

Carry forward of unused Annual Allowance

In this session we will be discussing carry forward of unused annual allowance. We will be looking at what it is, how to calculate it and planning issues that may arise.

It is no unusual for individuals to have spikes in their pension accrual, they might have a bonus in the year or make large amounts of profit and use the wherewithal to make a large pension contribution.

Individuals in defined benefit pension schemes may, as a result of promotion, find that they exceed the annual allowance of £50,000. In recognition of this, the Government has brought in carry forward of unused relief with effect from 6 April 2011, so that individuals can carry forward unused annual allowance from the 3 previous tax years to the current tax year, to enable a greater contribution in excess of the annual allowance.

Now, carry forward is automatic. The individual can self-certify - the registered pension scheme doesn't need any supporting documentation. The member does not have to make a claim to HMRC to use it and they don't need to show it on their tax return either, unless as a result of the carry forward there is still an annual allowance charge to pay for the current tax year.

Carry forward will apply on a continuous basis and will allow significant contributions to be made in a tax year, but a client will still have to have relevant earnings in order to cover those contributions.

So what are the rules?

There is a strict order in which you use your annual allowance in a particular tax year. First you must use the annual allowance for that tax year first. Then you use the carry forward from the earliest carry forward year, and so on.

In the 2011/12 tax year the carry forward years were those years when the annual allowance was greater than £50,000, but for the purpose of the carry forward calculation you assume a £50,000 annual allowance in those 3 tax years.

There is one thing to note about the calculation of benefits within those carry forward years, for defined benefit pension schemes and cash balance arrangements, you use a factor of 16 to calculate the increase in pension over the period, and you have an uplift of CPI on the opening balance.

Now you must have been a member of a registered pension scheme at some point in those carry forward tax years in order to have unused annual allowance. If the contribution in a carry forward year is in excess of £50,000 it may use up some or all of the unused annual allowance in a previous carry forward year.

What does that mean? Here are some examples that show the amount of carry forward based on contributions made in the carry forward years of 2008/09 to 2010/11.

In example 1 the individual is a member of registered pension scheme, but no contributions were made in 3 carry forward years. The amount of unused annual allowance that can be carried forward for this individual is, therefore, £150,000.

In example 2 they have no unused annual allowance for 2008/09 because the pension input exceeds £50,000. They have £10,000 from 2009/10 and the full £50,000 from 2010/11, making a total of £60,000 to carry forward.

Example 3 shows an important mechanism of the carry forward calculation. The total pension input over the carry forward period is the same as for example 2. However, the amount of unused annual allowance is £50,000 rather than £60,000.

Why is this? We will take each year turn.

In the 2008/09 tax year the unused annual allowance is £10,000, but for 2009/10, the pension input exceeded the deemed £50,000 annual allowance by £20,000. This used up the 2008/09 carry forward amount of £10,000. Effectively there is no carry forward of unused annual allowance from the 2009/10 tax year. In 2010/11 there is £50,000 to carry forward as no contributions were made this year.

The key point this example shows is that where contributions in any one of the intervening carry forward years is greater than £50,000, it may cancel out some or all of previous years unused annual allowance, but negative amounts will not be carried forward to the next year for the purpose of the calculation.

The last example illustrates this point again.

There is £50,000 unused annual allowance for 2008/09. The pension input amount of £150,000 in 2009/10 will use up some of this unused annual allowance. However, this has no effect on the unused annual allowance for the 2010/11 tax year. Therefore, the carry forward amount in respect of the 3-year period is £50,000. This is made up entirely of the unused relief from the 2010/11 tax year.

So now to the planning opportunities, for those people who are subject to the special annual allowance, carry forward may give them the scope to catch up on some contributions. This is especially where those people might have restricted themselves to £20,000 in the previous 2 tax years.

Now the tax relief will be available at their highest marginal rate. This could be at 50%, so it's worth making these contributions while the 50% tax relief still lasts. Now there is the ability to use this carry forward to make significant funding so that someone might also get back their personal allowance by reducing their taxable income to below £100,000.

It is also useful for people who may want to bring forward large contributions before they apply for fixed protection. Fixed

protection has to be applied for before 6 April 2012.

At the very least its worth considering carrying forward and making the contribution in respect of unused annual allowance for the 2008/09 tax year. All in all carry forward at the extreme allows someone to make larger contributions in the 2011/12 tax year.

For example, if they hadn't made any contributions at all while a member of a registered pension scheme in those 3 carry forward years, they could make up to £200,000 worth of contributions in the 2011/12 tax year.

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