

Pensions: The Annual and Lifetime Allowances

Each year the Government sets the maximum level of tax-free contributions that can be paid into to a pension and being in breach of these allowances can lead to some tough tax penalties. There are two allowances to be aware of.



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1. The Annual Allowance

The maximum amount that can be contributed to a pension each year and which is eligible for tax relief is called the Annual Allowance. For 2021/22 this is £40,000 which can be a combination of your own contributions and your employer contributions. To check whether you're reaching the annual allowance limit, you need to add up all your annual contributions **including** any tax relief added separately by HMRC. (*Remember that you only have one annual allowance, regardless of how many schemes you may have.*)

Note: If you are in a defined benefit pension linked to your salary, the calculation is not as simple and you should ask your employer or pension scheme provider to check your position. We can also assist with this calculation.

Higher Earners

There are additional rules for those on higher incomes, as the Annual Allowance is 'tapered' for individuals with 'adjusted' income of more than £240,000 (£150,000 in 2016/17 to 2019/20).

Adjusted Income – refers to your entire taxable income for the tax year, i.e. your salary plus any additional income such as bonus, benefits in kind (P11ds), rental income, interest, dividends, etc, plus the value of any employer contributions (which includes any employer contributions as a result of a salary exchange arrangement).

Tapering - means that for every £2 of income over £240,000, the annual allowance is reduced by £1 up to a maximum reduction of £36,000*. Individuals will still have an Annual Allowance of at least £4,000* as illustrated in the table below:

Adjusted Income	Annual Allowance
Up to £240,000	£40,000
£270,000	£25,000
£300,000	£10,000
£312,000 or greater	£4,000

*maximum reduction of £30,000 so at least £10,000 Annual allowance in 2016/17 to 2019/20

Threshold Income

Individuals with lower salaries who may have one off spikes in their employer pension contributions will not normally be subject to the tapered Annual Allowance. Instead a threshold income of £200,000* (which excludes pension contributions) will apply. However, anti-avoidance rules will also apply so that any salary sacrifice set up on or after 9 July 2015 will be included in the threshold definition. (**£110,000 in 2016/17 to 2019/20*)

The 'Carry Forward' Option

If you pay the maximum contribution for the current tax year, then you are able to carry forward any unused Annual Allowance from the 3 previous years. However, you must have been a member of a registered pension scheme in those years which you wish to carry forward.

If you have already taken an income from your pension using the new retirement flexibility rules introduced in April 2016, your Annual Allowance could already be restricted to £4,000 per annum and carry forward of unused Annual Allowance from the previous 3 years would not be available.

You *may* therefore be effected if

- a. your total income is greater than £240,000, and
- b. your total annual pension contributions exceed £4,000

Bear in mind that future wage increases could take you over the limit if you are already on a high salary.

Important Note – The maximum tax relievable contribution that an *individual* can pay to pensions each tax year is 100% of their relevant earnings or £3,600 whichever is the greater. This is subject to an overall maximum of the Annual Allowance together with any unused annual allowances from the previous 3 years.

2. The Standard Lifetime Allowance

The standard lifetime allowance, is, as its name implies, the maximum pension fund you can build up during your lifetime that is free of tax charges.

This amount normally increases each year in line with the Consumer Price Index and currently stands at £1,073,100. It will remain at this level until 2025/26. Unless you have some form of lifetime allowance protection, amounts over this limit are taxable: 55% if paid as a lump sum, or 25% if paid as an income.

Even if your pension pot is below the lifetime allowance but a reasonable size nonetheless, you may wish to refer to the tables over the page, which illustrate the investment growth that would be needed to reach the current standard lifetime allowance.

In certain circumstances it is possible to retain a higher Lifetime Allowance of £1.25m and would be possible if:

- the value of your pension savings at 6th April 2016 were in excess of £1m, *or*
- Since 6th April 2016 you/your employer will no longer pay any pension contributions in the future.

A Word of Caution

In some circumstances it may be worth continuing your pension contributions and paying the tax penalty anyway, for instance where your contributions are largely or entirely financed by your employer. However, you should seek professional advice and check all the implications carefully before taking any action.

There is clearly a lot to consider. For more information or assistance please get in touch with us on 01789 263257 or email us at justask@jffsltd.com

Information in this document is valid for tax year 2021/22

Annual growth rate required to fund for £1,073,100

Existing Fund Value \ Term to Retirement	5 years	10 years	15 years	20 years
£100,000	60.74%	26.78%	17.14%	12.60%
£200,000	39.93%	18.29%	11.85%	8.76%
£300,000	29.03%	13.59%	8.87%	6.58%
£400,000	21.82%	10.37%	6.80%	5.06%
£500,000	16.50%	7.94%	5.22%	3.89%
£600,000	12.33%	5.99%	3.95%	2.95%
£700,000	8.92%	4.36%	2.89%	2.16%
£800,000	6.05%	2.98%	1.98%	1.48%
£900,000	3.58%	1.77%	1.18%	0.88%

Growth rate shown is the compound annual rate payable at the beginning of each year

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Annual growth rate required to fund for £1,073,100
(Assuming you pay an ongoing contribution of £40,000 p.a.)

Term to Retirement Existing Fund value	5 years	10 years	15 years	20 years
£100,000	37.72%	11.67%	4.61%	1.50%
£200,000	26.44%	8.20%	2.96%	0.57%
£300,000	19.25%	5.72%	1.69%	-0.19%
£400,000	14.04%	3.78%	0.65%	-0.83%
£500,000	9.98%	2.20%	-0.22%	-1.37%
£600,000	6.69%	0.86%	-0.98%	-1.86%
£700,000	3.92%	-0.30%	-1.64%	-2.29%
£800,000	1.54%	-1.31%	-2.23%	-2.68%
£900,000	-0.53%	-2.22%	-2.77%	-3.04%

Growth rate shown is the compound annual rate payable at the beginning of each year

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