Annual Allowance

Video transcript

Here we're going to look at the Annual Allowance. Pensions can be a tax efficient way of saving. You get tax relief on your pension contributions and at retirement you can take 1/4 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.

In addition, certain tax charges might arise if the total payment is not within certain allowances. Note that it is your responsibility to manage your tax situation. USS provides information and some options to consider, but it's you that decides what to do.

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

If you exceed one of these 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 benefits if you go over your allowance.

But first a quick reminder of how benefits build up in USS. In USS you build up defined benefits (DB) in the Retirement Income Builder on salary up to your salary threshold. The salary threshold is currently £71,484. Your benefits at retirement from the Retirement Income Builder are based on a build up rate, the salaries that you earn 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 you your annual pension. And 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. And any additional contributions that you make will also go into your Investment Builder.

But, the salary threshold of just over £70,000 as it is now and the build-up rate of a 75th of salary only came in from 1 April 2024. The salary threshold was around £40,000 and the build-up rate was 85ths of salary between April 2022 and April 2024.

But for now, going back to the Annual Allowance. And in this section, we're going to look at the standard Annual Allowance. The standard Annual Allowance for the 2025/26 tax year is £60,000 and applies to the annual build-up of your pension benefits over each tax year across all of your pension savings.

For the previous two tax years, the standard Annual Allowance was also £60,000. But in 2022/23 it was £40,000. The way it works is, if the total build-up of your benefits over a tax year is below the Annual Allowance, you're not affected unless you're affected by the Tapered Annual Allowance, which is covered in a different section.

As we're still in the 2025/26 tax year now, what we're interested in is working out whether the Annual Allowance has been exceeded over the 2024/25 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 the Annual Member Statement from USS in their calculated figure and you'll need to add these onto your USS figures. Just to note though, the Annual Allowance does not need to take into account any State Pension benefits.

Annual Member Statements showing benefits built up to the 31 March 2025 and the Annual Allowance used up over the 2024/25 tax year will be available on My USS in the Autumn. My USS, just to remind you, is your online portal for your USS benefits.

To work out the amount of Annual Allowance you've used up, you need to consider any defined benefits (DB) and then defined contribution (DC) savings you have separately. Or in the case of USS Retirement Income Builder (DB) benefits and Investment Builder (DC) savings.

For the Retirement Income Builder, for USS, the measure is based on the pension block you've built up over the year, you times that by 16, plus you take account of any lump sum 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, 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) pension with another pension provider, these are going to be measured in the same way.

Now 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 the Annual Allowance.

Adding together all of your savings in the tax year across all your pension arrangements, these elements give you your pension value for the year, so your Annual Allowance that you've used. The amount of Annual Allowance you used up is then compared to the standard Annual Allowance for the relevant tax year.

Now, as I mentioned, at the moment we're interested in working out whether the Annual Allowance has been exceeded in the 2024/25 tax year, which is the last full tax year.

We're going to have a look at an example now of how this works. Here, I've got someone who had a salary of £125,000 and they paid £37,000 in additional contributions to the Investment Builder over the 2024/25 tax year. I'm going to assume for the purpose of this example that they only have benefits in USS and no other benefits or earnings from elsewhere.

To work out how much of the Annual Allowance they used up, we'll look at the Retirement Income Builder and the Investment Builder separately. Starting with the Retirement Income Builder.

All members build up a 75th of their salary up to the salary threshold as an annual pension block during the last scheme year and the salary threshold for the 2024/25 year was £70,296. Note the salary threshold did change from April 2025.

The salary threshold is now £71,484 and this will be used to calculate the pension built up over the year to the end of March 2026, the 2025/26 tax year. You multiply the pension built up over the year by 16, so that's a 75th of the salary threshold times 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 3 to get the total Annual Allowance built up from the Retirement Income Builder. And this, for this member amounts to £17,808.

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 any additional contributions. In this case, 20% of earnings above the threshold have gone into the Investment Builder from earning above the threshold and then there's this £37,000 additional contribution.

For this member, this gives total contributions into the Investment Builder of £47,941. So you add these together, together with the Retirement Income Builder allowance used up, and this member's used a total of £65,749 of their Annual Allowance.

As the standard Annual Allowance for the 2024/25 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 that there's a problem. If you did not exceed the Annual Allowance in the three previous tax years, you can use any unused allowances to offset excesses over the Annual Allowance in the year that you're looking at and that's called carry forward.

USS provide details of how much of the Annual Allowance you've used up for the three previous tax years on your Annual Member Statement, if you've gone over the standard Annual Allowance in a particular year.

Let's take a look at our example member and to look at what they could carry forward from unused allowances. Looking back over the last three tax years, they say used up an Annual Allowance of £21,800 in the 2021/22 tax year, £22,500 in the 2022/23 tax year and £24,000 in the 2023/24 tax year.

So they were under the standard Annual Allowance, which was £60,000 in the 2023/24 tax year, but £40,000 in the other two years. And they'll have some unused allowances therefore for all of the previous three tax years.

Therefore, this member can carry forward these unused allowances to the current tax year that we're looking at, so to the 2024/25 tax year. Any unused allowance is carried forward and utilised from the earliest year first.

The Annual Allowance for the 2021/22 tax year was £40,000, so this member has an unused allowance of £18,200 from that year. We can then use this amount to increase the standard £60,000 Annual Allowance for the 2024/25 tax year by a further £18,200.

So if we add that on there that takes us to £78,200 for the 24/25 tax year. As that member's pension value for the year was £65,749, the carry forward allowance covers the pension value over the standard Annual Allowance and that means for this member there's no tax charge and no further action.

Note that you can only look back over the last three tax years for unused allowances. So in this case, even though there's still around £15,000 of unused allowance from the 2021/22 tax year that will be lost going forwards, but the member will still be able to use the unused allowances from the tax years 2022/23 and 2023/24 in the Annual Allowance calculation for next year.

However, now let's assume that this member had been paying additional contributions over the last three years and they'd actually used up all their allowances in previous years. That means the member has exceeded the Annual Allowance because there's no carry forward to use and in this case there would be a tax charge to pay.

This member's exceeded the Annual Allowance by £5,749 and that means there'll be a tax charge at the member's marginal rate of tax. Now assuming this member’s paying tax at the 40% rate, that means there would be a tax charge of £2,300.

The member will be able to meet this cost directly through their self-assessment form or may be able to ask USS to pay this cost for them directly from their benefits and that's known as Scheme Pays.