Annual and Lifetime Allowances

Whilst pensions plans are a tax efficient way of saving for your retirement, HMRC do put limits on how much can be saved free of tax via annual and lifetime allowances. The rules are complicated and there are other things to consider that are not mentioned below. The Trustee and its advisors cannot provide financial advice to members and we would strongly advise that you seek independent financial advice, in particular if you think you are in any chance of breaching the allowances discussed.

Annual Allowance

This is the limit on the increase in value that can be added to your pension funds each year before you start paying tax, across all of the pension schemes you belong to. For anyone earning below £150,000 a year, this limit is currently £40,000. Above £150,000, the limit decreases by £1 for every additional £2 earned, down to a minimum of £10,000.

For your DC pension pot, the annual allowance used up is simply the value of contributions that you and Affinity Water make and these can be seen on your annual statements.

For DB pensions, the calculation is a bit more complicated. The allowance used up relates to the increase in the value of your DB pension over the year, which is approximately 16x the pension increase shown on your annual statement. So, if at the start of a year, you had built up pension of £13,000 per year and the next year this had risen to £14,000 per year, your annual allowance used would be approximately £16,000.

You can roll over unused allowances for a maximum of 3 years which may be significant if, via promotion or job change, you go over the £150,000 earning threshold.

Lifetime Allowance

As well as the annual allowance, there is a limit on the total value of your pension pots that can be accumulated tax-free. The rules are complex but put simply, the lifetime value of a DC pension is the value of all the DC pension pots you have. The lifetime value of a DB pension is calculated as 20x the annual pension that you receive, plus any tax-free cash that may come with that pension. From April 2018, the lifetime allowance is £1,030,000 and this is due to increase each year by CPI inflation.

How/When Is the Lifetime Allowance Calculated?

The lifetime value of pension is calculated by the pension provider on taking the benefit and expressed as a % of your lifetime allowance. For example, if you used £100,000 of a £500,000 pot to buy an annuity this year, you would get a certificate showing that you had used about 10% of your lifetime allowance. If you then moved the rest of your pot to an income drawdown the following year, you'd get a certificate showing that you'd used 40%. Once you get to 75, your lifetime allowance will be calculated as above on all funds remaining.

Money Purchase Annual Allowance (MPAA)

If you start accessing your funds after 55, there is a tax-free limit of £4,000 that you can reinvest in a DC scheme. You should consider getting financial advice if you're thinking of doing this.

What If I Exceed These Allowances?

If you exceed your Annual Allowance, this will trigger a tax payment which would require you to notify HMRC about via your self-assessment tax return and arrange the payment. If you exceed the Lifetime Allowance, there will be a Lifetime Allowance charge, possibly as well as an income tax charge.

Where Can I Get More Information?

All information about the Plan and your Personal Account can be found at www.affinitywaterpensions.co.uk