

## CASE STUDY

# CARRY FORWARD AND THE TRANSITIONAL ANNUAL ALLOWANCE

APPROVED FOR ADVISER USE ONLY | JANUARY 2024



*The ability to carry forward unused allowance gives some flexibility to those looking to make larger tax relieved contributions when their circumstances allow. However, the transitional annual allowance rules from 2015/16 add some additional complexity to the calculations.*

### The Challenges

It is coming up to the end of the 2016/17 tax year, and Geraldine has recently inherited some money from her late aunt. She would like to use some of the money to make a large contribution to her pension. Geraldine earns £48,000 a year and joined her first pension at the beginning of the 2015/16 tax year when she joined her current employer. The company offers a generous matched contribution scheme which Geraldine has been using to contribute 30% of her salary in total.

Geraldine is vaguely aware that there are limits to how much you can contribute each year while benefiting from tax relief, but it's not something she's fully considered before now as she was assured that her regular contributions would not cause a problem. However, now she would like to know how much of her inheritance she can contribute in a tax efficient way. She arranges a meeting with a financial adviser, Joey, to discuss things further.

### The Actions

Joey confirms that Geraldine can personally contribute up to the value of her earnings each year while claiming tax relief. However, if the total value of all her contributions, including her employer's, exceeds the annual allowance, then she will incur an annual allowance charge which

effectively takes back the tax relief on the excess amount.

Joey goes on to explain that the annual allowance is £40,000, and there is also a provision called 'carry forward' which allows people to use up unused annual allowance from up to three previous tax years. However, there is a condition that a person has to have been a member of a registered pension scheme during any year from which they wish to carry forward unused allowance. As Geraldine only joined a pension for the first time last tax year, that is the only one from which she will be able to use carry forward.

To make matters more complicated, Joey tells Geraldine that 2015/16 was a strange year for annual allowance calculations, due to an exercise to align everyone's pension input periods (the period of time over which pension savings are measured and tested against the annual allowance) to the tax year. Joey explains that there are sometimes situations where it would be beneficial to pay a contribution in one tax year, but to test it against the annual allowance for a different tax year. Before the alignment exercise, it was sometimes possible to alter pension input periods in order to achieve this. Now, however, all contributions are simply tested against the annual allowance in the tax year in which they are paid.

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Because of the alignment exercise, Joey can't calculate how much carry forward Geraldine has from 2015/16 just by knowing that she and her employer contributed £14,400 in total. He needs to know exactly when the contributions were paid. Geraldine checks her records and finds that her monthly contributions of £1,200 were paid on the 15<sup>th</sup> of each month.

Joey explains that he needs the dates because the alignment exercise involved splitting 2015/16 into two: the 'pre-alignment' and the 'post-alignment' periods. The amount of carry forward available depends on what was left at the end of the post-alignment period.

The pre-alignment period ran from 6 April 2015 to 8 July 2015. On 8 July, all pension input periods were closed, regardless of when they would otherwise have ended. The annual allowance for the pre-alignment period was doubled to £80,000. The post-alignment period then ran from 9 July 2015 to 5 April 2016, after which all pension input periods would run in line with the tax year. For those not affected by the money purchase annual allowance, the annual allowance for the post-alignment period was £0, plus up to £40,000 of unused allowance from the pre-alignment period. Joey explains that these complex rules prevented people from being unfairly disadvantaged by the alignment exercise, without enabling people to take unfair advantage of it either.

Geraldine comments that it's fortunate carry forward can only be used for three years, so that people won't need to look back to the 2015/16 rules for too long. However, Joey explains that unfortunately, advisers do sometimes need to look back further than three tax years to get a complete picture of someone's carry forward situation. This happens when someone has already exceeded the annual allowance in one of the previous three tax years, and it's necessary to go back further to work out where the carry forward to cover that previous excess came from.

## The Results

Due to the dates of Geraldine's contributions, she paid in £3,600 during the pre-alignment period. The annual allowance for her post-alignment period was therefore £40,000, and she contributed £10,800 in that time. This leaves Geraldine with £29,200 of available unused allowance to carry forward, giving her a total annual allowance this year of £69,200. Taking off the £14,400 she and her employer will already contribute this year, this would leave £54,800.

While Geraldine has inherited enough to contribute this much, she would be contributing over her earnings for the year. Therefore while she wouldn't exceed her annual allowance, she would not be eligible for tax relief on all that she paid in.

Instead, Joey suggests that Geraldine pays in a further £32,640 net, which with £8,160 of tax relief gives a total further contribution of £40,800 - on top of the £7,200 from her half of the matched contributions. This means that she has contributed as much as she can while claiming tax relief; additionally, her total for the year (including her employer's contribution) remains within her annual allowance. As Geraldine has not used all of her available carry forward allowance, she can consider using this next tax year if she wishes to make a further larger tax relieved contribution.

## Contact Details

If you'd like to speak to us about anything in this case study, please contact us on:

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