

# Carry forward of unused annual allowance

Pension investors can pay a pension contribution higher than their annual allowance and avoid a charge by carrying forward unused annual allowance from previous tax years.

Generally, the amount someone can save in a pension plan and benefit from tax relief is £40,000. This is unless the individual has flexibly accessed their pension benefits and the lower money purchase annual allowance (MPAA) of £4,000 is triggered. Or if the individual is a high earner and the tapered annual allowance applies.

However, individuals who are not subject to the MPAA can pay more than their annual allowance in a tax year and receive tax relief. This is done by carrying forward any unused allowance, if they have the personal earnings to support it.

## The rules

There are a few rules to understand before using carry forward:

- Individuals can carry forward unused annual allowance from the last three tax years. They must first use up this year's annual allowance, before going back to the earliest of the three previous tax years.
- Defined benefit accruals are valued using a factor of 16 and the value of the opening entitlement is increased in line with consumer price index (CPI) up to the current tax year.
- To use carry forward the individual must have been a member of a registered pension scheme in an earlier tax year. However, there is no need for them to have contributed – they could have been a deferred member.
- The total amount an individual can pay as a pension contribution, and receive tax relief on, will always be restricted by their personal earnings, even if they use carry forward.
- It is not possible to carry forward unused annual allowance against the MPAA. Defined contribution contributions must be limited to £4,000 to avoid a MPAA tax charge.

### Example – Varsha

Varsha earns £85,000. She wants to pay £80,000 into her pension in the 2020-21 tax year. Although £80,000 is greater than the £40,000 annual allowance, Varsha can do this by carrying forward unused tax relief from previous tax years.

Tax year	Annual allowance	Contribution	Unused annual allowance	After paying £80,000
2017-18	£40,000	£30,000	£10,000	£0
2018-19	£40,000	£40,000	£0	£0
2019-20	£40,000	£10,000	£30,000	£0
2020-21	£40,000	£0	£40,000	£0

Varsha allocates £40,000 first to the current year's annual allowance. She then uses up another £40,000 unused annual allowance from previous tax years.

This means she can make the £80,000 contribution she wanted to, and this uses up all of Varsha's carry forward allowances.

### Example – Jimmy

Jimmy earns £70,000. He has already paid a £15,000 pension contribution in May 2020. He wants to know the maximum additional contribution he can pay in the same tax year.

Tax year	Annual allowance	Contribution	Unused annual allowance	After paying £55,000
2017-18	£40,000	£10,000	£30,000	£0
2018-19	£40,000	£30,000	£10,000	£0
2019-20	£40,000	£0	£40,000	£35,000
2020-21	£40,000	£15,000	£25,000	£0

Jimmy has to use up this year's remaining annual allowance of £25,000 first. He has another £80,000 he can carry forward from previous years, making a total of £105,000. However, as Jimmy only earns £70,000, this is the maximum contribution he can make and receive tax relief. If he pays a further £55,000, he would still have unused annual allowance of £35,000 which he could carry forward to the next tax year.

## Using carry forward with the MPAA

Where the individual has flexibly accessed their benefits the MPAA of £4,000 will be triggered. It's not possible to use carry forward in conjunction with the MPAA. However, it's possible for an individual subject to the MPAA to carry on accruing benefits in a defined benefits scheme. And any unused annual allowance could be used to cover a large benefit accrual in a defined benefits scheme.

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## Using carry forward with the tapered annual allowance

The tapered annual allowance reduces the annual allowance for high-earning individuals down to a minimum of £4,000. Carry forward may be very useful to enable these individuals to pay a higher pension contribution than their tapered annual allowance allows.

The amount that can be carried forward is worked out by reference to the individual's reduced annual allowance in any given year.

Carry forward may also be helpful in shaping the taper. Whether the annual allowance will be tapered is only decided at the end of the tax year. This is because the calculation depends upon the individual's taxable income in the tax year, as well as other factors. They have to meet two measures before their annual allowance is tapered – their adjusted income has to be above £240,000 and their threshold income has to be above £200,000. See factsheet on tapered annual allowance (0322) for more information.

However, individuals may have the chance to shape their tapered annual allowance. They could pay (further) personal contributions before the end of the tax year to reduce their threshold income and possibly avoid their annual allowance being tapered.

### Example – Justin

Justin has been made redundant and his total income for the tax year 2020-21 is £250,000. His employer contributions into his Sipp for the tax year are £10,000. He has unused carried forward tax relief from the previous three years of £75,000.

Justin's adjusted income is:

$$£250,000 + £10,000 = £260,000$$

His tapered annual allowance is £30,000

However, Justin can reduce his threshold income by paying a member contribution. The maximum he can pay is:

$$£30,000 (£40,000 - £10,000) \text{ for } 2020-21$$

+ Carried forward annual allowance of £75,000

$$= £105,000$$

This would reduce his threshold income to:

$$£250,000 - £105,000 = £145,000$$

This brings his threshold income below £110,000, and his annual allowance would not be tapered, and instead remains at £40,000.

## Using carry forward

Individuals who want to use carry forward do not have to make a claim to HMRC to carry forward unused annual allowance, and if there's no annual allowance charge due they don't have to record the details on a self-assessment tax return. However, contributions always count in the tax year in which they are paid, which can be important for general tax planning. Obviously, good record keeping will help show what action was taken.

## The tax year 2015-16

The tax year 2015-16 was split into two 'mini' tax years. The annual allowance for the pre-alignment tax year (6 April 2015 to 8 July 2015) was £80,000, and was £0 for the post-alignment tax year (9 July 2015 to 5 April 2016). Individuals can carry forward any unused annual allowance from the pre-alignment tax year to the post-alignment tax year, up to a maximum of £40,000.

For carry forward, the pre-alignment tax year is ignored, and it's only the unused annual allowance from the post alignment tax year that can be carried forward (i.e. up to £40,000).



### If you only read one thing...

- Pension investors can pay a pension contribution higher than their annual allowance and avoid an annual allowance charge by carrying forward unused annual allowance from the previous three tax years.
- Individuals must use up the current year's annual allowance first then go back to the earliest of the three previous years.
- They can use carry forward in conjunction with the tapered annual allowance.
- They can also use carry forward to pay a higher personal pension contribution and so possibly reduce their threshold income. Doing so could help avoiding a tapered annual allowance.



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