Tax limits – Annual Allowance

This guide provides you with information about the Annual Allowance. This tax limit could potentially affect anyone who saves towards their retirement but is most likely to affect those with high levels of (or high increases in) pensionable pay or with a long period of service in their pension scheme, or anyone who makes a large additional contribution to their pension savings over the course of a year. This is only a broad summary of pension taxation law. Any requirement for you to pay tax charges on pension savings is governed by legislation, not this or other leaflets.

In this guide you will find more information about:

What the Annual Allowance is

The Annual Allowance is a limit on the amount of your pension savings that can benefit from tax relief each year. The most that you can save tax-free towards all your pension arrangements, in a single 'Pension Input Period', is the lower of 100% of your earnings over that period and the Annual Allowance.

The Pension Input Period for the Railways Pension Scheme and the British Transport Police Force Superannuation Fund runs from 6 April in one year to 5 April in the following year (i.e. in line with the tax year).

How the Annual Allowance affects you

The Annual Allowance for the 2016/17 tax year is £40,000, however, this will be reduced for people who have an "adjusted income" of over £150,000. This is referred to as the Tapered Annual Allowance. Furthermore, if and when you receive a lump sum or income from a defined contribution pension arrangement, an Annual Allowance of £10,000 might apply to some or all of your future pension savings. This is referred to as the Money Purchase Annual Allowance. Information on these allowances is given in this guide.

Should the increase in your pension savings be more than the Annual Allowance in a single year, you may be able to make use of any unused amount of Annual Allowance from the previous three tax years. However, you will be liable to pay tax on the pension savings you make which are in excess of the total of the Annual Allowance and any unused allowance you have from the previous three tax years. Any tax charges will be based on the rate of tax you would have to pay if the excess pension savings were added to your taxable income.

The government announced special measures for the 2015/16 tax year which enabled the Tapered Annual Allowance to be introduced from 6 April 2016. As a result of these 'transitional' measures, some people may have been able to make some further pension savings in excess of the Annual Allowance of £40,000 (and their unused carry forward) without incurring a tax charge, but only in the 2015/16 tax year. You will find more information about the Tapered Annual Allowance and the carry forward rule in this guide.

If you want to consider whether your pension savings will exceed the Annual Allowance, you need to understand how increases in your pension savings are worked out so that you can check them against the Annual Allowance. The way increases in pension savings are valued will depend on the type of pension arrangement you are a member of. There are two main types of pension arrangements available:

- Defined benefit (also known as 'final salary' or 'career average'); and
- Defined contribution (also known as 'money purchase')

With defined benefit arrangements, the amount of your pension is usually based on your pay and length of service. If you are a member of a defined benefit arrangement, then please refer to the section on ‘Pension savings under a defined benefit arrangement’.

With a defined contribution arrangement, you will not know in advance how much your benefits will be when you retire. Instead you build up a pension pot that is used to provide a lump sum and/or an income in retirement. If you are a member of a defined contribution arrangement, then please refer to the section on ‘Pension savings under a defined contribution arrangement’. If you have already received a lump sum or income from a defined contribution arrangement and are continuing to build up funds in a pension pot, this might have an impact on your Annual Allowance and you should refer to the section on the ‘Money Purchase Annual Allowance’.

Further information about the Annual Allowance can be found at https://www.gov.uk/tax-on-your-private-pension

Pension savings under a defined benefit arrangement

For defined benefit pension arrangements, the Pension Input Amount is measured by the increase in your benefit entitlement each Pension Input Period.

The increase in your benefits is worked out by taking the value of your pension and any lump sum at the start and end of the Pension Input Period. The difference, in excess of Consumer Prices Index (CPI) inflation, between the two amounts represents the growth in your benefits over the period. The growth in your scheme pension is multiplied by a factor of 16 and the growth in your scheme lump sum is then added to this figure. The total is your Pension Input Amount.

If your Pension Input Amount is greater than the Annual Allowance, you may be able to use any unused amount of Annual Allowance from the previous three tax years to offset your excess savings. However, if your pension savings exceed the Annual Allowance and any unused allowance you have from the previous three tax years, then you will have to report this to HM Revenue & Customs (HMRC) in a Self Assessment tax return. You will then have to pay tax on the amount in excess of the Annual Allowance and any unused Annual Allowance from the previous three years.

If you make contributions to Additional Voluntary Contribution (AVC) arrangements, such as BRASS or AVC Extra, then these also count towards the Annual Allowance amount but on a different basis because both BRASS and AVC Extra are treated as defined contribution arrangements. If and when you receive a lump sum or income from a defined contribution arrangement, your future pension savings might be subject to a lower Annual Allowance.

Example* – working out increases in your ‘pension savings’

For Annual Allowance purposes, the pension savings for a tax year are those made in the Pension Input Period. The Scheme and Fund’s Pension Input Periods run from 6 April one year to 5 April the next (i.e. in line with the tax year).

Working out the value as at 6 April		
Average pensionable pay	£25,000	a year
Amount of pensionable membership	24	years
Scheme pension	£6,500	a year
Scheme lump sum	£15,000	
Multiply annual rate of Scheme pension by factor of 16: £6,500 x 16	£104,000	
Add the Scheme lump sum to work out the opening value of your Scheme benefit entitlement: £104,000 + £15,000	£119,000	
Increase by Consumer Price Index (CPI) (in this example 3%): £119,000 x 1.03	£122,570	

Working out the value as at the following 5 April		
Average pensionable pay	£30,000	a year
Amount of pensionable membership	25	years
Scheme pension	£8,800	a year
Scheme Lump sum	£18,750	
Multiply annual rate of Scheme pension by factor of 16: £8,800 x 16	£140,800	
Add the Scheme lump sum to get the closing value of your benefit entitlement: £140,800 + £18,750	£159,550	
If you also make contributions to Additional Voluntary Contributions (AVCs) such as BRASS or AVC Extra these count towards the Annual Allowance amount, but on a different basis. In this example AVC contributions totalled	£2,000	

Your pension savings ('Pension Input Amount')

£159,550 - £122,570 + £2,000 £38,980

In this example, you would not have exceeded the standard £40,000 Annual Allowance limit and you would have £1,020 (i.e. £40,000 - £38,980) to carry forward from this Pension Input Period under the 'three-year carry forward' rule (explained later in this guide).

If you are entitled to other pension benefits from other sources (such as other pension arrangements in the Railways Pension Scheme or other pension arrangements outside the Railways Pension Scheme or British Transport Police Force Superannuation Fund), you will also need to find out how much your pension benefits have grown in each of these other sources. Then you need to add all of them together, before you can do the check against the Annual Allowance.

* This example is for illustrative purposes only. Your entitlement to benefits from the Scheme or Fund is governed by the pension Trust Deed and Rules, not this leaflet

There are various factors that can affect the level of growth in your pension and lump sum benefits each year. The main ones are:

Your level of 'Pensionable Pay' and 'Pensionable Restructuring Premiums'

As your Pensionable Pay and Pensionable Restructuring Premiums (if you have them) increase, so do your pension benefits and, as has already been mentioned, the growth in benefits will count towards the Pension Input Amount.

The legislation surrounding the calculation of the Pension Input Amount means that any increase in your benefits in line with inflation, as measured by the Consumer Prices Index (CPI), is ignored for Annual Allowance purposes.

If you receive a significant increase to your Pensionable Pay and/or Pensionable Restructuring Premiums above the level of CPI inflation, the growth in your benefits will be higher. The Pension Input Amount which counts towards your Annual Allowance will be higher in the Pension Input Period.

Your length of Scheme or Fund membership

As your membership in the Scheme or Fund increases, your pension benefits grow and your Pension Input Amount may be higher. For example, if you have many years of membership, the impact of any Pensionable Pay and/or Pensionable Restructuring Premium increase above CPI inflation will be much greater than for somebody with little membership.

In line with HMRC rules, when calculating your pension savings in the Scheme or Fund, benefits that have been transferred-out of the Scheme or Fund will be taken into account in the year the transfer takes place. Transfers-in to the Scheme or Fund will not be counted in the year the transfer takes place. Therefore, your pension savings in the Scheme, Fund and any other pension arrangements will not be "double-counted". If you transfer-in pension benefits from another pension arrangement, then any additional membership you purchase as a result will be included in calculating your pension savings in the Scheme or Fund in the years after the year of transfer.

Pension savings under a defined contribution arrangement

The Pension Input Amount for a defined contribution arrangement is simply the total of contributions paid into the arrangement during the Pension Input Period. This includes any contributions:

- you have paid to the arrangement;
- your employer has paid to the arrangement; or
- paid by someone else on your behalf.

Any investments returns are not included in Pension Input Amount.

If your Pension Input Amount is greater than the Annual Allowance, you may be able to use any unused amount of Annual Allowance from the previous three tax years to offset your excess savings. However, if your pension savings exceed the Annual Allowance and any unused allowance you have from the previous three tax years, you will have to report this to HM Revenue & Customs (HMRC) in a Self Assessment tax return. You would then have to pay tax on the amount in excess of the Annual Allowance and any unused Annual Allowance from the previous three years.

If you are entitled to other pension benefits from other sources (such as other pension arrangements in the Railways Pension Scheme or other pension arrangements outside the Railways Pension Scheme or British Transport Police Force Superannuation Fund) you will also need to find out how much your pension benefits have grown in each of these other sources. Then you need to add all of them together, before you can do the check against the Annual Allowance.

If and when you receive a lump sum or income from a defined contribution arrangement, your pension savings might be subject to the Money Purchase Annual Allowance.

Example – working out your Pension Input Amount in a defined contribution arrangement

For Annual Allowance purposes, the pension savings for a tax year are the pension savings made in the Pension Input Period. The Scheme and Fund's Pension Input Periods run from 6 April to 5 April (i.e. in line with the tax year).

Employee Scheme contributions*	£10,000
Employee Additional Voluntary Contributions	£1,000
Employer contributions	£15,000
Your pension savings ('Pension Input Amount')	**£26,000**

In this example, the standard £40,000 Annual Allowance limit was not exceeded.

Therefore, £14,000 is available to carry forward from this Pension Input Period under the 'three-year carry forward' rule (explained below).

*This includes any contributions your employer pays on your behalf as part of a salary sacrifice arrangement.

The Tapered Annual Allowance

Anyone with "adjusted income" over £150,000 will have their Annual Allowance reduced by £1 for every £2 of adjusted income over £150,000, up to a maximum reduction of £30,000. This is referred to as the Tapered Annual Allowance.

Due to the taper, people with adjusted income of £210,000 or more will have an Annual Allowance of £10,000.

For this purpose, adjusted income is typically based on:

- A person's taxable income from employment and non-employment (including income from personal assets, such as property and shares); plus
- The level of that person's pension savings, as measured by the Pension Input Amount.

Typically, people with a taxable income below £110,000 will not be subject to the new taper. However, the government has introduced measures to prevent salary sacrifice arrangements put in place on or after 9 July 2015 from being used to move people below this threshold.

Because adjusted income includes the level of a person's pension savings, some people may be subject to an Annual Allowance tax charge even though their gross earnings are below the £150,000 threshold and their pension savings are below the standard £40,000 Annual Allowance (as is shown in the following example).

Example – working out your Tapered Annual Allowance

Working out your adjusted income	
Pensionable pay	£110,000
Non-pensionable pay (e.g. bonus)	£25,000
Other income (e.g. rental income)	£10,000
Gross earnings	£145,000
Your pension contributions	£15,000
Taxable income (i.e. Gross earnings – tax-free contributions):	
£145,000 - £15,000	£130,000
Your Pension Input Amount	£35,000
Your adjusted income:	
£130,000 + £35,000	£165,000
Working out your Tapered Annual Allowance	
Adjusted income above £150,000 threshold:	
£165,000 - £150,000	£15,000
Tapered Annual Allowance:	
£40,000 – [£15,000 / £2]	£32,500
Excess pension savings above the Tapered Annual Allowance	
(before any allowance for carry forward):	
£35,000 - £32,500	£2,500

The three-year carry forward rule

You can carry forward any Annual Allowance that you have not used from the previous three tax years to the current tax year. The amount of the unused Annual Allowance can then be added to your current year's Annual Allowance to give you a higher available amount of tax-free pension savings. This rule may allow you to make occasional large amounts of pension savings without having to pay an Annual Allowance charge.

The three-year carry forward applies whether you are subject to the standard Annual Allowance of £40,000 or a Tapered Annual Allowance of between £10,000 and £40,000 (in which case the amount available to carry forward will be based on the unused Tapered Annual Allowance). However, the three-year carry forward does not apply directly to people who are subject to the Money Purchase Annual Allowance of £10,000. More information about the Money Purchase Annual Allowance can be found later in this guide.

You should note that the three-year carry forward is based on the fact that, for everyone, the Annual Allowance was £40,000 in the 2014/15 tax year and £50,000 in years prior to 2014/15 (since the Tapered Annual Allowance and Money Purchase Annual Allowance did not exist).

Example:

This table shows for three previous tax years, the Annual Allowance limit, the Pension Input Amount used by a particular person in each tax year and the amount of Annual Allowance that was not used in those tax years.

Tax year	Annual Allowance limit	Pension Input Amount used	Annual Allowance not used
2015/16	£40,000	£35,000	£5,000
2014/15	£40,000	£30,000	£10,000
2013/14	£50,000	£25,000	£25,000
TOTAL	**£130,000**	**£90,000**	**£40,000**

In this example, at the end of this three-year period the person had £40,000 of unused Pension Input Amount to carry forward to the following year.

Money Purchase Annual Allowance of £10,000

From 6 April 2015, if you start to take money from a defined contribution pension arrangement, this might trigger a lower Annual Allowance of £10,000. This limit is known as the Money Purchase Annual Allowance ('money purchase' being another term for 'defined contribution') and it only applies to pension savings in defined contribution arrangements. So, if you also have a defined benefit pension, you can still receive tax relief on pension savings of up to £40,000 a year.

Whether the new lower £10,000 Annual Allowance applies will depend on how you access your pension pot. An explanation of the rules regarding this can be found at https://www.gov.uk/tax-on-your-private-pension/annual-allowance. However, as a general guide, the main situations when you might trigger the Money Purchase Annual Allowance are if you:

- take all of your defined contribution pension pot as a lump sum;
- start to take ad-hoc lump sums from your defined contribution pension pot;
- put your defined contribution pension pot into an income drawdown fund and start to take an income;
- were in a flexible drawdown arrangement before 6 April 2015; or
- use your pension pot to buy an annuity contract under which the income can be reduced (an annuity is an insurance product that gives you a guaranteed income for life).

You won't trigger the Money Purchase Annual Allowance if you:

- take a tax-free cash lump sum and buy an annuity where the annual rate of income cannot be reduced (other than in permitted circumstances); or
- receive a small lump sum payment if your defined contribution pension pot is worth less than £10,000.

Once the Money Purchase Annual Allowance is triggered, it remains for all future Pension Input Periods for new defined contribution pension savings.

Testing against the Money Purchase Annual Allowance

If the Pension Input Amount relating to your defined contribution pension savings does not exceed the £10,000 Money Purchase Annual Allowance, then the test for your entire Pension Input Amount (from all arrangements, including pension savings in defined benefit schemes) are compared against your Annual Allowance (i.e. the standard Annual Allowance of £40,000 or, depending on the level of your Adjusted Income, the Tapered Annual Allowance of between £40,000 and £10,000 for 2015/16) and any unused Annual Allowance from the previous three tax years.

However, if the Pension Input Amount from your defined contribution pension savings exceeds the Money Purchase Annual Allowance, then you will have to pay a tax charge. The amount subject to the tax charge is the higher of:

A Your defined benefit Pension Input Amount
\+ Your defined contribution Pension Input Amount
\- Your Annual Allowance *plus* any unused Annual Allowance from the previous three tax years (where the total of the sum above is subject to a minimum of zero)

AND

B Your defined benefit Pension Input Amount *less* your 'Alternative Annual Allowance'* plus any unused Annual Allowance from the previous three tax years (subject to a minimum of zero)
\+ Your defined contribution Pension Input Amount *less* the Money Purchase Annual Allowance

*where your Alternative Annual Allowance = your (Tapered) Annual Allowance less the Money Purchase Annual Allowance

Impact on the three-year carry forward rule

You can't carry forward any unused Money Purchase Annual Allowance to offset against the defined contribution pension savings in another tax year.

Where the Money Purchase Annual Allowance has been triggered and, for the tax year in question, the defined contribution Pension Input Amount does not exceed £10,000, the amount of unused Annual Allowance available to carry forward to future Pension Input Periods is calculated under the normal rules.

If the defined contribution Pension Input Amount does exceed £10,000, then the unused Annual Allowance available to carry forward is calculated by reference to the defined benefit Pension Input Amount and your Alternative Annual Allowance, where your Alternative Annual Allowance is your (Tapered) Annual Allowance less the Money Purchase Annual Allowance (i.e. it is a limit between £30,000 and £0, depending on the level of your adjusted income).

Example – testing pension savings against the Money Purchase Annual Allowance

The following examples show how the rules above are applied:

Example 1

Defined benefit pension savings	£32,000
Defined contribution pension savings	£5,000
Total Pension Input Amount	£37,000
Annual Allowance[1]	£40,000

In this example, the defined contribution pension savings do not exceed the Money Purchase Annual Allowance of £10,000, so we test the entire Pension Input Amount against the person's Annual Allowance of £40,000. The person would not have exceeded this limit and has unused allowance to carry forward to the next tax year:

Unused Annual Allowance to carry forward £40,000 - £37,000 = £3,000

Note 1. This person is not subject to the Tapered Annual Allowance.

Example 2	
Defined benefit pension savings	£18,000
Defined contribution pension savings	£17,000
Total Pension Input Amount	£35,000
Carry forward of unused Annual Allowance from previous years	£12,000
(Tapered) Annual Allowance	£30,000
Defined benefit excess[1]	£18,000 - (£30,000 - £10,000 + £12,000) = £0
Defined contribution excess	£17,000 - £10,000 = £7,000
Total excess subject to tax[2]	**£7,000**
Unused Annual Allowance to carry forward	£20,000 - £18,000 = £2,000

Note 1. This amount cannot be less than zero. Here the sum = -£14,000, so we set the amount equal to zero.

Note 2.The total excess subject to tax is calculated using method B above and is greater than the total calculated under method A, which is: £18,000 + £17,000 – (£30,000 + £12,000) = 0 (because this total cannot be less than zero).

Paying tax on excess pension savings

If your Pension Input Amount in a particular Pension Input Period exceeds the Annual Allowance (after allowing for any unused Annual Allowance from any of the three previous years) or your Pension Input Amount for your defined contribution arrangements exceeds the Money Purchase Annual Allowance, if this limit is relevant to you, then you will have to pay a tax charge on the excess.

If you have to pay tax, there are two ways to do this. You can either:

- pay the amount required direct to HM Revenue & Customs (HMRC); or
- use the ‘Scheme pays’ option (if you qualify).

Whichever option you choose, you need to inform HMRC of the action you are taking by completing a Self Assessment tax return by 31 January following the end of the tax year, in line with HMRC requirements. If you choose to pay any tax charge direct to HMRC, this will also have to be done at the same time. If you wish to use the ‘Scheme pays’ option, you will need to submit a ‘Scheme pays’ notice to the Scheme or Fund by the 31 July immediately after the HMRC Self Assessment deadline.

If this applies to you, then we recommend that you read the available guide on ‘Paying tax on pension savings over the Annual Allowance limit’ for more information about this. This includes a copy of the ‘Scheme pays’ notice. It is available at www.railwayspensions.co.uk/resources/read-as-you-need or www.btppensions.co.uk. Alternatively, ring the Helpline on 0800 2 343434.

Transitional measures for 2015/16

The Tapered Annual Allowance was introduced from 6 April 2016 and the government announced transitional measures for the 2015/16 year. The aims of these measures were to:

- align all Pension Input Periods with the tax year (although the Pension Input Periods for the Scheme and Fund are already in line with the tax year, there are other pension schemes where this is not the case); and
- protect pension savings that individuals have already made from any retrospective tax charges.

These measures will apply to members of the Scheme and Fund, even though these schemes already have their Pension Input Periods in line with the tax year.

The transitional measures include the stopping of all Pension Input Periods in progress on 8 July 2015 (the date on which the government announced these changes to the Annual Allowance) and the creation of a one-off Pension Input Period between 9 July 2015 and 5 April 2016. Pension savings for these periods will be measured as follows:

- Pension Input Periods that ended within the 2015/16 year had a combined Annual Allowance of £80,000, reflecting the possibility that some people may have used their standard £40,000 Annual Allowance prior to 9 July 2015 for a Pension Input Period that was expected to end in the 2016/17 year.
- Depending on the level of pension savings made in the period up to 8 July 2015, up to £40,000 of the above allowance could have been used within the Pension Input Period from 9 July 2015 to 5 April 2016. The rule applying here is that the level of tax-free pension savings permitted in the period from 9 July 2015 to 5 April 2016 was the lesser of: £80,000 less the amount of pension savings in the period up to 8 July 2015; and £40,000.

The values of pension savings under a defined benefit arrangement, for use in the transitional calculations, was the total pension savings over both the Pension Input Period to 8 July 2015 and the period from 9 July 2015 to 5 April 2016 (calculated using the usual method for defined benefit arrangements, as explained earlier in this guide) allocated to each Pension Input Period on a proportionate basis. Therefore, roughly a quarter of your 2015/16 Pension Input Amount in respect of defined benefit accrual within the Scheme or Fund would have been allocated to the period up to 8 July 2015 and the remaining three-quarters was allocated to the period from 9 July 2015.

Another feature of the transitional measures is that the opening value of the defined benefit pension savings will be increased by 2.5%, rather than by the rate of inflation for September 2014, which was 1.2%.

For a defined contribution arrangement, the values of the pension savings to use in the transitional calculations will be the total of contributions paid into the arrangement during the relevant Pension Input Period.

Helpline: **0800 2 343434**
Website address: **www.railwayspensions.co.uk or www.btppensions.co.uk**
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We recommend that you get independent financial advice before making any important decisions about your pensions arrangements.

Read as you need