How to pay the annual allowance charge from your pension (Scheme Pays)

Background

Pension rules allow you to make contributions to your pensions of up to 100% of your UK relevant earnings each tax year (for most people this is simply their salary), and there is no limit on your employer making contributions provided they can justify them as part of your overall remuneration package.

However, there is another limit called the annual allowance, and if your total pension contributions exceed your personal annual allowance you will be subject to a tax charge, known as the annual allowance charge (AAC).

'Scheme Pays' is a way by which the AAC can be paid out of a pension scheme, rather than by you personally. This gives you the advantage of not having to find additional funds to pay the charge, but will decrease the value of your pension and you won't benefit from tax-free compound growth on the amount deducted to pay the charge.

Your annual allowance

An AAC arises when any of the annual allowances are exceeded. There are now four different annual allowances in place and your personal annual allowance will depend on your circumstances:

1. **Annual allowance (AA)**
   - This is the allowance that applies if you do not have income in excess of £260,000 and have not taken any pension income
   - Set at £60,000
2. **Money purchase annual allowance (MPAA)**
   - The MPAA applies if you have taken any income under flexi-access drawdown or a lump sum payment that is taxable. Your pension provider will have told you if this limit applies to you
   - Set at £10,000
3. **Tapered annual allowance (TAA)**
   - The TAA may apply to you if your income (including investment income) in the tax year is more than £260,000. Please read our Guide to annual allowance tapering for more information
   - If you are subject to the MPAA this will apply to you rather than any other higher amount under the TAA
   - Varies between £10,000 - £60,000 depending on income
4. **Alternative annual allowance (AAA)**
   - The AAA only applies to defined benefit (final salary) pension schemes, and only then if you have triggered and exceeded the MPAA in a money purchase (defined contribution) scheme such as a SIPP.
   - The AAA does not apply to your AJ Bell SIPP, but you may be able to use your SIPP to pay an AAC arising from exceeding your AAA
   - £50,000 or less (may be reduced by the taper)

For most people the annual allowance will be £60,000

If you have not flexibly accessed your pension benefits (i.e. have not triggered the MPAA) you can still use carry forward to reduce or eliminate any charge. If the MPAA has been triggered then carry forward can only be used in relation to defined benefit accrual.

The annual allowance charge (AAC)

To calculate the amount of the AAC, the total gross amount that has been contributed to all your pensions in the tax year in excess of your personal annual allowance is added to your income for the year, and then income tax is applied. If you have only made personal contributions in the tax year then effectively the charge will cancel out the tax relief you receive. However if your employer has made contributions then you will pay more income tax (but have the benefit of more funds in your pension). Any AAC you incur does not affect your employer's ability to claim a deduction for the purposes of calculating corporation tax.

An important point to remember is that the AAC is not penal for personal contributions, it is simply reclaiming the tax relief that you are not entitled to above the annual allowance. It is important that higher and additional rate tax payers claim their higher/additional relief via self-assessment in the usual way, so the AAC offsets it.

Where can Scheme Pays be used?

Scheme Pays can be used where:

the annual allowance charge (AAC) for the tax year exceeds £2,000, and the contributions paid to your SIPP for the tax year exceeds the annual allowance. With the compulsory version of Scheme Pays, it is the AA that must be exceeded, i.e. £60,000. If you have only exceeded the MPAA or TAA then Scheme Pays cannot be used. However, it may still be possible to use 'Voluntary Scheme Pays' instead.

For the scheme to be required to pay the charge you must notify the scheme by 31 July in the tax year two years after the tax year to which the AAC relates. For example, for a charge relating to the 2022/23 tax year the notification must be received by 31 July 2024. You cannot notify the scheme before the end of the tax year in which the charge arises.

If you intend to fully crystallise your benefits then the notification must be received before the crystallisation.

If the two conditions are met, and the scheme is notified before the deadline, then the scheme will become jointly liable with you for paying the charge. Once a valid notification has been submitted, and if the conditions are met, then you cannot withdraw the notice.

Scheme Pays can only be used when the £60,000 Annual Allowance is exceeded.

Voluntary Scheme Pays

When the conditions for Scheme Pays are not met then a scheme may pay your annual allowance charge on a voluntary basis.

This means Voluntary Scheme Pays can be used to pay charges arising from exceeding the MPAA or TAA whether or not the £60,000 AA is exceeded. It can also be paid from a scheme other than that which received the contributions relating to the charge. For example, a higher earner in a defined benefit scheme may exceed their Tapered Annual Allowance due to benefit accrual in that scheme, but could have the charge paid on a voluntary basis from a SIPP they also hold.

The payment made by the scheme under Voluntary Scheme Pays should be paid by your normal self-assessment deadline, i.e. 31 January in the tax year following that in which the charge arose.

To ensure that this deadline is met your scheme will need to account for the tax charge in quarter 3 which runs from 1 July to 30 September. The tax for this period is paid to HMRC by 14 November. If the request is received in quarter 4 (1 October to 31 December) this tax is only due to HMRC by 14 February so the 31 January deadline is unlikely to be met.

So if you have an annual allowance charge for 2022/23 that you want your scheme to pay under Voluntary scheme Pays you should provide them with the necessary information well in advance of 20 September 2023.

Voluntary Scheme Pays can be used to pay any annual allowance charge.

The scheme can still pay the charge on a voluntary basis at a later date but there is a risk you may receive a late payment interest charge, which would be 6% (6.75% from 13 April 2023). In practice this charge is not always applied when the self-assessment states that the scheme will be paying, but we cannot guarantee this.

In order to pay an annual allowance charge under the voluntary rules the scheme will need confirmation of the amount saved to other schemes (if applicable), the amount of the charge, and the amount you want the scheme to pay. It is possible for you to pay some of the charge personally, and some from the scheme.

Completing your self-assessment tax return

Anyone who has exceeded any of the annual allowances is required to report this to HMRC by completing a self-assessment tax return, even if you have not previously completed a return. You will need to complete the 'additional information' pages of the tax return (pages SA101 in the paper return). The boxes that need to be completed are in the 'Pensions Savings Tax Charges' section.

Pension Savings Tax Charges

7 Value of pension benefits in excess of your Available Lifetime Allowance, taken by you as a lump sum

£ . 0 0

8 Value of pension benefits in excess of your Available Lifetime Allowance, not taken as a lump sum

£ . 0 0

9 Lifetime Allowance tax paid by your pension scheme

£ . 0 0

10 Amount saved towards your pension, in the period covered by this tax return, in excess of the Annual Allowance

£ . 0 0

11 Annual Allowance tax paid or payable by your pension scheme

£ . 0 0

11.1 Value of pension benefits transferred subject to the overseas transfer charge

£ . 0 0

11.2 Tax paid by your pension scheme on your overseas transfer charge

£ . 0 0

12 Pension scheme tax reference number

PSTR

13 Amount of unauthorised payment from a pension scheme, not subject to surcharge

£ . 0 0

14 Amount of unauthorised payment from a pension scheme, subject to surcharge

£ . 0 0

15 Foreign tax paid on an unauthorised payment (in £ sterling)

£ . 0 0

16 Taxable short service refund of contributions (overseas pension schemes only)

£ . 0 0

Box 17 is not in use

18 Foreign tax paid (in £ sterling) on box 16

£ . 0 0

In box 11 you should enter the amount that the scheme has paid, or will pay, under either Scheme Pays or Voluntary Scheme Pays.

HMRC has produced guidance on completing the Pension Savings Tax Charges section, and a working sheet to calculate the amount of the charge. Both these documents can be found here: https://www.gov.uk/government/publications/pensions-tax-charges-on-any-excess-over-the-lifetime-allowance-annual-allowance-special-annual-allowance-and-on-unauthorised-payments-hs345-self/hs345-pension-savings-tax-charges-2018

Our process for Scheme Pays and Voluntary Scheme Pays

If you would like to use Scheme Pays or Voluntary Scheme Pays please contact us for a form. In all cases we will require a copy of your self-assessment return including the Pension Savings Tax Charges section with details of the annual allowance excess, and the amount to be paid by the scheme.

If you want to use Voluntary Scheme Pays and you have saved into other pension schemes that have led to the annual allowance charge, you will need to ask those other schemes to give you a pension savings statement showing the amount saved during the relevant tax year.

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