AJBell Investcentre

SIPP | ISA | GIA

Maximum contributions restricted by earnings

Points covered: Annual allowance; UK relevant earnings; carry forward

Mr Baker is employed as a manager for a large retailer on a salary of £45,000 a year. He has been a member of the company's group personal pension for a number of years. He has recently received an inheritance of £300,000 and would like to use some of this to make a substantial contribution to his pension.

Currently Mr Baker contributes 3% of his salary to his pension, and his employer contributes 5%, which equates to a total of £3,600 a year.

Mr Baker is aware that the annual allowance for pension contributions is £40,000 and believes that he can carry forward unused allowance from the previous three tax years.

However, Mr Baker's maximum contribution will be restricted by his earnings. The maximum personal contribution that can be made to a pension in any tax year is the higher of the 'basic amount' (currently £3,600) and relevant UK earnings. So, for Mr Baker this is £45,000.

As he is already contributing 3% of his salary – £1,350 – this means the maximum additional contribution will be £43,650.

He decides to put this amount in. This requires an additional net contribution of £34,920. When the 20% basic rate tax relief is added, this takes it up to £43,650.

Employer contributions are not restricted by relevant earnings, so the £2,250 contributed will not restrict his personal contribution.

The total contributions measured against his annual allowance will therefore be £47,250.

If this contribution is made in the "post-alignment period" (9 July 2015 – 5 April 2016) following the Emergency Budget announcement regarding the alignment of pension input periods (PIPs) to tax years, this will use up his post-alignment carried forward annual allowance of £40,000 for 2015/16 plus £7,250 carried forward from 2012/13.

Important information

This information is based on our current understanding of the pension changes. This is provided for information only, we do not provide advice.

Please note that the value of investments, and any income from them, can go down as well as up, and you may not get back your original investment. Tax rules can change in the future and the tax treatment depends on your personal circumstances. We do not offer advice about the options available, or the suitability of our products and services. Taking income from your SIPP instead of buying an annuity can be complex. You need to consider the investment returns that you may be able to achieve and the level of income that you wish to take.

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