HM Revenue
& Customs

Pensions tapered annual allowance

Who is likely to be affected?

- individuals with income of over £150,000, including the value of any pension contributions, who save in a registered pension scheme will be affected by the taper
- all savers in registered pension schemes will have their pension savings measured over a tax year
- scheme administrators of registered pension schemes and advisers who have clients who are members of registered pension schemes
- sponsoring employers of occupational registered pension schemes

General description of the measure

The measure will restrict pensions tax relief by introducing a tapered reduction in the amount of the annual allowance for individuals with income (including the value of any pension contributions) of over £150,000 and who have an income (excluding pension contributions) in excess of £110,000. In order to facilitate the taper, legislation will also be introduced to align pension input periods with the tax year as well as transitional rules to protect savers who might otherwise be affected by the alignment of their pension input periods.

Policy objective

The government's objective is to control the cost of pensions tax relief and help make sure pensions tax relief is fair and affordable.

Background to the measure

- the government announced in Summer Budget 2015 their intention to cut pensions tax relief for high earners by introducing a tapered annual allowance for those with incomes of over £150,000.
- draft legislation implementing the taper to the annual allowance, aligning pension input periods with the tax year and bringing in transitional provisions is published in Summer Finance Bill 2015.

Detailed proposal

Operative date

The annual allowance taper will have effect on and after 6 April 2016.

The legislation to align pension input periods with the tax year and to protect any savings will be effective from 8 July 2015.

The legislation for valuing defined benefit and cash balance pension savings for 2015-16 will be effective from Royal Assent to Summer Finance Bill 2015.

Current law

The current pension tax rules were introduced on 6 April 2006 (known as A-day) and are contained in Part 4 of Finance Act (FA) 2004. These rules provide for an annual limit on tax relieved pension savings which is currently £40,000, the recovery of excess relief through the annual allowance charge and the carry forward of unused annual allowance (sections 227 to 238A FA 2004).

Pension savings for a tax year are tested against the annual allowance over a 12 month period but this does not necessarily match the tax year. The period is known as the pension input period (section 238 FA 2004).

Where an individual flexibly assesses their pension savings (section 227G FA 2004), they are subject to a reduced annual allowance.

Proposed revisions

Legislation in Summer Finance Bill 2015 introduces a tapered reduction in the annual allowance from 6 April 2016, for those with an 'adjusted income' of over £150,000.

The 'adjusted income' definition adds-back any pension contributions, to prevent individuals from avoiding the restriction by exchanging salary for employer contributions. For those in defined benefit or cash balance arrangements, the value of the employer contribution will be calculated using the annual allowance methodology. That is the employer contribution will be the pension input amount for the arrangement, less the amount of any contributions made by or on behalf the individual during the tax year.

To provide certainty for individuals with lower salaries who may have one off spikes in their employer pension contributions, a net income threshold of £110,000 will apply. If the individual's net income is no more than £110,000 they will not normally be subject to the tapered annual allowance. However, anti-avoidance rules will apply so that any salary sacrifice set up on or after 9 July 2015 will be included in the threshold definition.

The rate of reduction in the annual allowance is by £1 for every £2 that the adjusted income exceeds £150,000, up to a maximum reduction of £30,000.

Where an individual is subject to the money purchase annual allowance, the alternative annual allowance will be reduced by £1 for every £2 by which their income exceeds £150,000, subject to a maximum reduction of £30,000.

The carry forward of unused annual allowance will continue to be available, but the amount available will be based on the unused tapered annual allowance.

All pension input periods open on 8 July 2015 are closed on that date, with the next pension input period running from 9 July 2015 to 5 April 2016. All subsequent pension input periods will be concurrent with the tax year from 2016-17 onwards.

To prevent retrospective taxation, individuals will have an £80,000 annual allowance for 2015-16, but subject to a £40,000 allowance for savings from 9 July 2015 to 5 April 2016. To achieve this, the 2015-16 tax year will be split into two notional periods, 6 April 2015 to 8 July 2015, the 'pre-alignment tax year' and 9 July 2015 to 5 April 2016, the 'post-alignment tax year'. All individuals will have an annual allowance of £80,000 for the 'pre-alignment tax year'. Where this amount has not been used in the 'pre-alignment tax year', it will be carried forward to the post-alignment tax year, subject to a maximum of £40,000. In addition, any unused annual allowance from the previous three years can be added to these amounts in the normal way.

The calculation of the pension input amount for the 2015-16 tax year will be modified for cash balance and defined benefits arrangements. Rather than having to calculate separately the pension input amount for pre-alignment and post-alignment tax years, the pension input amounts will be based on the total of the increase in the value of the individual's rights across the combined pension input periods for the arrangement ending in the period to 5 April 2016, but apportioned to the pre-alignment and post-alignment tax years.

Summary of impacts

Exchequer impact (£m)	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
	- 70	+260	+425	+900	+1180	+1280
	These figures are set out in Table 2.1 of Summer Budget 2015 and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside Summer Budget 2015.					
Economic impact	This measure is not expected to have any significant macroeconomic impacts. The costing takes into account a number of behavioural responses. These include: • individuals and employers reducing pension contributions which would be in excess of the annual allowance. This increases the amount of income subject to income tax • individuals in the taper region (between £150,000 and £210,000) reducing their incomes in response to the taper • a small increase in pensions contributions after announcement of the policy but prior to implementation.					
Impact on individuals, households and families	Around 300,000 pension savers are expected to have net incomes of at least £110,000 and could be affected by this measure. The measure is not expected to impact on family formation, stability or breakdown.					
Equalities impacts	HMRC data does not allow identification of groups sharing protected characteristics within the affected population. This measure will affect those with net incomes of at least £110,000. It is therefore assessed that the measure does not have a significant equalities impact. No other impacts are anticipated in respect of groups sharing other protected characteristics.					
Impact on business including civil society organisations	There will be some additional burdens for pension schemes and employers to provide information and guidance to individuals, to update their systems to reflect the changes to the annual allowance and pension input periods, and in some cases to do an extra end of year calculation. Anticipated one-off burdens include: salary and pension adjustments, legal and consultation advice, and training and familiarisation.					

	Anticipated ongoing burden increases arise from the need for pension schemes to send more individuals their contribution values (and information for carry forward), and dealing with scheme pays requests. In total, HMRC anticipates one-off costs across employers and pension schemes of £170 million, the majority of which is due to the need to align pension input periods to tax years, and additional annual burden of £20 million/year.
Operational impact (£m) (HMRC or other)	New guidance and tools to be developed to help individuals work out any tax liability. In addition the measure is likely to lead to an increase in contacts from the pensions industry and financial advisors to HMRC Pensions. Existing reporting procedures will need to be enhanced to deal with additional reports. The changes are estimated at £2 million for the necessary IT enhancements to HMRC systems.
Other impacts	Small and micro business assessment: the measure is not expected to have a significant impact on small and micro sized businesses. It would not be appropriate for the policy to apply differently according to the size of the firm within which the affected workers operate. Other impacts have been considered and none have been identified.

Monitoring and evaluation

The measure will be kept under review through communication with affected taxpayer groups.

Further advice

If you have any questions about this change, please contact Paul Cottis on 03000 564209 (email: pensions.policy@hmrc.gsi.gov.uk).