Annual Allowance (AA)

Video transcript

Here we'll look at the Annual Allowance (AA).

Pensions can be a tax efficient way of saving – you get tax relief on pension contributions and then at retirement, you can take a quarter of the value of your benefits tax-free.

You can pay in as much as you want into a pension scheme, but tax relief is only available if your personal contributions do not exceed 100% of your taxable income, and in addition, certain tax charges might arise if the total payment is not within certain allowances, as I'll explain.

It is your responsibility to manage your tax situation, and USS provides information and some options to consider, but it's you that decides what to do.

The first of the limits is the Annual Allowance. The Annual Allowance is the maximum amount of pension savings you can build up each year before you incur a tax charge. And there's three types of Annual Allowance. There's the standard Annual Allowance that applies to all members. There's the Tapered Annual Allowance that applies if you earn over a certain amount. And the Money Purchase Annual Allowance applies if you've got any defined contribution (DC) savings (including the Investment Builder savings) and you take some or all of them in certain ways.

If you exceed one of the allowances you may have to pay some pensions tax, but there is support available to help you do this and it does not mean you lose your benefits if you go over your allowance.

Before I go on to explain about the Annual Allowance, just a quick reminder of how benefits build up in USS. You build up defined benefits (DB) in the Retirement Income Builder on salary up to the salary threshold. The salary threshold is currently £74,208. Your benefits at retirement from the Retirement Income Builder are based on a build-up rate, the salaries that you earn each year and the length of time that you're in the scheme. You build up a block of pension each year equal to a 75th of your salary up to the salary threshold. Then when you retire, all the blocks of pension are added together (with increases) to give your annual pension. You'll also be entitled to a tax-free cash lump sum of three times your pension.

If you earn above the salary threshold then you'll also build up defined contribution (DC) savings in the Investment Builder. The equivalent of 20% of your earnings above the salary threshold will be put into your

Investment Builder savings pot. Any additional contributions that you make will also be put into the Investment Builder.

The salary threshold was previously around £40,000 and the build-up rate was 85ths from April 2022 to April 2024. But the salary threshold of just over £70,000 and a build-up rate of 75ths came in from 1 April 2024.

Going back to the Annual Allowance and we'll start with the standard Annual Allowance. The standard Annual Allowance for the 2026/27 tax year is £60,000 and it applies to the annual build-up of your pension benefits over each year across all your pension savings. For the previous three tax years, the standard Annual Allowance was also £60,000. But in 2022/23, it was £40,000.

The way that it works is if the build-up of your benefits over a tax year is below this Annual Allowance, you're not affected (unless, you're affected by the Tapered Annual Allowance, which we'll come on to). As we're still in the 2026/27 tax year, we're actually interested in working out whether the Annual Allowance has been exceeded over the 2025/26 tax year.

Your Annual Member Statement that you receive from USS each year will set out how much of your Annual Allowance you've used up from your USS benefits over the tax year, so you do not have to worry about working it out yourself. However, if you also paid into any other pension arrangements during the year, these will not be included in this calculated figure, and you'll need to add these onto your USS figures. Just to note, the Annual Allowance does not need to take account of any State Pension benefits.

Annual Member Statements showing benefits built up to 31 March 2026 and therefore the Annual Allowance used up over the 2025/26 tax year will be available on My USS in the autumn. And just as a reminder, My USS is your online portal for your USS benefits.

To work out the amount of Annual Allowance that you've used up, you need to consider any defined benefits (DB) and any defined contribution (DC) savings you have separately – or in other words, the Retirement Income Builder (DB) benefits and Investment Builder (DC) savings when we're talking about USS.

For the Retirement Income Builder benefits, defined benefits (DB) for USS, the measure is based on the pension block that you've built up over the year, times by 16, plus any lump sum that you've built up over the year. For the Investment Builder, the measure is based on the amounts that you and your employer have actually paid into your pot – but it does not include any investment returns.

If you've paid additional contributions into your Investment Builder or contribute to any other defined contribution (DC) with another pension provider, these are measured in the same way. Just to note that if you transfer a pension in to USS, this does not need to be taken into account in the calculation of Annual Allowance.

So adding together all of your savings across the tax year, across all your pension arrangements, these elements give you your pension value for the year – your Annual Allowance used. Then the amount of

Annual Allowance you've used up is then compared to the standard Annual Allowance for the relevant tax year.

At the moment, we're interested in working out whether the Annual Allowance has been exceeded in the 2025/26 tax year, which is the last full tax year, and we're going to have a look at an example of how this works. Here I have someone who has a salary of £125,000 and they paid £37,000 in additional contributions to the Investment Builder over the 2025/26 tax year. For the purpose of the example, I'm assuming this member only has benefits in USS and no other benefits or earnings from elsewhere.

To work out how much of the Annual Allowance they've used up, we have to look at the Retirement Income Builder and the Investment Builder separately. Starting with the Retirement Income Builder, the defined benefit (DB) part. All members built up a 75th of their salary up to the salary threshold as an annual pension block during the last scheme year. The salary threshold for 2025/26 was £71,484.

Just to note the salary threshold changed in April 2026. The salary threshold is now £74,208. That will be used to calculate the pension built up over this tax year to the end of March 2027, so will be used for the 2026/27 tax year figures.

But going back to this example, we multiply the pension built up over the year by 16 – so that's a 75th of the salary threshold times by 16. A lump sum of three times this pension amount is also built up, so we add on a 75th of the salary threshold times three to get the total Annual Allowance built up from the Retirement Income Builder, and that amounts to £18,109 for this member.

Then we look at the Investment Builder contributions paid in from normal contributions going into the Investment Builder from earning above the salary threshold and also any additional contributions. In this case, we have 20% of earnings above the salary threshold going into the Investment Builder. And there's also the £37,000 additional contributions. For this member that gives total contributions into the Investment Builder of £47,703.

So add these together, the Investment Builder and the Retirement Income Builder allowance used up, and this member's used a total of £65,812 of their Annual Allowance. As the standard Annual Allowance for the 2025/26 tax year was £60,000, this person has exceeded the Annual Allowance.

If your pension value has exceeded the Annual Allowance, it does not automatically mean there's a problem. If you did not exceed the Annual Allowance in the previous three tax years, you can use any unused Annual Allowance to offset any excess over the Annual Allowance in the year that you're looking at. This is called carry forward. USS provides details of how much of the Annual Allowance you've used for the previous three tax years on your Annual Member Statement if you've gone over the standard Annual Allowance in a particular year.

For our example member, let's have a look at what they could carry forward from unused allowances. We're going to look back over the last three tax years and say they've used up an Annual Allowance of £21,800 in the 2022/23 tax year, £22,500 in the 2023/24 tax year and £24,000 in the 2024/25 tax year. They were under the standard Annual Allowance, which was £60,000 in the 2023/24 and 2024/25 tax years, but it was £40,000 in the earliest year. They've got some unused allowances from all of the three previous tax years. Therefore, this member can carry forward these unused allowances to the 2025/26 tax year.

Any unused allowance is carried forward and utilised from the earliest year forward. The Annual Allowance for the 2022/23 tax year was £40,000. This member has an unused allowance of £18,200 from that year. We can use this to increase the standard £60,000 Annual Allowance by a further £18,200. So that means that can be carried forward to add on to the standard Annual Allowance, and that makes the overall Annual Allowance that can be used here £78,200.

As the member’s pension value for the year was £65,812, the carry forward allowance covers that pension value over the standard Annual Allowance and there's no tax charge and no further action for this member.

You can only look back over the last three tax years for unused allowances. So in this case, even though there's still around £12,000 of unused allowance from the 2022/23 tax year, that will be lost going forward, but the member will still be able to use those unused allowances from the 2023/24 and 2024/25 tax years in the Annual Allowance calculation for next year.

Now, let's assume that this member had been paying additional contributions over the last three years and actually they used up all their Annual Allowances in the previous three tax years. That means there's no unused allowances to take into account and means this member has exceeded the Annual Allowance for this tax year and there will be a tax charge to pay.

This member's exceeded the Annual Allowance by £5,812 above the £60,000 standard Annual Allowance and there will be a tax charge and that will be at the members marginal rate of tax. Assuming this member's paying tax at the 40% rate, there will be a tax charge of £2,325. They'll be able to meet this cost directly through their Self Assessment tax return, or may be able to ask the scheme, USS, to pay this cost for them directly from their benefits. And this is called Scheme Pays.