

The annual allowance charge

Scheme Pays



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The annual allowance was introduced with A day in the 2006/07 tax year. The essential principle of the allowance is to limit the amount of 'Tax privileged' pension savings an individual can accrue each tax year. The limit applies to all pension savings, including those made by the individual themselves or by their employer or any other third party. However, the annual allowance is not a restriction on the amount of tax relief given when the savings are made, but works by applying a tax charge when the allowance is exceeded.

The client will always be personally liable for this tax, regardless of whether the contribution was made by them, their employer or someone else. They may have to pay this directly to HMRC or, in some cases, it may be possible to pay it from their pension account – this is known as 'Scheme Pays'. All pension schemes must facilitate payment of the tax charge when requested to if certain conditions are met – this is known as 'Mandatory Scheme Pays'.* Some providers, including FundsNetwork, are more flexible and can facilitate payment of the charge when the mandatory conditions are not met. This is known as 'Voluntary Scheme Pays'.

The annual allowance charge – the basics

The annual allowance applies to savings in occupational and personal pension schemes made by an individual, their employer and on their behalf by someone else. If the person goes over an annual allowance once all their pension savings have been added together, they may have to pay an annual allowance tax charge. The amount of the charge will depend on the excess amount, how much the person has earned in the tax year and whether they have any unused annual allowance they can carry forward to reduce or potentially eliminate the charge.

A client's annual allowance will depend on certain factors. It is likely to be a very personal figure for the client, as it will be based on the current tax year's annual allowance, plus the value of any unused allowances carried forward from the previous three tax years. The standard annual allowance for the 2019/20 tax year is £40,000 but this could be lower, as shown by the table below.

Type of annual allowance	Limit 2019/20 tax year
The standard annual allowance This applies to everyone who isn't affected by the tapered annual allowance.	£40,000
The tapered annual allowance For those affected by the tapered annual allowance their annual allowance will be reduced by £1 for every £2 of 'adjusted income' above £150,000. This is subject to a minimum of £10,000. Please see our factsheet on tapered annual allowance for further details of how tapering works.	A sliding scale from £40,000 down to £10,000

*It may not always be possible, in certain situations, when entering the scheme or if the scheme is under Pension Protection Fund assessment.

Money purchase annual allowance (MPAA)

Clients that have triggered the MPAA will have an 'inner' restriction on the amount of pension savings that can be made to money purchase arrangements. This will not reduce the client's overall annual allowance but will limit the amount of total pension savings to money purchase arrangements to £4,000 (for the 2019/20 tax year).

Please be aware that if a client triggers the MPAA during a tax year, they may need to measure their contributions against two or three annual allowances.

Calculating the charge

If, after following the process below, either the annual allowance or money purchase annual allowance have been exceeded, then a tax charge will be calculated on the excess amount for the tax year in question. Broadly speaking, the charge will be calculated by notionally adding the excess amount to the client's taxable income for the year and charged at the client's marginal rate (or rates if an income tax threshold is crossed). The annual allowance excess will not have any effect on reducing or removing the client's personal income tax allowance.

Case Study 1 – calculating the charge

Scenario 1: Total annual earnings of £70,000

Mike and his employer have contributed £60,000 to his occupational pension during the 2018/19 tax year. He has the standard annual allowance of £40,000 available and has no unused allowances to carry forward from previous years. His total taxable income for the year is £70,000.



Scenario 2: Total annual earnings of £140,000

Had Mike's taxable income before the charge been £140,000, half of the excess would be charged at the higher rate (40%) and half would be charged at the additional rate (45%). This is because the £20,000 excess contribution is notionally added to his total annual earnings of £140,000, taking him over the threshold for additional rate tax of £150,000.



The above examples are based on UK Income Tax rates. Rates for Scottish Residents differ.

Paying the charge

If a charge is due, then the next step is deciding how to pay it.

1. Direct payment to HMRC

In some circumstances, the client may have to pay the charge directly to HMRC themselves, typically through self-assessment.

2. Scheme Pays

It may be possible for the client to pay some or all of the charge from their pension account. This is often more palatable for the client and may also offer a pecuniary tax advantage. This is particularly relevant where the lifetime allowance is also a consideration. However, the other side to this equation is that pension benefits will be reduced. This may be simple to understand and calculate for a money purchase arrangement, but may be very complex and sometimes quite punitive for a defined benefit arrangement.

Scheme Pays

There are two types of Scheme Pays. Depending on the amount of the charge, how the charge arose and the client's circumstances, they may have access to one, both or neither of them.

Mandatory Scheme Pays

If certain conditions are met, the pension scheme must fulfil requests to pay the charge from the pension and it will become jointly and severally liable with the client for some or all of the tax charge. However, this option is available in a limited number of circumstances:

- When the charge is over £2,000* and
- The client has exceeded the standard annual allowance of £40,000 (for this purpose the tapered annual allowance and MPAA are ignored).

It does not apply when:

- The client has exceeded the tapered annual allowance and/or the MPAA, but has not exceeded the £40,000 standard annual allowance or;
- They have an overall charge of £2,000 or more but this is not based solely on the contributions to that scheme.

It partially applies when:

- The client has exceeded the tapered annual allowance or the MPAA and has exceeded the £40,000 standard annual allowance. In this situation, it will only cover any charge on the excess over £40,000.

* There is no minimum that the client can ask the scheme to pay but if this is less than £2,000 then they will need to confirm to the scheme that their total annual allowance tax charge liability is greater than £2,000.

Case Study 2 – Mandatory Scheme Pays

Sarita has put £60,000 into her pension and has a tapered annual allowance (TAA) of £15,000.



The above example is based on UK Income Tax rates. Rates for Scottish Residents differ.

Voluntary Scheme Pays

Any pension scheme can offer Voluntary Scheme Payments but many do not. Where a scheme does offer this facility, there are no minimums and the scheme can pay any annual allowance tax charge even if the charge is not in relation to pension savings to that arrangement. In fact, it may even be possible to transfer benefits to an arrangement in order to facilitate this. However, where Voluntary Scheme Pays is offered, the scheme will never become jointly and severally liable for the charge and it remains the sole liability of the client. As such, the reporting and payment deadlines for Voluntary Payments are different to Mandatory Payments.

Voluntary Scheme Payments are available with the FundsNetwork Pension.

Deadlines for Scheme Pays requests

If a client wants to use the Scheme Pays facility, the deadlines for the request must be adhered to. If the deadline is missed, then the option may not be available. The deadlines for FundsNetwork Pension Scheme Pays requests are shown below.

For Voluntary Scheme Pays, the deadline ensures there is enough time for the tax charge to be received by HMRC, by the deadline for personal tax of 31 January following the end of the tax year. The client should wait to receive confirmation that the scheme is prepared to and has paid the tax charge before they submit their self-assessment form (this is not necessary for Mandatory Scheme Pays as, if the conditions are met, the scheme is obliged to pay the tax charge).

Where the client does not have all of the relevant information to calculate the charge, it is possible to pay an estimated tax charge. This would need to be corrected when the information is received.

Next steps for FundsNetwork Scheme Pays requests

If a client has a FundsNetwork Pension from which they wish to pay an annual allowance tax charge – and are within our relevant deadline – you can request a Scheme Pays form on their behalf.

- Once you have completed and returned the Scheme Pays form on behalf of your client, we will arrange for the charge to be paid to HMRC within 45 days of the end of the reporting quarter.
- You or your client will need to complete the relevant sections of their self-assessment form or notify HMRC directly.

To find out more about our pension, please visit fundsnetwork.co.uk/pension. You can also find a wide range of technical information about pensions and tax on our [Technical Matters](#) hub, a resource dedicated to helping advisers keep in touch with all the latest developments in the world of retirement planning.

FundsNetwork Scheme Pays deadlines

The following deadlines apply for Scheme Pays requests for our pension:

Scheme type	Tax year	Deadline
Voluntary Scheme Pays	2019/20	31 August 2020
Mandatory Scheme Pays	2018/19	31 July 2020