allowance (MPAA) may apply to you. If you need to know more about these restrictions, you may find our [MPAA factsheet](#) helpful. You can find both of these at: [Fidelity.co.uk/allowances](https://www.fidelity.co.uk/allowances).

What happens if I exceed the annual allowance?

If you go over your annual allowance you will normally face a tax charge. In other words, your excess contribution will be subject to your marginal rate of income tax (generally the highest rate at which you pay tax). The amount of the charge is determined and normally paid through the income tax self-assessment process.

It may be possible for the charge to be deducted directly from your pension savings although specific conditions usually need to be met (this is known as 'Scheme Pays' and you will have to make a formal request to your pension scheme provider). **Do be aware that even if the charge is paid by your scheme, you will need to include details of this on your self-assessment.**

Please remember that it is your responsibility to monitor if your annual allowance is exceeded and for notifying HMRC, if applicable, that an annual allowance charge is due.

Is there a way to invest more than the annual allowance and still receive tax relief?

Potentially, yes. If you earn enough and haven't put the maximum amount into all of your pensions in the previous three tax years, you may be able to use up your unused annual allowances. This is known as 'carry forward'. The annual allowance was £40,000 for the 2017/18 and 2016/17 tax years (unless you were subject to a tapered or money purchase annual allowance). Special rules were in operation for the 2015/16 tax year meaning it may have been possible to pay in as much as £80,000 depending on when payments were made in the tax-year.

There are a number of rules which apply to carrying forward unused allowances and so you may find our '[carry forward factsheet](#)' helpful. You can find it at: [fidelity.co.uk/allowances](https://www.fidelity.co.uk/allowances)

If you are subject to the tapered annual allowance (TAA) you may still be able to use carry forward but only in relation to unused allowance measured against your TAA. See our tapered annual allowance guide if you need more information.

Note that once you become subject to the money purchase annual allowance it is no longer possible to use carry forward to make higher contributions from this point onwards, although if you have a salary-related scheme (defined benefit/final salary scheme) it may still be possible in relation to these schemes.

How do I maximise contributions in this tax year?

If you want to make any tax-efficient pension contributions in this tax year, you can do so, by 05 April 2019. For a workplace pension, it may be possible to arrange to make any additional contributions by contacting your employer and/or payroll provider.

Summary of the annual allowance

- It is the maximum level of pension contributions that will receive tax relief each tax year (or, to put it a different way, the maximum level of contributions before you face a tax charge) subject to having sufficient earnings in a tax year.
- It applies to work-based and personal pensions, including final salary (defined benefit) and money purchase (defined contribution) pensions. State pension benefits do not count.
- It applies to contributions you make, plus those from your employer and any made on your behalf by someone else, such as a partner or parent. **Don't forget to include the value of any tax relief that is added by your pension provider** (which will depend on the type of scheme that you are in).
- Unless you are subject to the tapered annual allowance, money purchase annual allowance or using carry forward, £40,000 is the total amount that would qualify for tax relief subject to having sufficient earnings in the tax year.
- If you stay within the annual allowance, you benefit from full tax relief (as long as you are also within 100% of your relevant earnings for the tax year).
- If you go over an annual allowance once all the contributions to your pensions have been added together, you may have to pay a charge. Note, there is a separate Lifetime Allowance that limits how much you can save in pensions overall. For more information on this, read our [Lifetime Allowance guide](#) available at: fidelity.co.uk/allowances
- The amount of the annual allowance charge will depend on the amount you have gone over the allowance by and how much you have earned in the tax year.

The three (or four) allowances		Limits	
		2017/18 tax year	2018/19 tax year
1	The standard annual allowance This applies to everyone who isn't affected by the specific rules for the allowances 2 and 3 below.	£40,000	£40,000
2	The tapered annual allowance If you earn more than £150,000 in adjusted income, your annual allowance reduces by £1 for every £2 over this level – all the way down to a minimum of £10,000. See our tapered guides for full details.	A sliding scale from £40,000 down to £10,000	A sliding scale from £40,000 down to £10,000
3	The money purchase annual allowance Once you have taken taxable income from your pension pot using pension freedoms, your annual allowance for contributions to money purchase pensions is reduced.	£4,000	£4,000
4	If you are an active member in a final salary scheme, an alternative annual allowance is available for building up benefits in those schemes. Note that it may also be affected by the tapered annual allowance. Please speak to your scheme administrator for details.	£36,000	£36,000

HOW CAN FIDELITY HELP?



If you would like to discuss your pension account or anything covered in this guide, please call the Pensions Service Centre on 0800 368 6868.

You can also visit [fidelity.co.uk/pensions](https://www.fidelity.co.uk/pensions) or speak to an authorised financial adviser.

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