# How your **pension is taxed**

Your guide to **pension tax** rules and allowances

isio.



# Understanding tax and your pension

This guide explains the main pension tax rules and allowances that apply to your savings. It will help you understand how they may affect your pension while you're paying into it, and when you retire, including:


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The information in this guide applies to members with both defined benefit (DB) and defined contribution (DC) pension benefits.



Isio, Birmingham

# How tax relief works

**One of the great advantages of saving for retirement with a pension is that some of the money that would normally go to the government in tax goes towards your pension instead. This is known as tax relief.**

Tax relief usually boosts your pension savings by at least 20%. Over time, this extra money can make a significant difference to the amount you save for retirement.

There are **two ways** you can get tax relief on your pension contributions.

These are known as:

Relief at source

Net pay arrangement

You pay into your pension through a net pay arrangement. This means your pension contributions are taken from your pay before tax, so you pay less tax overall.

Instead of paying tax on that portion of your earnings, it goes straight into your pension.

With this method, you get full tax relief at your highest rate automatically, so you don't need to claim anything separately.




**Example:** If you're paying tax at the basic rate (20% income tax) and you put **£100** into your pension, it will usually cost you **£80**. The remaining **£20** comes from tax relief.

# How much tax relief can I get?



## Each tax year until you're 75, you can usually get tax relief on the money you pay into your pension up to the lower of:

- your annual earnings – for most people, earnings include salary, wages, bonuses and self-employed income (HMRC calls these "relevant UK earnings"), and
- your annual allowance, which is **£60,000** for most people

The annual allowance (AA) looks at the total pension savings built up during the tax year across all your pension arrangements (see page 5).

You may be able to pay more into your pension than these limits if your scheme allows it. However:

✗ any contributions above your earnings will not normally qualify for tax relief, and

✗ you may have to pay a tax charge if your total pension savings exceed your available annual allowance

You cannot get tax relief on pension contributions you've made after age 75.

### What limits apply?

You can usually get tax relief on pension contributions up to the total amount you earn in a year, before tax, subject to the tax limits that apply.

There are limits on how much of your pension savings can benefit from tax relief each year and over your lifetime.

These limits are set by the government and may change at the start of each tax year in April. You may trigger charges if you go over them.

**Kristine Dela Torre | Belfast team**



# Pension tax limits while you're saving

## Annual allowance (AA)

### Affects most people saving into a pension.

The AA is the main tax allowance affecting defined benefit (DB) and defined contribution (DC) members.

This is the limit on the total pension savings built up across all of your pension arrangements during a tax year (also known as the pension input period) before you may need to pay an AA tax charge. For DC pensions, this is usually based on the total amount paid in to your pension pot by you and your employer.

For DB pensions, this is based on the increase in the value of your pension benefits over the tax year rather than the contributions paid.

The AA for the 2026/2027 tax year is **£60,000**.

## Money purchase annual allowance (MPAA)

### Only applies if you've started taking taxable benefits from a DC pension

The MPAA limit is **£10,000** a year.

If the total contributions to your DC pension paid by you and your employer in the tax year exceed this limit, an annual allowance tax charge may apply to the excess amount.

If you're paying into both a DC and a DB pension and have an MPAA, different limits may apply to your pension savings. If your DC pension savings exceed the MPAA, an alternative annual allowance (AAA) may apply to your DB pension savings. For most people, the AAA is **£50,000**.



# Tapered annual allowance (TAA)



## The TAA only affects high earners.

It reduces how much you can pay into your pensions before you may have to pay an AA tax charge.

The taper applies if both of the following are true in a tax year:

- your taxable income is over £200,000 – usually all your income minus the amount you pay into a pension, and
- your 'adjusted income' is over £260,000 – all your income plus the amount your employer pays into your pension, or the amount your DB pension has grown by

If both apply, your AA is reduced by £1 for every £2 of adjusted income above £260,000. The maximum reduction is £50,000, which means your AA can be as low as £10,000 if your adjusted income is £360,000 or more.



Depending on your income and pension savings, your AA could be anywhere between £10,000 and £60,000. You can find more detailed information about the TAA on the MoneyHelper website at moneyhelper.org.uk/en/pensions-and-retirement/tax-and-pensions/tapered-annual-allowance.

**Richard Paddle | London team**



## Lifetime allowance (LTA)

**The LTA was abolished in 2024.**

It was a limit on the maximum amount you could save into all your pensions throughout your working life before you had to pay tax.

It affected those with the largest pension savings. For the tax year 2023/2024, it was set at £1,073,100. The LTA was abolished in April 2024 and was replaced by **three lump sum allowances**.

## The lump sum allowance (LSA)

When you retire, you can usually take some of your pension as a one-off cash payment without paying tax on it. This is often called a tax-free lump sum.

There is a limit on how much tax-free cash you can take across all your pensions combined. This limit is called the lump sum allowance (LSA).

For most people, the maximum tax-free lump sum they can take in total is **£268,275**. This is usually up to 25% of your pension savings.

Some people have special protection linked to the old LTA rules. If you have this protection, your tax-free lump sum may be higher and will be based on 25% of your protected amount.

If the scheme is the only pension you have, you only need to make sure that the total tax-free cash you want to take from the scheme isn't more than £268,275 (or your protected amount, if you have one).



## The lump sum & death benefits allowance **(LSDBA)**

The LSDBA is a limit on how much tax free cash can be paid out from a person's pensions during theirlifetime and following their death. This limit applies to the total of all tax-free lump sums paid to and in respect of that person apart from the following:

- small lump sums (under £10,000)
- charity lump sum death benefits
- winding-up and trivial commutation lump sums, and
- certain death benefits from funds crystallised before 6 April 2024 where the member dies before age 75 (for example, payments under a pension guarantee period)

The LSDBA is **£1,073,100**.

If the total tax-free lump sums paid go over this limit, the extra amount is not tax free. The person who receives the money will have to pay income tax at their own tax rate on anything above the limit.

Some people have special protection linked to the old LTA rules. If you have this protection, your LSDBA may be higher and will be based on your protected amount.

## The overseas transfer allowance **(OTA)**

The OTA is a limit on how much tax-free pension money you can move out of the UK. This only applies if you transfer your pension to an approved overseas pension scheme (called a Qualifying Recognised Overseas Pension Scheme, or QROPS).

For most people, the maximum you can transfer without paying extra tax is £1,073,100.

Each transfer to a QROPS from 6 April 2024 will reduce this limit.

Some people have special protection linked to the old LTA rules. If you have this protection, your OTA may be higher and will be based on your protected amount.

If the value of your pension transfer is more than your OTA, the amount over the limit may be charged with a 25% overseas transfer tax.



# What happens if you go over the annual allowance

## How we'll let you know

If your pension savings in schemes administered by Isio go over the AA, we'll send you a pension savings statement. This statement will tell you how much of your allowance you've used and what your options are.

You may need to pay a tax charge if:

- your total pension savings in a tax year go over the AA, plus any unused allowance you've carried forward from the previous three tax years, or
- your savings in DC pensions go over the MPAA (if this applies to you)

If you have pension benefits in more than one scheme, your savings might not exceed the AA in each scheme on their own but could do so when added together. In this case, you can ask each scheme administrator for a statement to help you check whether your total pension savings for the year go over the AA or MPAA.

If you think your AA may be reduced because of the TAA and you haven't received a statement from Isio, you can ask for one to help you work out whether you may need to pay a tax charge.

**To do this, call us on 0800 122 3200.**



## Carrying forward unused annual allowance

You can carry forward any unused AA from the previous three tax years and add it to your allowance for the current tax year.

This can increase the amount you can save into your pension without needing to pay a tax charge. It can be helpful if you want to pay more in a particular year.

You can carry forward unused AA from the previous three tax years, whether you have:

- **the standard AA of £60,000, or**
- **a TAA of between £10,000 and £60,000**

If the taper applies to you, the amount you can carry forward is based on any unused tapered allowance from those earlier years.

If the MPAA applies to you, you cannot use any unused allowances from previous tax years to increase the amount you can contribute to a DC pension. This means that you can't use carry forward to increase your MPAA limit.

However, if you also have DB pension benefits, you may still be able to carry forward unused AA from the previous three tax years when working out whether those DB pension benefits exceed the AA.

It's your responsibility to work out whether you can use carry forward and how much you have available.

You can check if you have any unused annual allowances on the government's website at [tax.service.gov.uk/pension-annual-allowance-calculator](tax.service.gov.uk/pension-annual-allowance-calculator).



# If you go over the annual allowance

## If you go over your available allowance, you'll need to pay tax on the excess amount. You can deal with this in one of two ways:

### 1 Ask the scheme to pay on your behalf

You can ask your pension scheme to pay the tax charge to HMRC on your behalf. This is known as Scheme Pays. It allows you to pay the charge using your pension, rather than paying it yourself. If you want to use Scheme Pays, you need to complete and submit a form to your scheme administrator, Isio

**There are two types of Scheme Pays** – **mandatory** and **voluntary**. If you meet certain conditions you may qualify for mandatory Scheme Pays. In these cases, your scheme must pay the tax charge on your behalf.

If you don't meet the conditions for mandatory Scheme Pays – for example, if your tax charge is less than £2,000 – your request may be considered under the scheme's voluntary Scheme Pays arrangements instead. Whether voluntary Scheme Pays is available will depend on the scheme rules and any Trustee discretion that applies.




You can find more information about how Scheme Pays works in the dedicated guide and on the government's website at gov.uk/guidance/who-must-pay-the-pensions-annual-allowance-tax-charge.

### 2 Pay the tax charge yourself

You can choose to pay the tax charge directly to HMRC. If you do this, then HMRC will include the charge in your usual tax calculation.



# You'll need to let HMRC know how you'll pay your charge

## Whichever option you choose, you'll need to let HMRC know by completing a self-assessment tax return by 31 January following the end of the tax year. This will either:



calculate how much tax you need to pay and explain how to pay it, or



confirm that your pension scheme has paid the charge on your behalf

You can find more information about this on the MoneyHelper website at moneyhelper.org.uk/en/work/self-employment/how-to-fill-in-a-self-assessment-tax-return.



# How salary sacrifice works

**You may be able to pay more into your pension through salary sacrifice, if the scheme rules allow.**

Salary sacrifice allows you to exchange part of your salary for a non-cash benefit, such as higher pension contributions.

Your employer then pays this amount into your pension on top of their usual contributions.

Because your salary is lower, you'll usually pay less tax and National Insurance. This means you could take home more pay overall, while also increasing the amount going into your pension.



If you'd like to find out more about salary sacrifice or whether it's available to you, please contact us on **0800 122 3200**.

**Ian Wort | Croydon team**



# Income tax on your pension

**You'll usually need to pay income tax on your pension. We'll take away any tax due before we pay it to you.**

When we first set up your payments, we'll use a temporary tax code until we receive confirmation of your correct tax code from HMRC.

- If you pay too much tax before HMRC confirms your tax code, we'll repay the overpaid amount.
- If you think your tax code is wrong, please contact HMRC directly and ask them to check and update it if necessary. We are unable to contact HMRC on your behalf.
- If HMRC tells you that your tax code has been updated, it may take some time for the new code to be sent to us and applied to your pension.

For more information, visit gov.uk/tax-codes/how-to-update-your-tax-code.



# Where to go for help and support

Pension tax rules can feel complex, but you don't need to figure them out alone. If you're unsure how any of the allowances apply to you, speak to Isio or use the free, impartial guidance available below.



## Get in touch

**Call:** 0800 122 3200

Please have your membership reference number to hand when you call. You can find this in your online account and on any correspondence from Isio about your pension.

**Email:** adminhelp@isio.com

We aim to reply within 10 working days.

**Send us a message:** Visit yourisio.com/forms/member-enquiry, complete the form and select Submit. Once we've resolved your query, we'll get back to you.

## Getting guidance

### MoneyHelper

MoneyHelper offers free support on a wide range of financial matters. This includes a variety of pension topics.

**Visit:** moneyhelper.org.uk/en/pensions-and-retirement/tax-and-pensions

### GOV.UK

The UK government's official website has clear information on pension tax rules.

**Visit:** gov.uk/tax-on-pension

The government's Tax Confident campaign is a free HMRC resource designed to help people understand tax in plain English and build confidence in managing their tax affairs. It covers key life stages and situations, including planning for retirement.

**Visit:** taxconfident.campaign.gov.uk

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