

Annual Allowance (AA)

The Annual Allowance is assessed each tax year and essentially comprises two measurements. The first is the increase in value of your defined benefit savings and the second is the amount of pension contributions paid by you, or on your behalf, into a defined contribution pension scheme.

Any excess AA savings over your allowance may be subject to income tax at your highest marginal rate.

The standard AA is £40,000 (2022/23), however the amount of AA available to you may be lower depending upon your own individual financial situation.

This is because HMRC have introduced a sliding scale to reduce the available AA limit for higher earners. This is typically referred to as the 'Tapered Annual Allowance' and means that, whilst the standard allowance remains £40,000, an individual's allowance could be reduced to as little as £4,000 dependent upon your individual financial circumstances.

If you exceed the amount of AA available to you in a tax year you are permitted to carry forward any unused AA from the previous three years and offset this against the excess amount used in the current year.

How is the AA valued?

To calculate the amount of AA used within a defined benefit pension scheme it is necessary to calculate your "Pension Input Amount".

The "*opening value*" is calculated by taking the closing value of your defined benefits at the end of the previous tax year and increasing this to the end of the current tax year, to account for inflation, based upon the increase in the Consumer Prices Index.

For both USS and SAUL defined benefit arrangements, the effect of increasing the opening value by inflation can effectively be ignored due to the fact that since 2016 the Career Average benefits earned within the scheme are re-valued by the same measure of CPI and used to calculate the value of your closing benefits and thus this increase cancels out.

The "*closing value*" is the value of your defined benefits at the end of the current tax year.

The "*Pension Input Amount*" is then calculated by subtracting the "*opening value*" from the "*closing value*", and multiplying the result by a factor set out in legislation.

The current factor is 16 but the value of any additional cash sum has to be accounted for and so, for both USS and SAUL defined benefit schemes, a factor of 19 should be applied.

The value of "Pension Input Amount" used for any defined contribution arrangements is simply the gross amount of contributions paid into the defined contribution scheme by both yourself and your employer.

Note that investment returns are not included in the calculation, it is purely the contribution amount paid.

Your total "Pension Input Amount" for any tax year is therefore any defined benefit "Pension Input Amount" plus any defined contribution "Pension Input Amount".

What is the tapered Annual Allowance?

From the 2016/17 tax year HMRC introduced a sliding scale to reduce the available AA limit for higher earners.

With effect from the 2020/21 tax year, HMRC increased the limits at which 'tapering' of an individual's allowance starts to be applied. However, the maximum amount of taper which may be applied has increased for those highest of earners.

From the 2020/21 tax year, the taper means that an individual's available allowance could be reduced to as little as £4,000 for the year, depending upon their individual financial circumstances.

For the tax years 2016/17 to 2019/20 an individual's available allowance could be reduced to as little as £10,000 for each year, depending upon their own financial circumstances.

The government website contains more detailed information regarding the [Tapered AA](#) but in summary, there are two definitions of "income" measurement to be considered:

Firstly, you need to assess if your taxable income (what HMRC call your "threshold income") is over the threshold of £200,000 (2022/23). A lower threshold of £110,000 applies for the years 2016/17 to 2019/20. Note that this is your total taxable income in the year from all sources, not just your regular salary from LSE.

If this exceeds the threshold, then you need to calculate what HMRC refer to as your "adjusted income". To calculate your "adjusted income" you essentially need to add your total *Pension Input Amount* for the year to your "threshold income" for the year.

If your "adjusted income" is more than £240,000 (2022/23) for the year then your AA will be reduced on a sliding scale. This applied if your "adjusted income" was more than £150,000 for any of the years 2016/17 to 2019/20.

Your tapered AA is reduced by £1 reduction for every £2 of income over £240,000 (over £150,000 2016/17 to 2019/20).

The reduction is subject to a minimum reduced AA of £4,000 if your "adjusted income" is £312,000 or more. The minimum reduced AA is £10,000 for 2016/17 to 2019/20 if your "adjusted income" was £210,000 or more for those years.

In practice, this means that you may not be able to accurately work out in advance the amount of tapered AA available to you for the year until you calculate your total taxable earnings on your self-assessment tax return after the end of the tax year.

Money Purchase Annual Allowance (MPAA)

If any individual has already accessed any defined contribution funds, HMRC have introduced a limit to prevent those individuals from accessing those benefits and then re-investing the same funds back into another pension scheme (essentially receiving double tax relief on those funds).

This limit is known as the Money Purchase Annual Allowance ("MPAA").

The MPAA does not apply to you unless you have accessed any defined contribution funds in a particular way.

The MPAA restricts the amount of future contributions that you can pay into a defined contribution arrangement to £4,000 (2022/23) before a tax charge becomes payable.