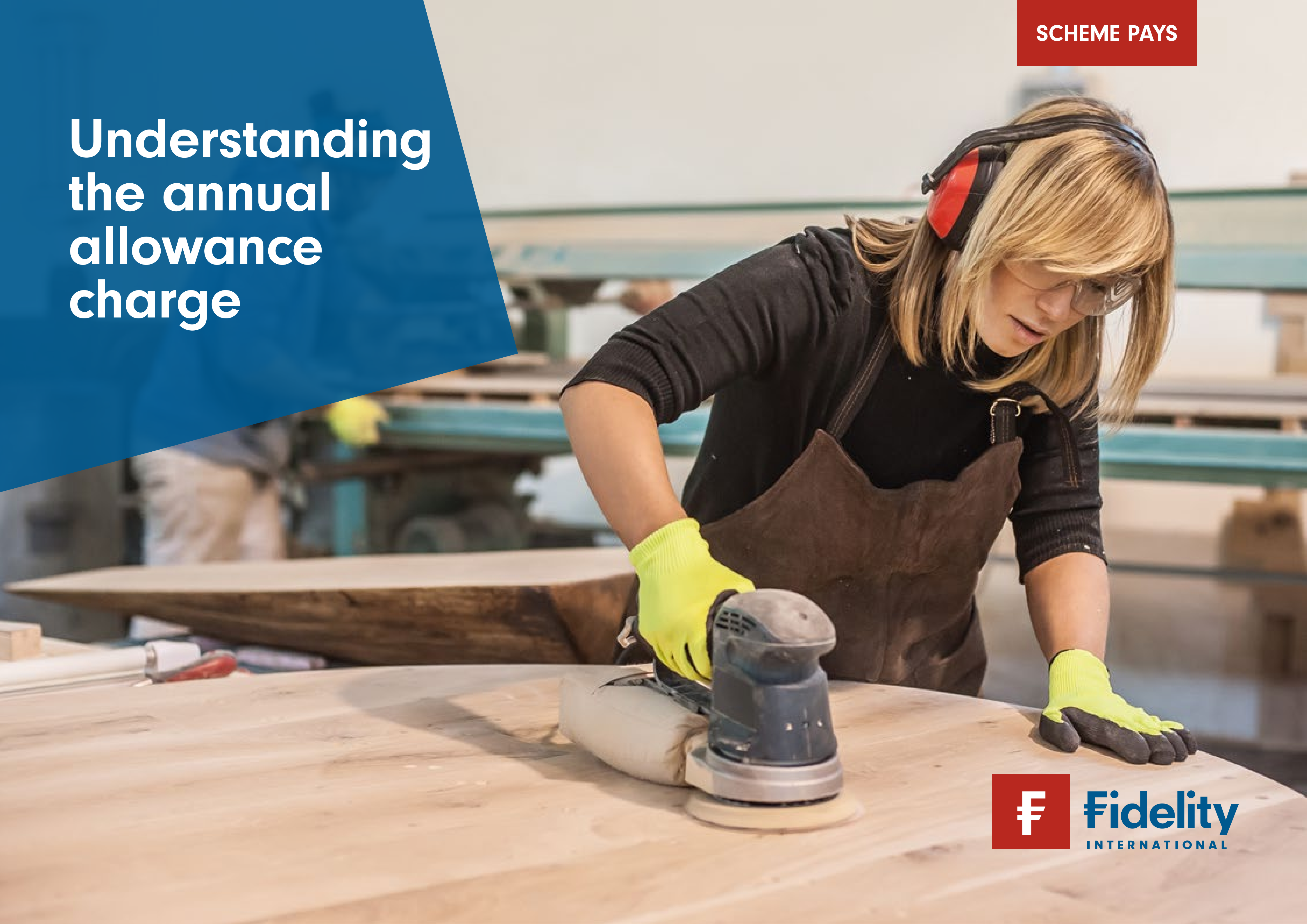
SCHEME PAYS

Understanding the annual allowance charge



Fidelity INTERNATIONAL

Understanding the annual allowance charge

The annual allowance is the maximum amount that can be built up in your personal and workplace pensions each year free of tax. If you go over it, you may have to pay an 'annual allowance charge'.

IN THIS GUIDE, WE LOOK AT:

- **How to check whether you have exceeded an allowance, and by how much**
- **How you may be able to carry forward unused annual allowance to reduce a charge**
- **How the annual allowance charge is calculated**
- **What payment options could be available to you including the deadlines and tax penalties**

The information in this guide is correct as at 6 April 2023. Changes announced in March 2023 have not been reflected in this guide.

A five-step checklist for the annual allowance

The biggest challenge with the annual allowance is that the government makes it **your responsibility** to check whether you have gone over it – and to calculate how much the tax charge is when you do.

This isn't easy, which is why we've created a five-step checklist to help you work out if you may need to pay a charge and if you do, how much it is and how you might be able to do this.

STEP 1 Work out your annual allowances for the tax year

STEP 2 Check if you have exceeded an annual allowance

STEP 3 Check if carrying forward unused annual allowance could reduce or even eliminate the excess

STEP 4 Calculate what the annual allowance charge will be

STEP 5 Work out how and when to pay the charge

Annual allowance basics

Before we begin, here's a quick reminder about what the annual allowance is:

- 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)
- It applies to work-based and personal pensions (sometimes referred to as 'private pensions'), including final salary (defined benefit) and money purchase (defined contribution) accounts
- 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
- If you stay within the annual allowance, you benefit from full tax relief (as long as you are also within 100% of your earnings for the tax year)
- If you go over an annual allowance once all your pension contributions have been added together, you may have to pay a personal tax charge.
- The amount of the charge will depend on the amount you have gone over an allowance by, less any available carry forward amounts, and how much you have earned in the tax year.

Please note that the value of tax benefits from a pension depends on your circumstances, and tax rules may change in the future.

STEP
1

Work out your annual allowances for the tax year

You may not be surprised to hear that there's a lot of jargon you have to wade through just to work out which annual allowance applies to you. We've tried to simplify it as much as we can, by turning it into two questions to answer, but if you need more help, you may like to speak with your pension provider or an authorised financial adviser.

Unless you already have these, we suggest obtaining pension savings statements for all pension arrangements you have been in for the tax-year you are looking at. These will confirm the amounts paid, provide details of the applicable amounts to carry forward, if applicable, and help to determine if a charge might be reduced or even eliminated.

Question 1:

Have you taken any taxable income from a pension pot using the government's freedom rules?

If you haven't taken any money out of your pension at all, just go straight to question 2.

If you have taken money out, but it falls into one of the following five categories, also go to question 2.

- Just tax-free cash (even if you're planning on taking drawdown later)
- To buy an annuity or pension (a guaranteed lifelong income)
- Income from a final salary (defined benefits) pension
- Capped drawdown (where your income payments have to stay below a limit set by the government)
- Small pot lump sum withdrawals (where a pension pot worth less than £10,000 is taken as cash)

If you have taken a taxable income from a pension pot, you will be subject to the **money purchase annual allowance** (see box 3 on the following page). This applies if you have

- Taken an Uncrystallised Funds Pension Lump Sum (often referred to as UFPLS)
- Set up Flexi-access drawdown (where you can take as much as you want, whenever you want)
- Set up income from a short-term annuity (one that pays for an agreed term and not for life)
- Taken income that's over the limit from a capped drawdown plan

Please note that these are the four main types of taxable income that can be taken from a pension pot, but there are others. It's a good idea to check with your pension provider if you're not sure.

The key thing to understand here is that your allowance reduces from the moment you first take a taxable income. If your first flexible withdrawal is part way through the tax year, the reduced allowance must be used from that date forward for contributions until the end of that tax year.

From the beginning of the next tax year, the reduced allowance applies for the whole tax year. This means that in the first year you take a taxable income., you may need to measure the contributions to your pensions against the standard and/or tapered annual allowance **and** the money purchase annual allowance (boxes 1, 2 and 3 on the next page).

Question 2:

Are you considered a "high earner" for annual allowance purposes?

This question sounds like it should be a lot more straightforward, but again, the rules are more complicated than you may expect. A brief summary is on the right. If you are at all unsure how it works, we have a guide available that can help but getting personal tax advice could also be appropriate.

Income in this context is all of your taxable income rather than simply your earnings, so includes income from employment or self-employment, including bonuses, interest from savings, share dividends, rental income etc.

What counts though is your 'Adjusted Income', and this is taxable income and includes all the contributions to your pensions including those paid by your employer too.

	The three (or four) allowances	Limits From 2020/21 tax year	Limits From 2023/24 tax year
1	**The standard annual allowance** This applies to everyone who isn't affected by the specific rules for allowances 2 and 3 below.	£40,000	£60,000
2	**The tapered annual allowance** For high earners, the annual allowance may reduce depending on your "Adjusted Income" See our **tapered annual allowance guide** for full details.	If your "Threshold Income" is £200,000 or more for tax year 2020/21 onwards, your annual allowance will reduce by £1 for every £2 above an "Adjusted Income" of £240,000 or more. A sliding scale from £40,000 down to £4,000 applies for anyone with an adjusted income of £312,000 or more.	If your "Threshold Income" is £200,000 or more for tax year 2023/24 onwards, your annual allowance will reduce by £1 for every £2 above an "Adjusted Income" of £260,000 or more. A sliding scale from £60,000 down to £10,000 applies for anyone with an adjusted income of £360,000 or more.
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	£10,000
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	£50,000

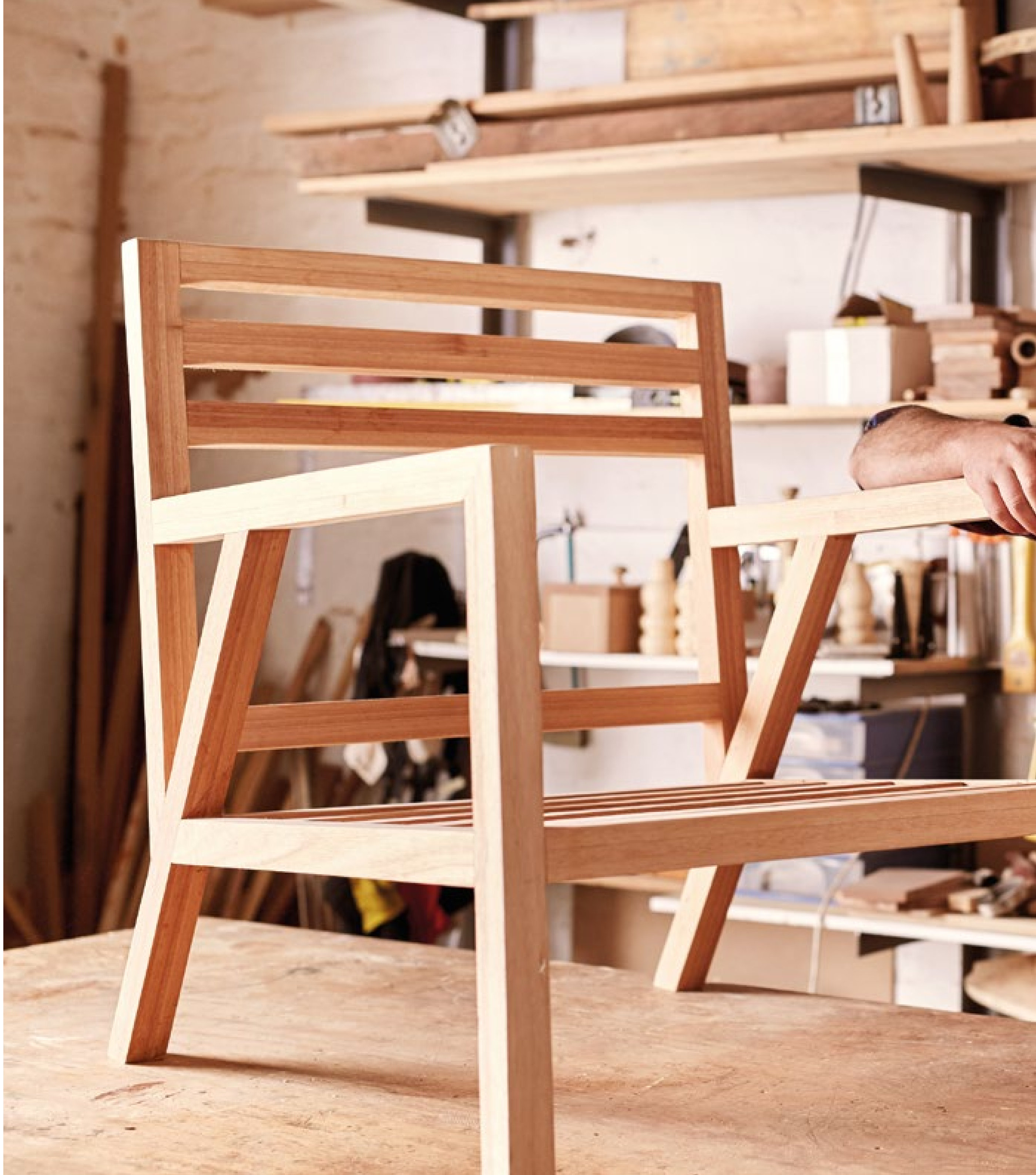
STEP 2

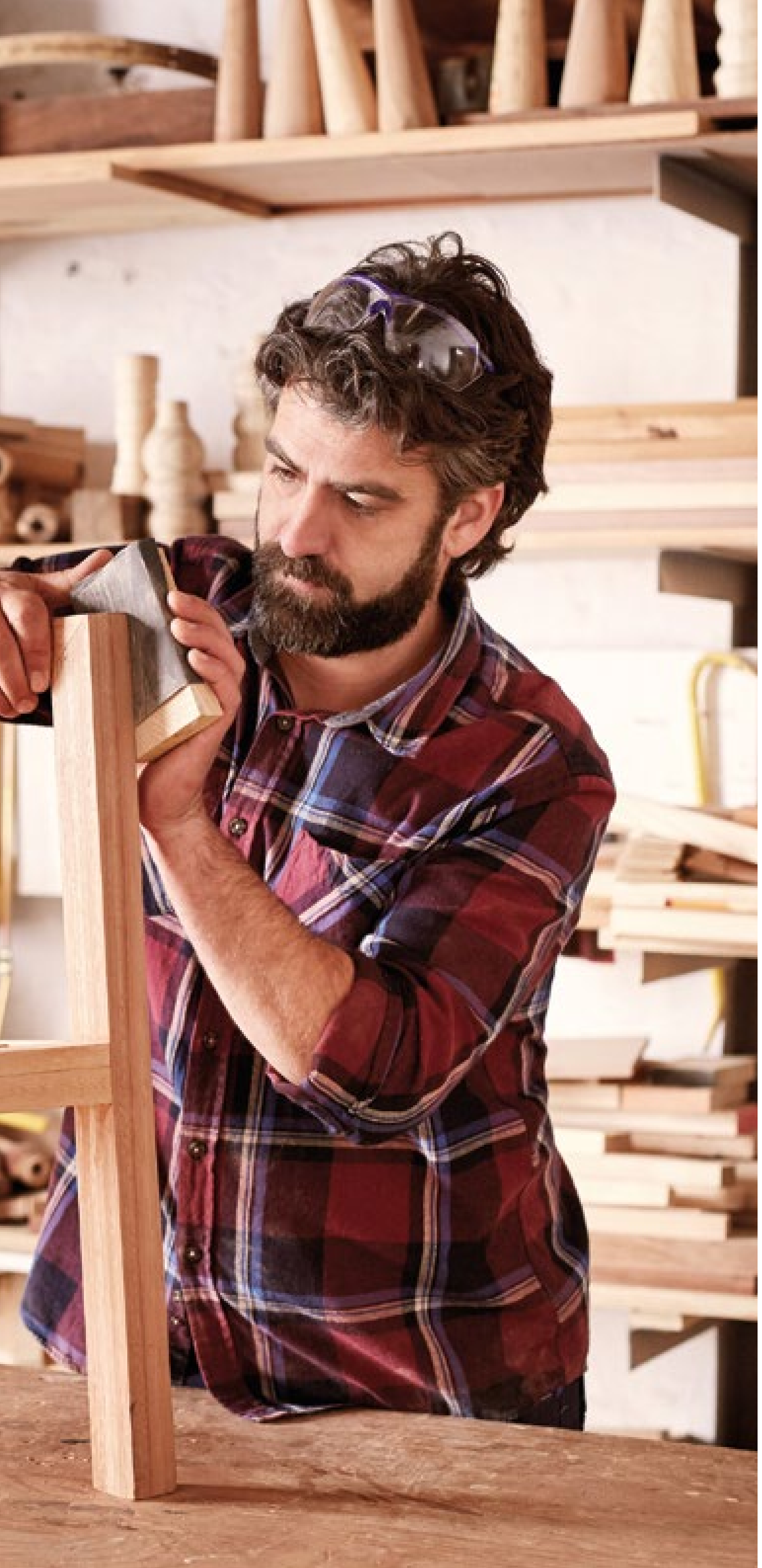
Calculate if you have exceeded the annual allowance

Now you know the annual allowance(s) you need to measure your contributions against, you need to work out how much you have contributed and then compare this against the applicable annual allowance(s):

- **For money purchase pensions:** You need the total contributions paid during the tax year from you, your employer and anyone else. You can get this by contacting your provider, if contributions are paid close to the tax year start and finish, it's a good idea to ask your provider for a pension savings statement to be sent. If you have several pensions you will need the figures for all of them and will need to combine the values for each applicable tax-year.
  - Your provider can also tell you if their records indicate you are subject to the money purchase annual allowance and from which date.
- **For final salary schemes:** You need to know the value of any increases to benefits. This is more complicated, but your pension provider should be able to give you the information you need.

Note that if you have exceeded the standard and/or money purchase annual allowance in a given arrangement, the scheme administrator will have sent you a pension savings statement automatically.





Making the calculation for the 2022/2023 tax year

Now just subtract the total contributions in a tax-year from your annual allowance. If you get a positive number, there's no charge to pay. If you get a negative one, go to step 3.

For example:

Annual Allowance £40,000 − **Total contributions** £30,000 = **Positive figure** £10,000 No charge to pay

Annual Allowance £40,000 − **Total contributions** £50,000 = **Negative figure** -£10,000 You may have to pay a charge

Please note this information is for the 2022/23 tax year only and will not be valid for 2023/24 due to changes already announced.
If you're subject to the tapered or money purchase annual allowance, you'll need to subtract from that figure instead. If you have triggered the money purchase annual allowance in the year you are looking at, you need to consider the contributions paid from the trigger date in this calculation.

STEP
3

Check if carrying forward unused annual allowance could reduce or even eliminate the excess

If you have exceeded the standard annual allowance or tapered annual allowance, you can carry forward any unused allowance from the three previous tax years in addition to this year's allowance to reduce or eliminate any charge due. Just make sure you are still within 100% of your earnings for the tax year you are making the calculation. You must use any unused allowance from the earliest year first. For more information, read our **Carry Forward guide** you can find it at: **retirement.fidelity.co.uk/allowances**

Note that if you have triggered the money purchase annual allowance you cannot use unused allowances from previous tax years.

If you don't have enough unused annual allowances from previous years to cover your excess contributions for this tax year, you will need to tell HMRC and arrange to pay the annual allowance charge. The excess amount **MUST** be shown on your self-assessment or notified to HM Revenue & Customs (HMRC) directly.

If you have enough unused allowances in previous years to cover excess contributions from the current year, you should record and keep this information for future reference. You are not required to show the excess on your self-assessment.

Can more than one annual allowance apply?

Yes. If you take a flexible withdrawal during the tax year, then you may need to measure your contributions against two or three annual allowances, this is explained previously.

HMRC Helpsheet HS345 Pension savings - tax charges provides more detail and can be found on the **gov.uk website**

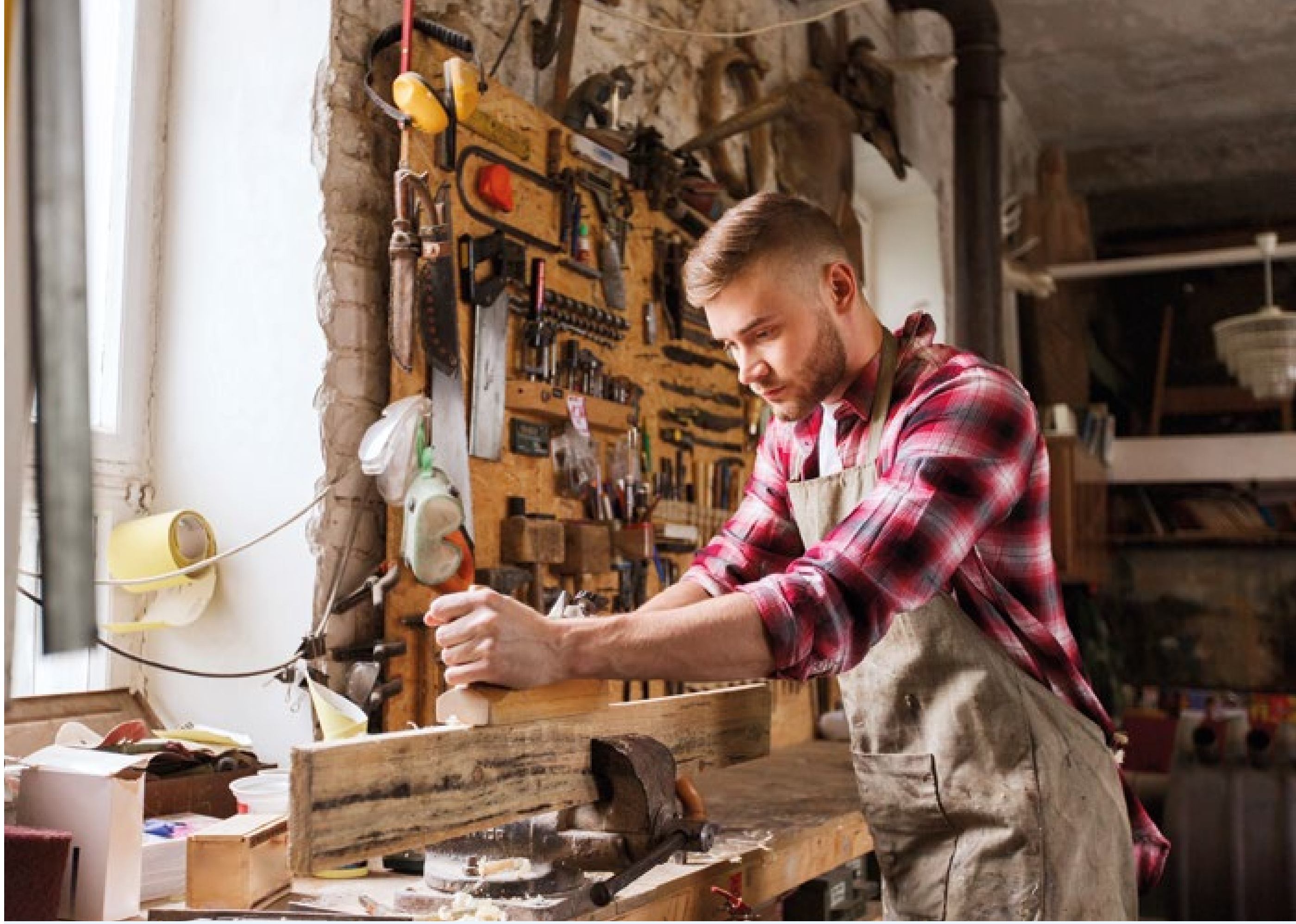
STEP
4

Work out what the annual allowance charge will be

You should enter the amount by which you have exceeded all your available allowances on your self assessment tax return. The annual allowance charge payable will be at your highest marginal rate of income tax.

You'll need to complete the 'Pension savings tax charges' section. If you don't usually complete a self assessment return you can contact HMRC directly with details of your National Insurance number and the amount by which you have exceeded your available allowances.

HMRC can then work out the charge for you.



Here's a quick example

Mike and his employer put £60,000 in his workplace pension during the 2022/23 tax year. He has the standard annual allowance of £40,000 available and has no unused allowance to carry forward from previous years. This means he must pay an annual allowance charge on £20,000

His total taxable income for the year is £70,000. To calculate the charge, he adds £20,000 to this figure – making his taxable income £90,000 for the 2022/23 tax year.

This means all £20,000 is over the threshold for higher-rate taxable income (£37,700 in the 2022/23 tax year), so the annual allowance charge is £8,000 (£20,000 x 40%).

* Care needs to be taken if the excess amount takes you over one of the tax bands as tax at different rates will apply to different sections on the excess amount.

The example above is based on UK tax rates applying. Rates for Scottish and Welsh tax payers may differ.

STEP
5

Check how to pay the charge

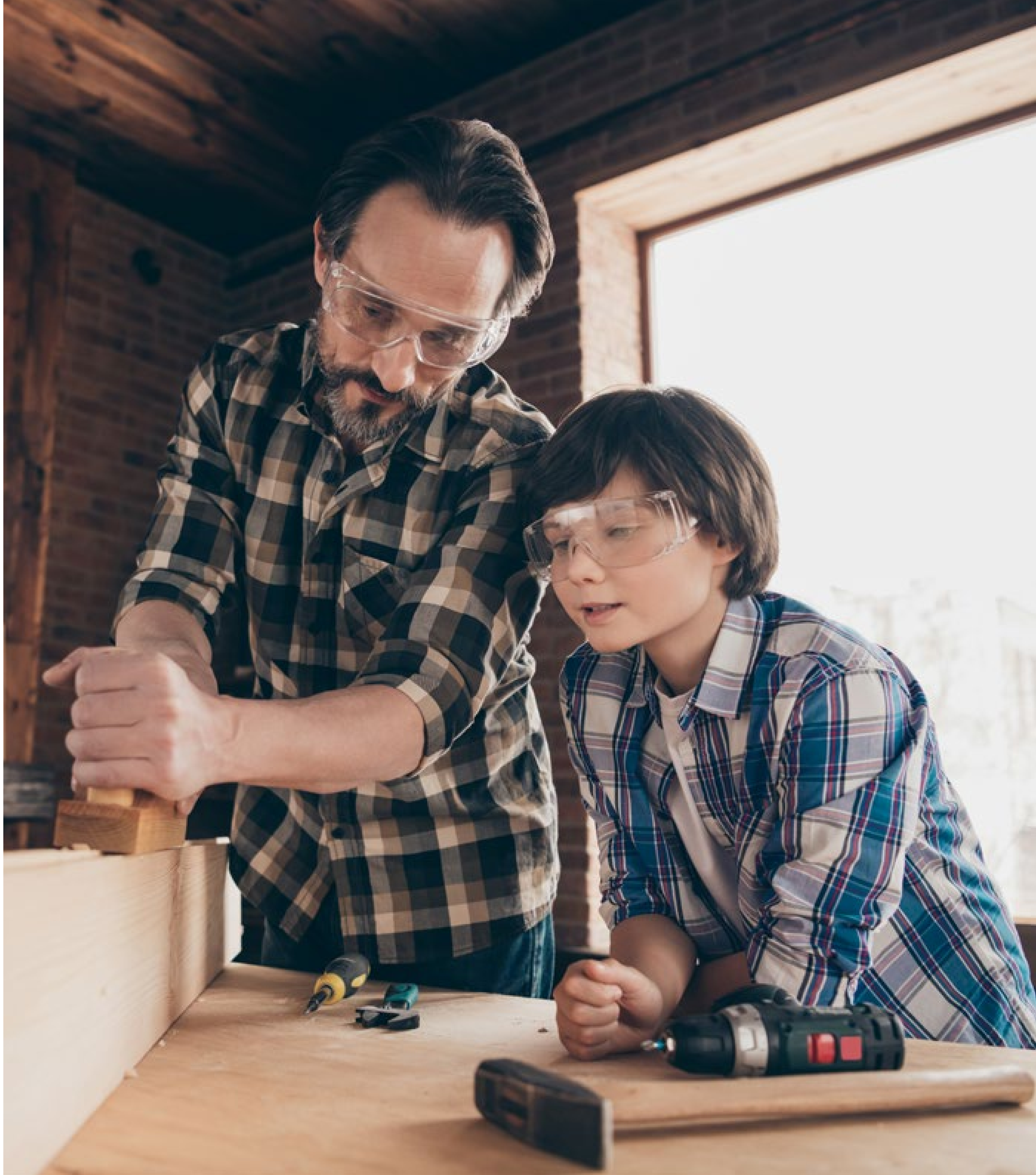
If you are facing a charge, the last step is to pay it. There may be two ways you can do this:

- You may pay the charge yourself, usually as part of your self-assessment return.
- It may be possible for you to pay the charge from your pension account. This is known as Scheme Pays. It can help, as the charge is paid from untaxed money, rather than money you have already paid tax on. However, there will be less in the pension to grow over the years to your retirement.

There are two types of Scheme Pays. You should discuss which options are available to you with your pension provider.

- **Mandatory Scheme Pays:** As long as you meet certain conditions, your scheme must offer this option and it will be jointly and severally liable with you for the charge. However, this option is available in a limited number of circumstances.
- **Voluntary Scheme Pays:** Your pension scheme is **not obliged** to offer this option, but if it does, you may find it a more appropriate way of paying a charge. However, you remain liable for the charge until it is paid.

The deadlines for each type are very different and must be strictly adhered to. Voluntary Scheme Pays is subject to the criteria we set and cannot be processed if received after the deadline. Exact details are shown on the following pages.



Mandatory Scheme Pays

Your scheme must offer this option if:

- Your total annual allowance charge for the tax-year is over £2,000* **and**
- Your pension contributions into that specific pension scheme have exceeded the standard annual allowance, in this example we'll use the annual allowance of £40,000 that applied for the 2022/23 tax-year.

It does not apply when:

- You have gone over the tapered annual allowance and/or the money purchase annual allowance, but have not exceeded the £40,000 level of the standard annual allowance or;

It partially applies when:

- You have exceeded the tapered annual allowance or the money purchase annual allowance **and** gone over the standard annual allowance. In this situation, it will only cover any charge on the excess over £40,000.

For our example, imagine Peter has a tapered annual allowance (TAA) of £15,000 and has put £60,000 in his pension. Although he has gone over the TAA by £45,000, he is only £20,000 over the standard annual allowance. This means the maximum his scheme must pay is the charge on the excess, (£20,000 in this example) above the standard annual allowance. The scheme does not have to pay the charge on the other £25,000, Peter must pay this himself. He can choose to pay all or part of the charge on the excess (£20,000) over the standard annual allowance or utilise Mandatory Scheme Pays to cover the charge.

	Contributions		Payment Options
Excess over the Standard Annual Allowance	£20,000	Total amount (ignoring any available carry forward) on which a charge is due	Peter/ Mandatory Scheme Pays
Standard Annual Allowance £40,000	£25,000		Peter
	£15,000	TAA	No charge

If you want to use Mandatory Scheme Pays with Fidelity:

- **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 2022/23 tax year, you have until the 31 July 2024 for the transaction to be completed

Voluntary Scheme Pays

You will need to **check** with your pension provider to see if this option is available. If it is, you can elect for the charge to be paid from your pension account, as long as you have contributed to the pension in the relevant tax year and the excess arises in it.

This can be used for charges of any size. Equally, it can be used whether or not you exceed the standard annual allowance while exceeding the tapered annual allowance or money purchase annual allowance.

In Peter's example below, Voluntary Scheme Pays may be available to meet the charge on the excess over the tapered annual allowance (in this example £25,000).

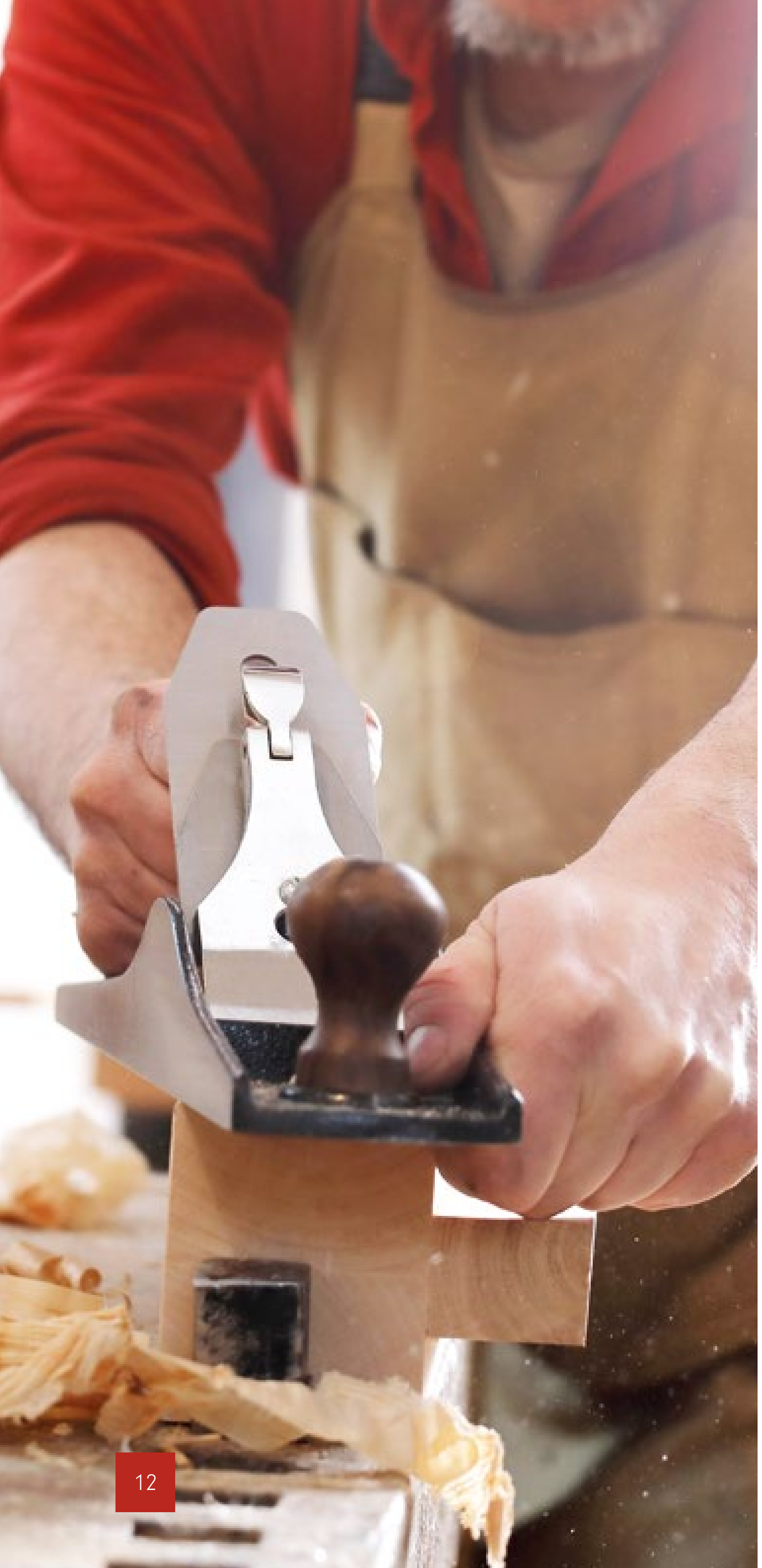
	Contributions		Payment Options
Excess over the Standard Annual Allowance	£20,000	Total amount (ignoring any available carry forward) on which a charge is due	Peter/ Mandatory Scheme Pays
Standard Annual Allowance £40,000	£25,000		Peter/ Voluntary Scheme Pays
	£15,000	TAA	No charge

If you want to use Voluntary Scheme Pays with Fidelity:

- **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 2022/23 tax year, you have until the 31 August 2023 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.

In certain circumstances you may need to request both types of payment., you may have to request both Mandatory and Voluntary (if available) Scheme Pays to pay the respective amounts of your total annual allowance charge.

* Based on contributions paid to a defined contribution plan or increases in benefits in a defined benefit (including final salary and career average) scheme you are still an active member of.



Timeline for Annual Allowance Tax Charge

5 April 2023 **1**

2 31 July 2023

3 31 August 2023

2022/23 Tax Year

2023/24 Tax Year

1

Annual Allowance excess for 2022/23 identified
You will need to do this yourself if you have contributed to more than one arrangement or are subject to a tapered annual allowance.

2

Deadline for submitting a request for mandatory scheme pays for the 2021/22 tax year

3

Deadline for submitting a request for voluntary scheme pays for the 2022/23 tax year
31 August is a specific deadline that ensures there is enough time to review and agree to payment of the charge before you submit your self-assessment return – where we will confirm the amount of the annual allowance tax charge that the scheme will pay. If we receive a voluntary scheme pays request **after this deadline, it will not be possible to process** it in time for it to be included in the pension schemes' tax return (that are subject to different reporting periods) that must be completed before the deadline for self-assessment. As a result the request will be declined.

4 31 January 2024

5 5 April 2024

31 July 2024 **6**

2023/24 Tax Year

4

Deadline for submitting self-assessment returns for the 2022/23 tax year

If you're intending to use **voluntary scheme pays**, you should wait to receive confirmation that the scheme is prepared to pay the tax charge **before** you submit your self-assessment. If you're intending to use **mandatory scheme pays**, you **will not** need to have received confirmation that the scheme will pay the tax charge **before** you submit your self-assessment as where **the conditions are met**, the scheme is obliged to pay the tax charge.

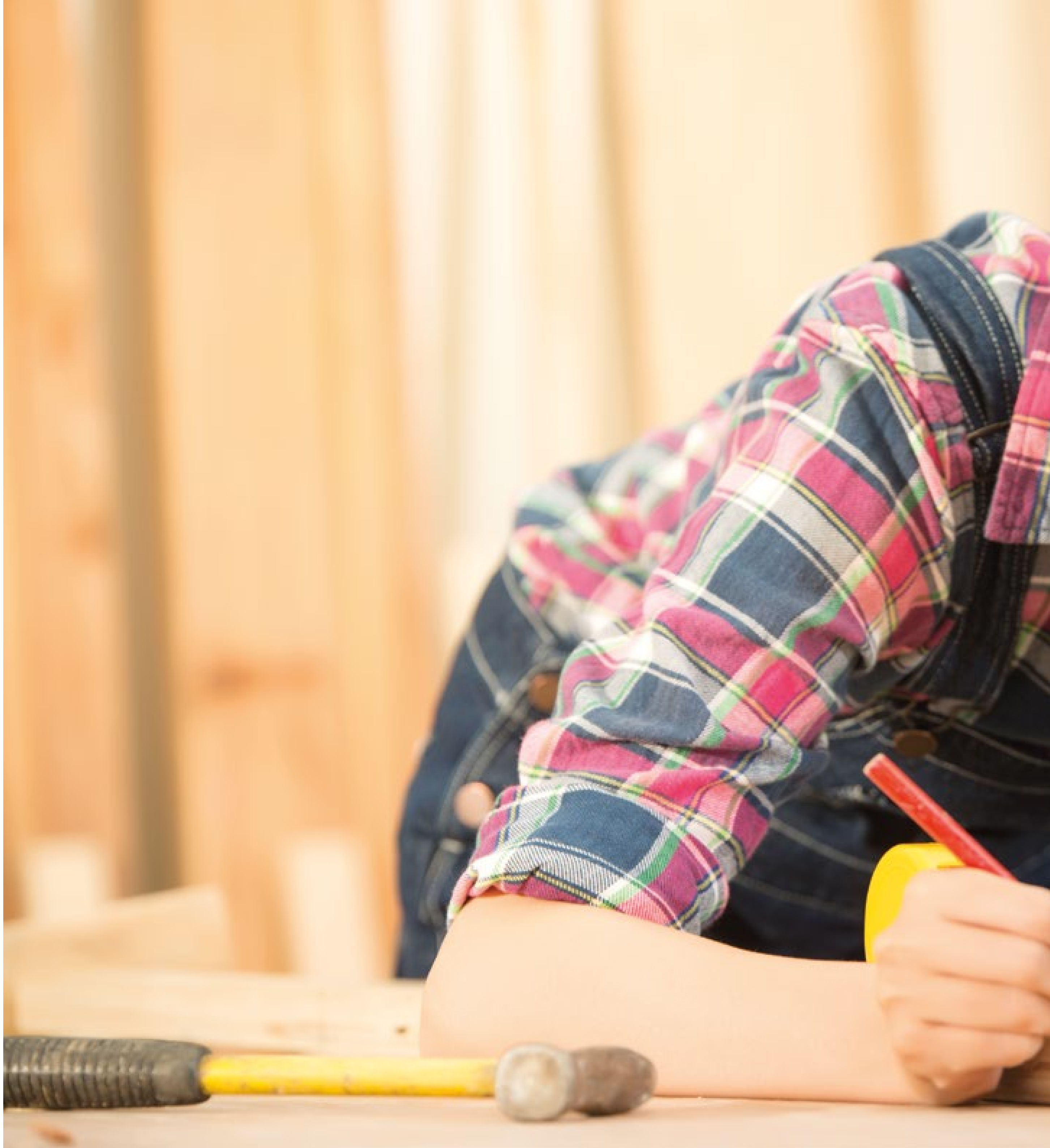
5

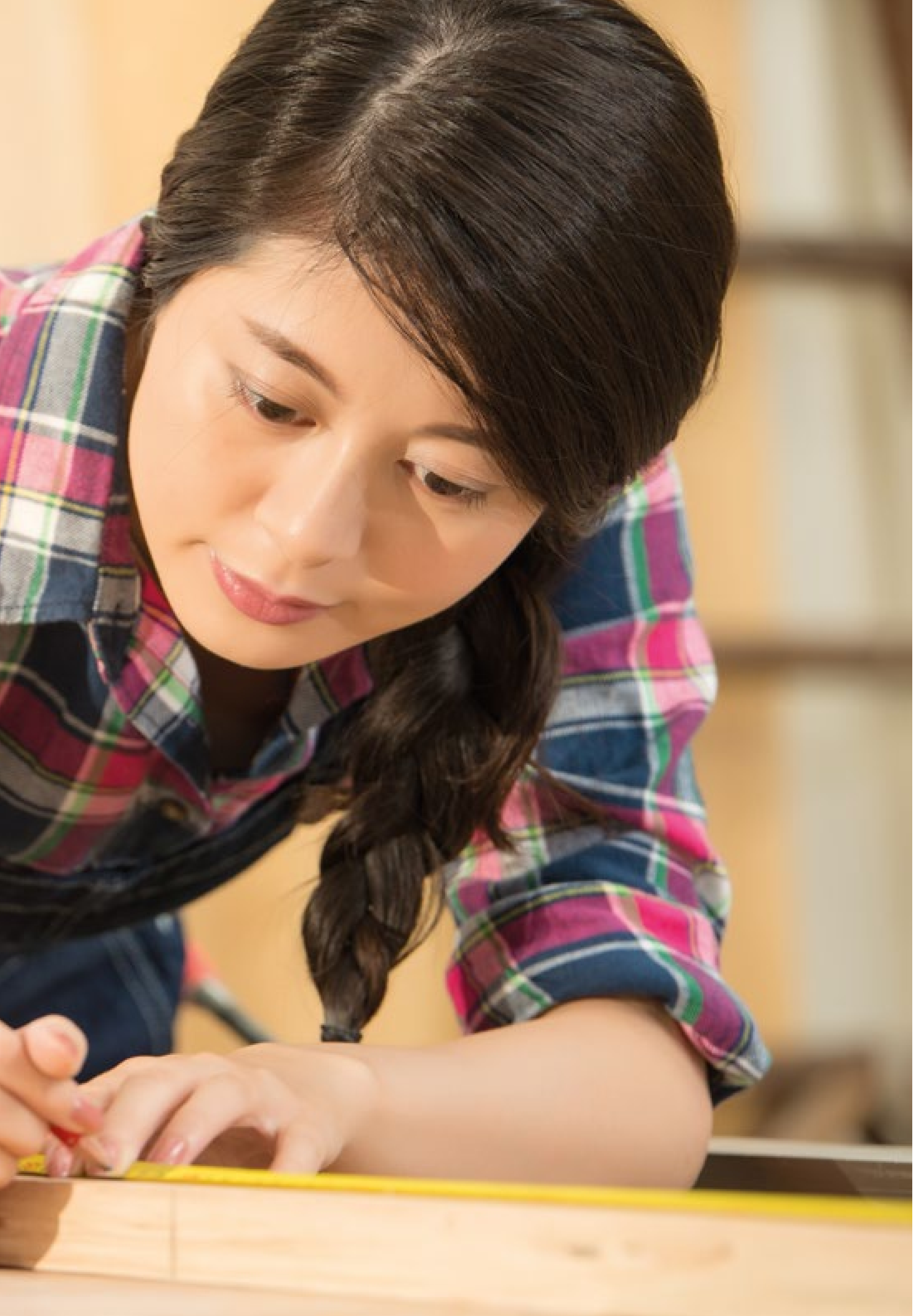
Annual allowance excess for 2023/24 identified

You will need to do this yourself if you have contributed to more than one arrangement or are subject to a tapered annual allowance.

6

Deadline for submitting a request for mandatory scheme pays for the 2022/23 tax year





Next steps

- If you have not already received one, request a Pension Savings Statement for the respective tax-year, from all of your pension providers.
- If contributions have been made to your Fidelity plan and you wish to use Scheme Pays, and are within the relevant deadline to pay an annual allowance charge with Fidelity, please ask us for a Scheme Pays form. Note that a separate form will be required for each scheme pays type for each specific charge amount.
- Once you have filled in and returned your Scheme Pays form, we will review your request and confirm if it is available through your plan.
- If the pension arrangement **agrees** to pay the charge, you will still need to complete the relevant sections of your self-assessment form or notify HMRC directly.

If you need further information after reading this guide, please do contact us. However, your tax affairs are your responsbility and we cannot provide you with specific advice or calculate your annual allowance charge for you. As this can be a complex topic, you may wish to take advice from an appropriately qualified adviser.

For information about your pension account, please contact the Workplace Investing Service Centre on **0800 3 68 68 68** between 8am and 6pm on UK business days. If possible, please make sure you have your password when you call.

Alternatively, you can email the Pension Service Centre at **pensions.service@fil.com**. You can also view your pension account by logging into PlanViewer at **fidelitypensions.co.uk**

HOW CAN FIDELITY HELP?

If you would like to discuss your pension account, please call the Workplace Investing Service Centre on 0800 368 6868.

You can also visit fidelitypensions.co.uk or speak to an authorised financial adviser.

Workplace Investing

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