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
How the Annual Allowance affects you
Pension savings under a defined benefit arrangement
Pension savings under a defined contribution arrangement
The Tapered Annual Allowance
The three-year carry forward rule
The Money Purchase Annual Allowance (which may apply if you have already taken payment from a defined contribution pension arrangement)
Paying tax on excess pension savings

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 had been increased from £40,000 to £60,000 with effect from 6 April 2023(this is subject to further changes in the future), however, this will be reduced for people whose taxable income is more than £200,000 and who have an "adjusted income" of over £260,000. 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, a separate Annual Allowance might apply to some or all of your future defined contribution pension savings that is currently £10,000. 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.

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 or your employer 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	
Scheme pension		

Scheme Lump sum	£8,800 £18,750	years a year
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 or your employer 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 £60,000 Annual Allowance limit and you would have £21,020 (i.e. £60,000 - £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.

Retirement options

If, when you retire, you choose the level pension option and elect to receive a higher pension from the Scheme or Fund until your State Pension Date and a lower pension thereafter, then the value of your benefits at the end of the Pension Input Period in which you retire will be based upon the higher pension figure. This means that the Pension Input Amount that counts towards your Annual Allowance (AA) will be greater than it would otherwise have been.

Similarly, if you have already left the Scheme or Fund but don't want to start receiving your Scheme or Fund benefits until after your Normal Pension Age, then you may be entitled to receive an uplift to your benefits on retirement to take into account their late payment. However, this increase will be greater than normally permitted for pension scheme members under tax legislation and you will have a higher Pension Input Amount in respect of the tax year in which you retire.

If your Pension Input Amount is greater than the AA and any unused AA from the previous three tax years, then you will have to pay a tax charge.

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 (AA) from the previous three tax years to offset your excess savings. However, if your pension savings exceed the AA 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 AA and any unused AA 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 AA.

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 AA 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 £60,000Annual Allowance limit was not exceeded.

Therefore, £34,000 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

From 6 April 2023, anyone with a taxable income exceeding £200,000 and an “adjusted income” over £260,000 will have their Annual Allowance reduced by £1 for every £2 of adjusted income over £260,000, up to a maximum reduction of £50,000 for anyone with an adjusted income of £360,000 or more. This is referred to as the Tapered Annual Allowance.

Previously, from 6 April 2016 up to 5 April 2020, the taxable income limit was £110,000, the adjusted income limit was £150,000 and the maximum reduction to the standard Annual Allowance was £30,000. From 6 April 2020, both the taxable income limit and the adjusted income limit were increased by £90,000. Until 5 April 2023, this gave a taxable income limit of £200,000 and an adjusted income limit of £240,000 respectively. Before 6 April 2023, the maximum reduction to an individual’s Annual Allowance was £36,000 for anyone with an adjusted income of £312,000 or more.

The level of the allowance available to you under the Tapered Annual Allowance will depend on the combination of the level of your pension savings and the level of your taxable income. Depending on these factors, the Annual Allowance for the 2023/24 tax year onwards may be as low as £10,000 or as high as £60,000.

For this purpose, adjusted income in any tax year is typically based on:

- A person’s taxable income from employment and non-employment (including income from personal assets, such as bank interest, dividends and property income); plus
- The amount of any pension contributions that person has paid via a net pay arrangement (i.e. an arrangement where the employer deducts the pension contribution from the person’s gross pay before tax is calculated); plus
- The level of that person’s pension savings, as measured by their Pension Input Amount(s), less any pension contributions that they or their employer have paid which received tax relief (i.e. not just those paid under a net pay arrangement).

Typically, people with a taxable income below £200,000 will not be subject to the 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 £260,000 threshold and their pension savings are below the standard £60,000Annual Allowance.

As we do not have details of your taxable income or the elements that will make this up, we suggest that you carry out an assessment of what your available Annual Allowance may be, based on an estimate of what your threshold income and adjusted income may be. There are various calculation tools and apps on the internet that may be able to assist you.

Example – working out your Tapered Annual Allowance

Working out your adjusted income	
Pensionable pay	£240,000
Non-pensionable pay (e.g. bonus)	£35,000
Other income (e.g. rental income)	£10,000
Gross earnings	£285,000
Your pension contributions	
- paid into occupational pension scheme via net pay arrangement	£15,000
- paid into personal pension scheme using tax relief at source.	£5,000
Taxable income (i.e. Gross earnings less pension contributions deducted before tax):	
£285,000 - £15,000	£270,000
Your Pension Input Amount:	

Your adjusted income: £270,000 + £15,000 + (£45,000 - £15,000 - £5,000)	£45,000 £310,000
Working out your Tapered Annual Allowance Adjusted income above £260,000 threshold: £310,000 - £260,000 Tapered Annual Allowance: £60,000 – [£50,000 / £2] Excess pension savings above the Tapered Annual Allowance (before any allowance for carry forward): £45,000 - £35,000	 £50,000 £35,000 £10,000

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 £60,000 or a Tapered Annual Allowance of between £10,000 and £60,000 (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, which has been increased to £10,000 with effect from 6 April 2023. More information about the Money Purchase Annual Allowance can be found later in this guide.

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
2023/24	£60,000	£35,000	£25,000
2022/23	£40,000	£30,000	£10,000
2021/22	£40,000	£25,000	£15,000
TOTAL	**£140,000**	**£90,000**	**£50,000**

In this example, at the end of this three-year period the person had £50,000 of unused Pension Input Amount to carry forward to the following year.

The Money Purchase Annual Allowance

The Money Purchase Annual Allowance ('money purchase' being another term for 'defined contribution') was introduced from 6 April 2015, and if you start to take money from a defined contribution pension arrangement, this might trigger a lower Annual Allowance. For example, it might apply if you take some benefits, carry on working and continue to make pension contributions.

The Money Purchase Annual Allowance only applies to future contributions made by you or your employer into defined contribution arrangements, which includes BRASS, AVC Extra and the IWDC section of the RPS. This has been increased from £4,000 to £10,000 with effect from 6 April 2023.

Whether the lower Money Purchase 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 a fixed-term annuity contract under which the income can be reduced (an annuity is an insurance product that gives you a guaranteed income for life or for a fixed term).

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

- are a DB member and take your BRASS funds as part of your main scheme benefits.
- take a tax-free cash lump sum and buy a lifetime annuity where the annual rate of income cannot be reduced (other than in permitted circumstances); or
- put your defined contribution pension pot into an income drawdown fund and don't start to take an income from it.
- receive a small lump sum payment if your occupational scheme defined contribution pension pot is worth less than £10,000, or receive a small lump sum payment of less than £10,000 from non-occupational defined contribution pension pots unless you have already received 3 other small lump sum payments; or

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 any defined contribution pension savings made by you or your employer (including BRASS, AVC Extra and the IWDC section of the RPS) does not exceed the Money Purchase Annual Allowance, then your entire Pension Input Amount (from all arrangements, including pension savings in defined benefit schemes) is tested against your Annual Allowance (i.e. the standard Annual Allowance of £60,000 or, depending on the level of your Adjusted Income, the Tapered Annual Allowance of between £10,000 and £60,000 for 2023/24 onwards) and any unused Annual Allowance from the previous three tax years.

However, if the Pension Input Amount from any defined contribution pension savings made by you or your employer 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 (MPAA) to offset against the defined contribution pension savings in another tax year.

Where the MPAA 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 (AA) available to carry forward to future Pension Input Periods is calculated under the normal rules.

If the defined contribution Pension Input Amount does exceed the MPAA, then the unused AA available to carry forward is calculated by reference to the defined benefit Pension Input Amount and your Alternative AA, where your Alternative AA is your (Tapered) Annual Allowance less the MPAA (i.e. it is a limit up to £50,000, depending on the level of your adjusted income).

Example – testing pension savings against the Money Purchase Annual Allowance (MPAA)

The following examples show how the rules above are applied:

Example 1

Defined benefit pension savings	£34,000
Defined contribution pension savings (such as BRASS)	£3,000
Total Pension Input Amount	£37,000
Annual Allowance[1]	£60,000

In this example, the defined contribution pension savings (made by you or your employer) do not exceed the MPAA of £10,000, so we test the entire Pension Input Amount against the person's AA of £60,000. The person would not have exceeded this limit and has unused allowance to carry forward to the next tax year:

Unused AA to carry forward	£60,000 - £37,000 = £23,000

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

Example 2

Defined benefit pension savings	£18,000
Defined contribution pension savings (such as AVC Extra)	£15,000
Total Pension Input Amount	£33,000
Carry forward of unused AA 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	£15,000 - £10,000 = £5,000
Total excess subject to tax[2]	**£5,000**
Unused AA to carry forward[3]	£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 + £15,000 – (£30,000 + £12,000) = 0 (because this total cannot be less than zero).

Note 3. Here, £20,000 is the member's "Alternative Annual Allowance", calculated as the Tapered Annual Allowance less the Money Purchase Annual Allowance (i.e. £30,000 less £10,000).

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, then you will need to submit a 'Scheme pays' notice to the Scheme or Fund. This will need to be submitted by the 31 July immediately after the HMRC Self-Assessment deadline if you have exceeded the full Annual Allowance (and have a statutory right to use the scheme pays option). However, your form will need to be submitted in time for tax to be paid by 31 January if you have incurred a tax charge as a consequence of the Tapered Annual Allowance.

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/knowledge-hub/help-and-support/RAYN or www.btppensions.co.uk. Alternatively, ring the Helpline on 0800 012 1117.

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