House of Commons Library

Research Briefing

14 October 2024

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Pension tax relief: the annual allowance and lifetime allowance

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Summary

In the UK, pensions are only usually liable for income tax at the point they are withdrawn. There is tax relief for contributions to pension schemes below certain thresholds (someone can't usually pay more than their annual earnings, or more than £60,000 a year, without paying income tax). Growth in the value of pension investments is not usually taxed.

This briefing gives an overview of the limits to pension income tax relief in the UK. For a general overview of pensions taxation, see the Library briefing Pensions Tax.

How are private pensions taxed in the UK?

In the UK, private pensions use an "exempt, exempt, taxed" (EET) model for income tax:

- Exempt: people do not pay income tax on pension contributions, although there are limits on these contributions.
- Exempt: people do not pay income tax if their pension investments increase in value.
- Taxed: withdrawals from pensions incur income tax like other income. However, people can withdraw up to 25% of their pension as a tax-free lump sum (a one-off payment).

What are the limits to pension income tax relief?

There are limits on the amount of pensions income tax relief someone can receive.

Limits to tax-free contributions

An annual allowance limits the amount someone can pay into pension schemes each year before they must pay income tax. In 2025/26, people can contribute up to £60,000 into pension schemes without paying income tax.

Usually, people cannot receive tax relief on pension contributions above their annual earnings. However, people can still contribute up to £3,600 a year, including tax relief, even if their earnings are lower than this (see box 4 below).

The annual allowance is tapered (reduced) for higher earners. It is reduced by £1 for every £2 someone earns over £260,000 (including pension contributions). Tapering stops when the annual allowance reaches £10,000.

In defined contribution pension schemes people build up a pot of money that can be used for retirement. In certain circumstances if someone withdraws money from a defined contribution scheme then the amount that they can contribute to these schemes in future – and still receive tax relief - reduces permanently. The lower allowance, known as the money purchase annual allowance, is set at £10,000 a year.

Abolition of the lifetime allowance

There was a limit on the amount people can build up in pension schemes over their lifetime and still receive tax relief.

At the Spring Budget 2023, the government announced that it would abolish the lifetime allowance. It started this process by removing the tax charge for exceeding the lifetime allowance from 6 April 2023 and abolished the lifetime allowance fully in the Finance Act 2024 from 6 April 2024.

What are the options for reform?

The Library briefing Reform of pension tax relief discusses in more detail the different approaches that may be taken to taxing pensions, and reforms that have been made to the UK system.

1 Background

1.1 Income tax

All "non-savings" income is subject to income tax at the same rates. This includes income from earnings, pensions, taxable social security benefits, trading profits, and income from property.[1]

There is no income tax on the first part of someone's earnings – their personal allowance. The standard personal allowance is £12,570 in 2025/26.[2]

There are three main rates of income tax:

- The basic rate of 20%
- The higher rate of 40%
- The additional rate of 45%[3]

There are different rates of income tax in Scotland (see box 1 below).

1 Devolution and income tax

The Scotland Act 2012 introduced the Scottish rate of income tax from April 2016, and the Wales Act 2014 introduced the Welsh rate of income tax from 6 April 2019.[4]

In Scotland, income tax rates now differ from those in the rest of the UK.

1 Further information is available in Commons Library research briefing CBP 9993, Direct taxes: rates and allowances for 2024/25
2 The personal allowance may be larger for people claiming marriage allowance or blind person's allowance. It is tapered for people with an income over £100,000 and reduces as their income increases until £127,000 where people have no personal allowance remaining.
3 HMRC, Overview of Tax Legislation and Rates, November 2024 (Annex A)
4 Scotland Act 2012, s 25-27, and Wales Act 2014, s 8-11

People pay income tax in bands, which means they pay different rates of tax on different parts of their income. The table below shows the income tax rates people pay in each band if they have the standard personal allowance of £12,570 in 2025/26.

Income tax rates 2025/26

England, Wales and Northern Ireland			Scotland		
	Band	Rate		Band	Rate
Basic	£12,571 to £50,270	20%	Starter	£12,571 to £15,397	19%
Higher	£50,271 to £125,140	40%	Basic	£15,398 to £27,491	20%
Additional	Over £125,140	45%	Intermediate	£27,492 to £43,662	21%
			Higher	£42,663 to £75,000	42%
			Advanced	£75,001 to £125,140	43%
			Top	Over £125,140	47%

Source: HM Government, Income Tax rates and Personal Allowances

1.2 Income tax relief

When people contribute to their pension they receive income tax relief.[5] People do not pay income tax on their pension contributions, although there are limits to the amount of tax relief people receive. The amount of tax relief someone receives depends on their marginal rate of income tax (see box 2 below).

2 Marginal rate of income tax

Because people do not pay income tax on their pension contributions, they receive income tax relief at the same rate as the income tax they would have paid if they had not contributed to a pension.

The marginal rate of income tax is the tax rate someone would have paid on their last pound of earnings.

5 HMRC, Pensions Tax Manual, PTM044100 - Contributions: tax relief for members: conditions, 7 April 2025

1.3 What are the limits on pensions tax relief?

There are limits on the amount of pensions tax relief someone can receive.

Limits to tax-free contributions

A person cannot usually receive tax relief on pension contributions worth more than their annual earnings.[6] However, people can still contribute up to £3,600 a year, including tax relief, even if their earnings are lower than this.[7]

There is also an annual allowance. The annual allowance restricts the amount of tax relief someone can receive on pension contributions.[8] In 2025/26, people can contribute up to £60,000 into pension schemes without paying income tax.[9]

The annual allowance tapers (reduces) for higher earners. The annual allowance reduces by £1 for every £2 someone earns over £260,000 (including pension contributions). Tapering stops when the annual allowance reaches £10,000.[10]

3 Types of pension scheme in the UK

There are two main types of pension schemes in the UK:

- Defined benefit schemes pay a promised pension based on factors, such as salary and length of service. A sponsor, usually an employer, guarantees the payment of the promised benefits. The pension provides an income for life and may include a lump sum.
- Defined contribution schemes provide a pot of money for retirement instead of a guaranteed pension. The value of the pension pot can increase or decrease depending on factors, including investment returns and contributions made.

Once someone accesses their savings from a defined contribution pension scheme, the tax relief they receive on contributions to defined contribution pension schemes in future permanently reduces to the money purchase annual allowance (MPAA).[11] In 2025/26 the MPAA is £10,000.[12]

6 Finance Act 2004, s 190
7 This would be a maximum contribution of £2,880 a year with 20% tax relief of £720 through a relief at source pension scheme. Further details about relief at source schemes are available in the Commons Library research briefing CBP 625 Pensions tax.
8 Finance Act 2004, sections 227-238A
9 Finance Act 2004, section 228
10 Finance Act 2004, s 228ZA as amended by Finance (No. 2) Act 2023
11 Defined contribution schemes are referred to as money purchase schemes in legislation.
12 Finance Act 2004, Section 228ZA

Lifetime allowance

There is not a limit on the amount people can build up in pensions over their lifetime.

Previously the lifetime allowance was the maximum pension savings someone could usually receive tax relief on. At the Spring Budget 2023, the government announced that it would abolish the lifetime allowance.[13] It started this process by removing the tax charge for exceeding the lifetime allowance from 6 April 2023 and abolished the lifetime allowance fully in the Finance Act 2024 from 6 April 2024.[14]

In 2023/24, the standard lifetime allowance for most people was £1,073,100.[15]

There remain related limits on the amount people can receive from a pension without paying income tax which link to the value of lifetime allowance. Section 3 of this briefing paper covers these.

1.4 Developing the current pensions tax system

The current pensions tax system is based on reforms introduced on 6 April 2006, known as “A-day”. On A-day, the pensions tax system was significantly simplified by replacing the eight earlier tax schemes with a single system.[16] This aimed to simplify the system and put people in a better position to make informed choices about pension saving.[17]

Previously, there had been a range of limits on annual contributions and final benefits in pension schemes. The 2006 reforms replaced these with annual and lifetime limits, applying across pension schemes, on the amount of savings eligible for tax relief.[18]

The two limits introduced by the Finance Act 2004 were the annual and lifetime allowances.

Although there have been subsequent reforms, such as the abolition of the lifetime allowance (see section 3 of this briefing), A-day remains the foundation of the current pensions tax relief system.

Further background on A-day is available in the December 2008 Library briefing Pension tax simplification.[19]

13 HM Treasury, Spring Budget 2023, 15 March 2023
14 Finance Act 2024, sch 9
15 Finance Act 2021, s 28
16 HC Deb 17 March 2004, c 329
17 HM Treasury, Simplifying the taxation of pensions, December 2002
18 As above
19 Commons Library research briefing SN 2984, Pension tax simplification, 11 December 2008

2 The annual allowance

2.1 What is the annual allowance?

An annual allowance restricts the amount someone can contribute to a pension and receive tax relief in any given year. In 2025/26 it is £60,000.[20]

It is also the case that someone cannot usually receive tax relief on pension contributions worth more than their annual earnings.[21] However, people can still contribute £3,600 a year into a pension with tax relief even if they earn less than this.[22]

2.2 What is the tapered annual allowance?

The annual allowance tapers, which means it reduces for higher earners.

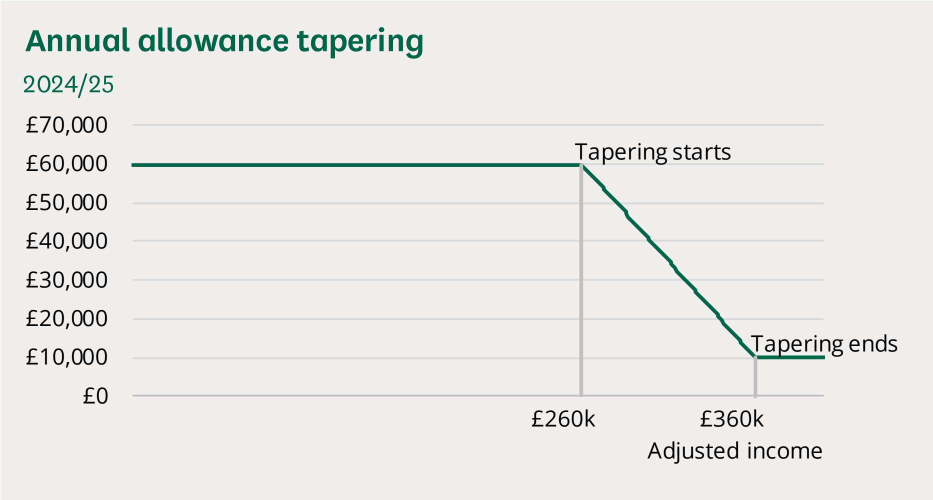
In 2025/26 someone's annual allowance tapers (reduces) if:

- their income before tax is above £200,000; and
- their income including pension contributions (adjusted income) is above £260,000.[23]

Someone's annual allowance reduces by £1 for every £2 of adjusted income they earn above £260,000.[24]

As shown in the chart below, tapering stops when someone's annual allowance reaches £10,000.[25]

[20] Finance Act 2004, s 228 as amended by Finance (No. 2) Act 2023
[21] Finance Act 2004, s 190
[22] This would be a maximum contribution of £2,880 a year with 20% tax relief of £720 through a relief at source pension scheme. Further details about relief at source schemes are available in the Commons Library research briefing CBP 625 Pensions tax.
[23] HM Revenue and Customs, Pensions Tax Manual, PTM051100 – Annual allowance: essential principles, 7 April 2025
[24] Finance Act 2020, s 22
[25] As above



2.3 How are annual allowance contributions calculated?

The calculation of contributions towards the annual allowance differs between defined contribution schemes and defined benefit schemes.

The calculation for defined contribution schemes

Defined contribution schemes provide a saving pot. Any contribution to a defined contribution scheme which receives tax relief counts towards someone's annual allowance.[26]

The calculation for defined benefit schemes

The calculation for defined benefit schemes is more complicated.[27]

Defined benefit schemes pay a promised pension based on factors such as salary and length of service. Defined benefit schemes usually pay an income and may also pay a promised lump sum at retirement.

The amount that a defined benefit pension contributes towards someone's annual allowance is:

- The change in the value of any lump sum
- Plus 16 times the value of the annual pension

The calculation then adjusted for inflation as measured by the consumer prices index.

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26 Finance Act 2004, ss 230 to 233
27 The calculation is set out in the Finance Act 2004, ss 234 to 236

2.4 What is the Money Purchase Annual Allowance?

The pension freedoms, which the government introduced in April 2015, gave people more flexibility about how they accessed their defined contribution pension schemes. Before April 2015, most people had to buy an annuity which provided a guaranteed income for life. Now people can withdraw money from their pensions while leaving the rest of it invested.[28]

Defined contribution schemes are sometimes known as money purchase schemes. The government intended the money purchase allowance to prevent people using the pension freedoms to avoid tax on their employment income. Without the money purchase annual allowance, people could place their income into a defined contribution scheme (up to the annual allowance) before immediately withdrawing 25% tax free. People could also withdraw the remaining 75% and pay income tax on that the same way as other income.[29]

To avoid people using the pension freedoms this way, once someone accesses a defined contribution pension, the amount that they can contribute to defined contribution schemes in future without paying tax permanently reduces. In 2025/26 someone who has withdrawn money previously from a defined contribution scheme has a money purchase annual allowance of £10,000.[30]

2.5 What happens if someone exceeds the annual allowance?

If someone contributes more than their annual allowance into pension schemes, then they may need to pay tax on those contributions. But there are options to support them.

Carry forward

If someone has not used all their annual allowance in one year, they may be able to use it in a future year. Carry forward allows someone to make use of any unused annual allowance from three previous tax years.[31]

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28 HM Treasury, Budget 2014, 19 March 2014, para 1.156-66

29 HM Treasury, Freedom and choice in pensions: Government response to consultation, Cm 8901, July 2014, para 2.27

30 HM Revenue and Customs, Policy Paper: Pension Tax Limits, 15 March 2023

31 The relevant legislation is sections 228A, 228B and 228C of the Finance Act 2004. These sections were introduced by schedule 17 of the Finance Act 2011.

Carry forward was introduced in October 2010 to stop people who typically contributed below the annual allowance from facing a tax charge by exceeding it in a single year.[32]

Scheme pays

Scheme pays was also introduced for people with a tax charge for exceeding the annual allowance who may have difficulty paying the charge directly from their current income.[33] It allows people who have exceeded their annual allowance and have a tax charge of more than £2,000 to choose for the charge to be paid for from their pension savings.[34]

Scheme pays involves the scheme effectively making a loan to pay the charge, which the member repays with interest.

2.6 Pension taxes for public officials

Constituents sometimes ask whether these rules apply to MPs and other high-earning public servants, such as senior civil servants and judges. The answer is that the rules apply to registered pension schemes, which includes the MPs' Pension Scheme and the Civil Service Pension Scheme.[35]

Some pension schemes for judges however are de-registered for tax purposes, which means income tax is paid on contributions.[36] However contributions to these do not attract tax relief and the lifetime allowance or annual allowance do not apply.

For more detail, see the Commons Library briefing Judges Pension Schemes.

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32 HM Treasury. Restricting pensions tax relief through existing allowances: a summary of the discussion document responses (PDF), October 2010

33 HM Treasury, Options to meet high annual allowance charges from pension benefits: a discussion document, November 2010, para 1.7

34 HM Revenue and Customs, HC Deb, 3 March 2011, c31-32WS and Pensions Tax Manual – Annual allowance: tax charge: scheme pays: general, 7 April 2025

35 Explanatory Memorandum to SI 2006 No. 920, para 7.1; MPs' CARE Pension Scheme – PCPF - Guide for scheme members (May 2015); Civil Service Pensions, Your alpha benefits explained

36 Judicial Pension Scheme 1993 – scheme guide (PDF), November 2014, p4

3 The abolition of the lifetime allowance

The government introduced the lifetime allowance in 2006 as part of the simplification to the pension tax regime (see section 1.4 above).[37] It was the maximum amount of pension savings someone could usually receive tax relief on. Someone with pension savings above the lifetime allowance would pay a tax charge on this amount. In 2023/24 the lifetime allowance was £1,073,100.[38]

At the Spring Budget 2023, the government announced that it would abolish the lifetime allowance.[39] It started this process by removing the tax charge for exceeding the lifetime allowance from 6 April 2023 and abolished the lifetime allowance fully in the Finance Act 2024 from 6 April 2024.[40]

3.1 What was the lifetime allowance?

The lifetime allowance was the amount someone can usually build up in a pension without paying tax. The standard lifetime allowance was £1,073,000 in 2023/24.[41] People with certain protections may have retained a higher lifetime allowance (covered in section 3.4 below).

To determine if someone had exceeded their lifetime allowance a check took place when certain events occur. This was typically when someone:

- First received money from a pension scheme
- Transferred a pension overseas before age 75
- Reached the age 75 or dies before this without accessing their pension.[42]

The lifetime allowance check was against the value of all of someone's pensions.

37 For more information see Commons Library research briefing SN 02984, Pension tax simplification
38 Finance Act 2021, s 28
39 HM Treasury, Spring Budget 2023, 15 March 2023
40 Finance Act 2024, sch 9
41 HM Revenue and Customs, PTM081000 - The lifetime allowance and the lifetime allowance charge: essential principles of the lifetime allowance, 7 April 2025
42 HM Revenue and Customs, Pensions Tax Manual, PTM081000 - The lifetime allowance and the lifetime allowance charge: essential principles of the lifetime allowance, 7 April 2025

3.2 What happened if someone exceeded the lifetime allowance?

Before April 2023, if someone's pensions were worth more than the lifetime allowance when a lifetime allowance check took place, then a tax charge would be due. A breach of the lifetime allowance led to a lifetime allowance charge on the difference (excess) between the lifetime allowance and the amount received:

- If the excess was a regular pension income, 25% of the excess.
- If the excess was a lump sum, 55% of the excess.

The scheme administrator and the individual shared responsibility for payment.[43]

3.3 Tax-free lump sums

When someone becomes entitled to certain pension benefits, the scheme may pay them a tax-free lump sum. This can be worth up to the lower of:

- 25% of the value of a pension; or
- 25% of the lifetime allowance.

Before 6 April 2024, those subject to the standard lifetime allowance of £1,073,100 could receive a maximum lump sum of £268,275 tax-free.

When someone dies their beneficiaries might receive a lump sum from their pension. The amount of tax paid on the lump sum will depend on the age the person was when they died:

- If they die before the age of 75 then normally no tax is paid. If the lifetime allowance has been exceeded, then there will be a lifetime allowance tax charge.
- If someone dies after the age of 75 (or they die before the age of 75 and the pension has not been paid within two years of the death) then anyone who inherits the pension will be taxed on payments at their marginal rate of income tax.[44]

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43 HM Revenue and Customs, Pension Tax Manual, The lifetime allowance and lifetime allowance charge, 7 April 2025

44 HM Revenue and Customs, Pensions Tax Manual, PTM073100 - Death benefits: lump sums: defined benefits lump sum death benefit, 7 April 2025

Since the removal of the lifetime allowance, lump sums are be tested against a new threshold – the lump sum allowance. The lump sum allowance is set at the same amount as someone could previously receive without paying tax, £268,275, which is 25% of the lifetime allowance in 2023/24. People pay tax on any lump sums above this level at their marginal rate of income tax.[45]

3.4 Protections

The original lifetime allowance was £1.5m in 2006.[46] This increased annually until it reached its highest level in April 2010 at £1.8m. Over the following years it reduced to £1m by April 2016.[47]

Protections covered those who already exceeded the newer lower limits.[48] The lifetime allowance increased in line with inflation between 2017 and 2020 to bring it to its current level of £1,073,100.[49]

Primary protection

People who already had pension rights which would exceed the lifetime allowance on its introduction in 2006 could register for primary protection.[50] This allowed them to maintain their lifetime allowance at the same percentage above the lifetime allowance – accounting for any future increases.

Enhanced protection

Anyone with a pension before 6 April 2006 could register for enhanced protection, providing they stopped contributing to any tax-relieved pension scheme.[51] Protection from the lifetime allowance charge applied to all subsequent increases to the value of the pension.

Fixed protection

Each time the lifetime allowance decreased (in 2012, 2014 and 2016) individuals could apply for fixed protection. This allowed individuals to keep

45 HM Revenue and Customs, Pensions Tax Manual, PTM171000 - Lump sum allowance and lump sum and death benefit allowance: lump sum allowance, 7 April 2025

46 The Finance Act 2004

47 A summary of the changes is available in section 4 of this paper. HM Revenue and Customs, Rates and Allowance – Pension Schemes, 2 November 2009; HM Revenue and Customs, Pension scheme rates, 6 April 2024

48 HM Revenue and Customs, Pensions Tax Manual, PTM09100 - Protection from the lifetime allowance charge essential principles, 6 October 2023

49 HM Revenue and Customs, Pensions Tax Manual, PTM081000 - The lifetime allowance and the lifetime allowance charge: essential principles of the lifetime allowance, 6 October 2023

50 HM Revenue and Customs, Pensions Tax Manual, PTM09100 - Protection from the lifetime allowance charge essential principles, 6 October 2023

51 As above

the higher level of lifetime allowance.[52] However, they would only have very limited opportunity to build up further pension benefits. People could lose these protections in a number of circumstances.

Individual protection

Individual protection was available for the decreases to the lifetime allowance in 2014 and 2016.[53] It offers more flexibility than fixed protection and does not restrict future pension savings. Instead, individuals gain a personalised lifetime allowance equal to the value of their pension savings on the day before the introduction of the lower lifetime allowance.

52 HM Revenue and Customs, Pensions Tax Manual, PTM09100 - Protection from the lifetime allowance charge essential principles, 6 October 2023

53 As above

4 Changes to pension tax relief since 2006

The table below shows the levels of the main pension tax relief allowances and the levels of income for tapering of the annual allowance (section 2.2 of this paper) since introduction:

Table 1 Pension tax relief allowances (£)

	Standard lifetime allowance	Standard annual allowance	Tapered annual allowance (minimum)	AA tapering threshold income	AA tapering adjusted income	Money purchase annual allowance
2006/07	1,500,000	215,000	-	-	-	-
2007/08	1,600,000	225,000	-	-	-	-
2008/09	1,650,000	235,000	-	-	-	-
2009/10	1,750,000	245,000	-	-	-	-
2010/11	1,800,000	255,000	-	-	-	-
2011/12	1,800,000	50,000	-	-	-	-
2012/13	1,500,000	50,000	-	-	-	-
2013/14	1,500,000	50,000	-	-	-	-
2014/15	1,250,000	40,000	-	-	-	10,000
2015/16	1,250,000	40,000	-	-	-	10,000
2016/17	1,000,000	40,000	10,000	110,000	150,000	10,000
2017/18	1,000,000	40,000	10,000	110,000	150,000	4,000
2018/19	1,030,000	40,000	10,000	110,000	150,000	4,000
2019/20	1,055,000	40,000	10,000	110,000	150,000	4,000
2020/21	1,073,100	40,000	4,000	200,000	240,000	4,000
2021/22	1,073,100	40,000	4,000	200,000	240,000	4,000
2022/23	1,073,100	40,000	4,000	200,000	240,000	4,000
2023/24	1,073,100 [a]	60,000	10,000	200,000	260,000	10,000
2024/25	-	60,000	10,000	200,000	260,000	10,000
2025/26	-	60,000	10,000	200,000	260,000	10,000

a) The lifetime allowance charge for exceeding the lifetime allowance was removed for the 2023/24 tax year.

Source: Finance Acts 2004 onwards