HM Revenue & Customs

Pensions: Transitional provisions for aligning pension input periods

Technical Note
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Introduction

The Government announced on 8 July 2015, that for 2016-17 onwards the annual allowance for tax relieved pension savings will be reduced for those with incomes of over £150,000. Their annual allowance will be reduced by £1 for every £2 of income they have over £150,000 with a maximum reduction of £30,000. In advance of the introduction of this tapered annual allowance, transitional rules are being introduced from Budget Day to align pension input periods with the tax year by April 2016 and to protect any savings already made before Budget from retrospective tax charges.

This note provides draft guidance on the transitional rules that apply from Budget Day along with a brief overview of the tapered annual allowance rules. You should be aware that this technical note is based on the draft legislation which is subject to change as it progresses through Parliament. Final updated guidance will be provided after the legislation receives Royal Assent.

If you have any comments on this technical note, please send these to pensions.policy@hmrc.gsi.gov.uk

Chapter 1 Aligning pension input periods

As from 6 April 2016, the amount of your annual allowance for a tax year will be restricted if you have income of over £150,000 for that tax year. To ensure the measure works as intended it is necessary to align pension input periods with the tax year. This chapter sets out how the change to align pension input periods will operate.

Current pension input period rules

A pension input period is the period over which the amount of pension saving (pension input amount) under an arrangement is measured. The measurement works on the principle of how much was saved from the start of the pension input period to the end of the pension input period.

A pension input period for an arrangement under a registered pension scheme does not have to be exactly the same as the tax year.

A pension input period normally runs for a year, for example from 1 January to 31 December. A pension input period can be less than a year. The first pension input period for an arrangement cannot be longer than 12 months but a subsequent pension input period for that arrangement can be longer than 12 months.

An individual can have more than one pension input period, but cannot have more than one pension input period relating to the same arrangement ending in the same tax year. See PTM052000 for further information about the current pension input period rules.

Transitional rules for pension input periods

All pension input periods open on 8 July 2015 will end on 8 July 2015.

The next pension input period will be 9 July 2015 to 5 April 2016 for these arrangements.

This means that all existing arrangements on 8 July 2015 will have two or three pension input periods ending in tax year 2015-16, depending on the start date of the open pension input period.

For new arrangements that have their first pension input period starting on or after 9 July 2015 and on or before 5 April 2016, the pension input period will start on the normal commencement day (see PTM052100) and will end on 5 April 2016.

This means that some individuals may have put in pension savings of more than £40,000 prior to the Budget, on the expectation that these savings would be tested against the annual allowance for tax years 2015-16 and 2016-17 but which will now be only tested against the annual allowance for 2015-16. Transitional rules are therefore being introduced to ensure that in these circumstances pre-Budget savings of up to £80,000 are protected from an annual allowance charge.

Pension input period rules from 6 April 2016

Pension input periods will continue to exist from 6 April 2016, but they will be aligned with the tax year. We will consider at a later stage whether we can further simplify the rules by removing the concept of a pension input period altogether.

From 6 April 2016, all existing arrangements will have a 12 month pension input period from 6 April 2016 to 5 April 2017. All subsequent pension input periods will be for the period 6 April to 5 April. It will not be possible to vary this pension input period.

Any new arrangement that has a first pension input period commencing on or after 6 April 2015, will have a first pension input period that starts on the normal commencement day (see PTM052100) but which ends on 5 April in the same tax year as the pension input period started. All subsequent pension input periods will be for the period 6 April to 5 April. It will not be possible to vary this pension input period.

Chapter 2 Transitional rules for the annual allowance for tax year 2015-16

Basic Principles

As in most arrangements, the length of all the pension input periods that will end in tax year 2015-16 will be greater than 12 months, transitional rules are required to protect savers who have made savings prior to Budget on the assumption that their pension input period would not change.

Everyone will have a total annual allowance of £80,000 for 2015-16, plus any available carry forward. Individuals will then have an allowance of up to £40,000 for post-Budget savings plus remaining carry forward from 2014-15, 2013-14 or 2012-13.

Example 1

Ian has pension savings of £73,000 for pension input periods ending in 2015-16 of which £61,000 was made before 9 July 2015 and £12,000 after. Ian is not subject to the money purchase annual allowance. As Ian's total savings are less than £80,000 and his post-budget savings are less than £40,000, Ian will not have an annual allowance charge for 2015-16.

How this will work

As set out in Chapter 1, all pension input periods open on 8 July 2015 will end on that date with the next pension input period 9 July 2015 to 5 April 2016.

Savings for pension input periods ending in 2015-16 will then be split into two mini tax years depending on whether the pension input period ends on or before Budget or is a post-Budget pension input period which will end on 5 April 2016.

Individuals will have an annual allowance of £80,000, plus any available carry forward, for all their pension savings in all pension input periods ending on or after 6 April 2015 and on or before 8 July 2015.

Savings from 9 July 2015 to 5 April 2016 will have a nil annual allowance, but up to £40,000 of any unused annual allowance from the period up to 8 July 2015 is added to this. If an individual had pension savings at some time in the period 9 July 2015 to 5 April 2016 but was not a member of a registered pension scheme at any time during the period 6 April 2015 to 8 July 2015 that individual will have an annual allowance of £40,000 for the period 9 July 2015 to 5 April 2016.

In addition any remaining carry forward from the 2012-13, 2013-14 and 2014-15 is added to this.

Example 1A

Ian has made pension savings of £61,000 for pension input periods ending from 6 April 2015 to 8 July 2015. This is tested against the annual allowance of £80,000 for that period. His savings are therefore £19,000 less than £80,000, and so Ian's annual allowance for post-Budget savings is the allowance of nil plus the £19,000 carry forward from pre-Budget plus any other of other carry forward that he has available.

Splitting the 2015-16 tax year and the annual allowance

The 2015-16 tax year will be split into two mini tax years for the purpose of the annual allowance, the pre-alignment tax year and the post-alignment tax year. This guidance note refers to these as mini tax years.

The pre-alignment tax year

The annual allowance for savings made during pension input periods ending in the pre-alignment tax year is £80,000, plus any available carry forward. That is for any savings in any pension input period ending between 6 April 2015 and 8 July 2015.

Example 2

Leonora is a member of an arrangement with a pension input period from 1 June 2014 to 31 May 2015. Under the changes to the pension input period, the next pension input period will be from 1 June 2015 to 8 July 2015. Leonora's combined pension savings in these two pension input periods ending in the pre-alignment tax year, will be tested against the pre-alignment annual allowance of £80,000.

The post-alignment tax year

The annual allowance for savings made during the post-alignment tax year is the amount of the £80,000 that has not been used from the pre-alignment tax year, subject to a maximum of £40,000, plus any remaining available carry forward from 2012-13, 2013-14 or 2014-15. That is for any savings in the pension input period that will end on 5 April 2016.

For those who haven't been a member of a registered pension scheme during the pre-alignment tax year, they will have an annual allowance of £40,000 for the post-alignment tax year.

Example 3

Leonora's savings in the pre-alignment tax year are £17,000. Her annual allowance for the post-alignment tax year will therefore be the maximum of £40,000 plus any available carry forward.

Example 4

Ian's savings in the pre-alignment tax year are £61,000. His annual allowance for the post-alignment tax year is therefore £19,000 plus any available carry forward.

The money purchase annual allowance

Under existing legislation, for the tax year 2015-16 onwards individuals who flexibly access pension savings in a money purchase arrangement will trigger the money purchase annual allowance rules. These individuals will be subject to a modified annual allowance test and will have a £10,000 annual allowance in respect of their money purchase pension savings (the 'money purchase annual allowance'). See PTM056500 for information about the money purchase annual allowance.

If the £10,000 money purchase annual allowance limit is exceeded for a tax year, individuals will have a reduced £30,000 annual allowance for the remainder of their pension savings for that tax year, (in addition to the £10,000 money purchase annual allowance). This reduced allowance in respect of the remaining pension savings is defined in the legislation as the 'alternative' annual allowance.

Following the changes announced on 8 July 2015, there are also amended money purchase annual allowance rules if an individual flexibly accesses their pension savings during 2015-16.

If flexible access has occurred in the pre-alignment tax year, the money purchase annual allowance for savings made during the pre-alignment tax year is £20,000, and the alternative annual allowance for this period is £60,000.

The money purchase annual allowance for savings made during the post-alignment tax year is the amount of the £20,000 that has not been used from the pre-alignment tax year, subject to a maximum of £10,000. The alternative annual allowance will be nil but again any unused annual allowance from the pre-alignment tax year and any unused annual allowance from 2012-13, 2013-14 or 2014-15 can be added to this. If the chargeable amount for the pre-alignment tax year is the default chargeable amount, then up to £40,000 can be carried forward from the pre-alignment tax year, if it is the alternative chargeable amount then this carry forward is limited to £30,000.

If flexible access occurs in the post-alignment tax year, the money purchase annual allowance for savings made during the post-alignment tax year is £10,000 and the alternative annual allowance will be up to £30,000.

Example 5

Vimla flexibly accesses her pension savings on 1 May 2015. She is therefore subject to the money purchase annual allowance for the pre-alignment and post-alignment tax year. Her total pension savings for the pre-alignment tax year were £42,000 of which £8,000 were money purchase savings. Vimla therefore has a money purchase annual allowance of £10,000 for the post-alignment tax year.

Example 6

Harsadray flexibly accessed his pension savings on 1 October 2015. He is therefore subject to the money purchase annual allowance for the post-alignment tax year. Harsadray has a money purchase annual allowance of £10,000 for the post-alignment tax year.

If his post flexi-access money purchase savings for the post-alignment tax year are less than £10,000, all his post-alignment tax year savings will be tested against a nil annual allowance, plus any unused annual allowance from the pre-alignment tax year as well as 2012-13, 2013-14 or 2014-15.

If his post flexi-access money purchase savings for the post-alignment tax year are more than £10,000, his defined benefit savings plus his pre flexi-access money purchase savings will be tested against a nil alternative annual allowance, plus any unused annual allowance from the pre-alignment tax year as well as 2012-13, 2013-14 or 2014-15.

Calculating the pension input amount for 2015-16

As pension savings will be tested against two different tax years for 2015-16 (for the pre and post-alignment tax years), two different pension input amounts are required for each arrangement.

Defined contribution arrangements

For defined contribution arrangements (known as other money purchase arrangements under the tax legislation), the pension input amount for each mini tax year will be the total of all relievable member contributions plus all employer contributions paid in respect of the individual in a pension input period ending in the mini tax year. That is in accordance with section 233 of Finance Act 2004 and exactly the same way as it is currently calculated, except for the change in tax year.

Defined benefits and cash balance arrangements

For defined benefits and cash balance arrangements there are special rules that apply for calculating the pension input amounts for the mini tax years in 2015-16. This is to help scheme administrators by removing the need to value pension savings on 8 July and potentially other dates.

The pension input amount for the pre and post-alignment tax years will be a proportion of the pension input amount calculated as if all the pension input amounts for pension input periods ending in the tax year 2015-16 had been made in a single pension input period (this is known as the combined period).

The pension input amount for the post-alignment tax year will therefore be the proportion of the pension input amount for the combined period that relates to 9 July 2015 to 5 April 2016. This will be PIACP x 272/D, where;

- PIACP is the pension input amount for the combined period;
- 272 days is the number of days from 9 July 2015 to 5 April 2016 (2016 is a leap year); and,
- D is the number of days in the combined period

The pension input amount for the pre-alignment tax year will therefore be PIACP minus the pension input amount as calculated above for the post-alignment tax year.

Example 7

Pete is a member of a defined benefits arrangement, with a pension input period normally of 1 January to 31 December. His combined period is therefore from 1 January 2015 to 5 April 2016 and his pension input amount for the combined period is £45,000.

Pete's pension input amount for the post-alignment tax year is therefore £45,000 x 272/(365+96) = £26,551.

Pete's pension input amount for the pre-alignment tax year is therefore £45,000 - £26,551 = £18,449.

Calculating the pension input amount for the combined period

As the combined period will be at least 12 months, there are two changes to the normal pension input amount calculation to ensure the changes are fair.

For both cash balance and defined benefits arrangements the opening value of the individual's rights at the start of the combined period is uprated by 2.5% (the appropriate percentage). This is used rather than the CPI increase for September 2014 which was 1.2%.

Similarly for the purposes of calculating the relevant percentage which is used to work out whether the deferred member carve out applies, 2.5% should be used rather than CPI for a month falling within the pension input period. See PTM051200 for information about the existing deferred member carve out rules.

Example 8

Rosie is a member of a defined benefits arrangement with a pension input period of 1 January to 31 December. It is a final salary scheme with 1/60th accrual. Rosie has pensionable pay at the end of 31 December 2014 of £110,000 which has risen to £120,000 by 5 April 2016. Rosie had completed 20 years 100 days on 31 December 2014. This is Rosie's only arrangement and she has no carry forward available.

The opening value of Rosie's rights would be 16 x £110,000 x 1/60 x (20 + 100/365) = £594,703

The closing value of Rosie's rights would be 16 x £120,000 x 1/60 x (21 + 196/366) = £689,137

Rosie's pension input amount for the combined period is therefore £689,137 – (£594,703 + 2.5% (the uprating factor)) = £689,137 - £609,571 = £79,566.

Rosie's pension input amount for the post-alignment period is £79,566 x 272/(365+96) = £46,946. Her pension input amount for the pre-alignment period is therefore £79,566 - £46,946 = £32,260

Rosie has total pension input amounts for the pre-alignment tax year of £32,260. As this is less than £40,000, Rosie can carry forward £40,000 from the pre-alignment tax year to the post-alignment tax year.

Rosie has a pension input amount for the post-alignment tax year of £46,946

Rosie therefore has an annual allowance charge on £6,946 in respect of the post-alignment period and for the 2015-16 tax year overall.

Individuals who become deferred members during the combined period

To help scheme administrators there are also special rules where an individual becomes a deferred member during the combined period and where but for the changes there would have been a pension input period for that arrangement commencing in 2015-16 but after they became a deferred member. For example these will apply where an individual became a deferred member of an arrangement on 31 August 2015 and without these changes that pension input period would have ended on 31 December 2015.

In these circumstances the period after the pension input period would have ended to 5 April 2016, can be treated as if it were a pension input period. Therefore someone who is a deferred member throughout this latter period can have a nil pension input amount for this period, and the scheme administrator will not need to carry out any valuations for this period.

How the rules will work

The rules will apply in the following circumstances.

- The individual is a member of a defined benefits or cash balance arrangement which has a pension input period that is open on 8 July, and which would have ended after 8 July but before 5 April 2016 (the cut-short period) without the changes being made by this legislation, and
- The individual became a deferred member during a pension input period that ended before 9 July 2015, or where they became a deferred member in a pension input period that would have ended on or after 9 July 2015 and before 5 April 2016 if these changes had not been made), and
- For the period to 5 April 2016 and starting the day after the cut-short period would have ended, if that had been a pension input period, the pension input amount for that period would have been nil because the individual satisfied the deferred member carve out. See section 230(5B) Finance Act 2004 for cash balance arrangements or section 234(5B) Finance Act 2004 for defined benefits arrangements.

Where these apply, the closing value for the combined period which ends on 5 April 2016 which would normally be calculated based on the value on that day, is calculated on the day the cut short period would have or did end.

Example 9

Christine is a member of a defined benefits arrangement with a pension input period of 1 January to 31 December. Christine becomes a deferred member of the arrangement on 1 October 2015. Christine can therefore be treated as a deferred member for the period 1 January 2016 to 5 April 2016 if the deferred member carve out would have applied ordinarily if 1 January 2016 to 6 April 2016 was a pension input period.

The pension input amount for Christine's combined period is therefore based on the period 1 January 2015 to 31 December 2015.

Calculating the pension input amount for the pre and post-alignment tax years

As the normal time apportionment would not be appropriate where the member becomes a deferred member during the combined pension input period, there is an adjustment to this calculation.

- If the pension input period in which the member became a deferred member ended before 9 July 2015, then the apportionment is 100% to the pre-alignment tax year, and nil to the post-alignment tax year.
- If the pension input period in which the member became a deferred member would have ended on or after 9 July 2015, then the apportion for the post-alignment tax

year is x/y x 100, where x is the number of days from 9 July 2015 to the day when the pension input period would have ended, had the legislation not changed and y is the number of days from the beginning of the first pension input period that ends in 2015/16 (the first day of the combined period) to the day when the pension input period would have ended.

Example 10

Sepp is a member of a cash balance arrangement and became a deferred member on 2 June 2015. The pension input period for Sepp's arrangement is 1 August to 31 July. His combined period therefore runs from 1 August 2014 to 5 April 2016. However as he became a deferred member on 2 June 2015, providing he met the conditions for the deferred member carve out to apply from 1 August 2015 to 5 April 2016, then in calculating his pension input amount for the combined pension input period the closing valuation is as at 31 July 2015.

Sepp's pension input amount for the combined period is £60,000, (based on an end date of 31 July 2015). As he became a deferred member in a pension input period that ended on or after 9 July 2015, his pension input amount for the post-alignment tax year is £60,000 x 23/365 = £3,781 and for the pre-alignment tax year is £60,000 less £3,781 = £56,219

Example 11

As example 8 above, Christine is a member of a defined benefits arrangement with a pension input period of 1 January to 31 December. Christine becomes a deferred member of the arrangement on 1 October 2015. The pension input amount for Christine's combined period is therefore based on the period 1 January 2015 to 31 December 2015.

Her pension input amount for the combined period is £55,000. As she became a deferred member in a pension input period that would have ended on or after 9 July 2015 but before 5 April 2016, her pension input amount for the post-alignment tax year is £55,000 x 176/365 = £26,521 (176 is the number of days from 9 July to 31 December 2015 inclusive and 365 is the number of days of the combined period, from 1 January to 31 December inclusive).

Christine's pension input amount for the pre-alignment tax year is £55,000 - £26,521 = £28,479.

Carry Forward

Carry forward will continue to apply as currently, that is any unused annual allowance from the three previous tax years can be carried forward to the current tax year.

However there are special rules that apply for tax year 2015-16, as for the purposes of the annual allowance 2015-16 has been split into two mini tax years, the pre-alignment tax year and the post-alignment tax year. The two mini tax years will be treated as one tax year for the purposes of calculating which years unused annual allowance can be carried forward from.

For the pre-alignment tax year, carry forward will therefore be available for any unused annual allowance from 2012-13, 2013-14, and 2014-15, as at present.

For the post-alignment tax year, carry forward will be available for any unused annual allowance from these same three tax years, 2012-13, 2013-14, and 2014-15, where it hasn't been used up by the pre-alignment tax year, plus the limited carry forward (up to £40,000) from the pre-alignment tax year.

For three tax years after 2015-16, carry forward will be available as follows:

For 2016-17 from 2013-14, 2014-15 and the pre-alignment tax year

For 2017-18 from 2014-15, the pre-alignment tax year and 2016-17

For 2018-19 from the pre-alignment tax year, 2016-17 and 2017-18.

Paying any annual allowance charge for 2015-16

An individual's annual allowance charge for 2015-16 will be the total of any charge arising from either the pre-alignment tax year or the post-alignment tax year or both. If a charge arises from both mini tax years, theses should not be reported separately.

Any annual allowance charge for 2015-16 should be reported on the 2015-16 Self-Assessment Tax Return as normal.

There are no new reporting requirements for scheme administrators in connection with the transitional year. Therefore as now, pensions savings statements for 2015-16 will need to be provided where required to members on or before 6 October 2016, regardless of which mini tax year any charge arises from.

Chapter 3 The tapered annual allowance

Overview

From 6 April 2016, individuals who have income for a tax year of greater than £150,000, will have their annual allowance for that tax year restricted. It will be reduced, so that for every £2 of income they have over £150,000, then their annual allowance is reduced by £1.

The income definition for this restriction will not be the same as taxable income, but will include the value of pension savings. This is known as adjusted income. This will ensure the restriction applies fairly and cannot be avoided for example through salary sacrifice.

To provide some certainty for scheme administrators and individuals over who may be affected, and to ensure that lower paid individuals are not affected by the addition of pension savings, this restriction will be subject to an income floor of £110,000 which will normally be an individual's net income for the tax year. This is known as threshold income.

Where an individual has threshold income of £110,000 or less they cannot be subject to the restriction regardless of the level of their adjusted income.

The maximum reduction to the annual allowance will be £30,000, so that anyone with adjusted income of or above £210,000 will have an annual allowance of £10,000.

As at present, any unused annual allowance from the three previous tax tears will be able to be carried forward and added to the individual's annual allowance. Where this annual allowance is reduced by the taper, the carry forward will be the balance of the tapered amount.

Income definitions

Adjusted income (£150,000)

The restriction will apply for an individual for any tax year where their adjusted income is greater than £150,000.

For this purpose the definition of adjusted income will be;

- the individual's net income for the tax year as calculated under steps 1 and 2 of section 23 of the Income Tax Act 2007, plus,
- the amount of any relief under section 193(4) of Finance Act 2004 (a claim for excess relief under net pay) and section 194(1) of Finance Act 2004 (relief on making a claim) deducted at step 2, plus,
- the amount of any pension contributions made from any employment income of the individual for the tax year under net pay, under section 193(2) of Finance Act 2004, (to ensure fairness between those who have contributions deducted via net pay and those through relief at source), plus,
- where non domiciled individuals make contributions to overseas pension schemes, any relief claimed under Chapter 2 of Part 5 of the Income Tax (Earnings and Pensions) Act 2003 for the tax year, plus,
- the value of any employer contributions for the tax year, but less,
- the amount of any lump sum death accrues to the individual in the tax year mentioned in section 636A(4ZA). That is those that were previously subject to the special lump sum death benefit charge but will, from April 16, be taxed at the recipient's marginal rate.

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The value of the employer contributions in respect of an arrangement for a tax year will be the pension input amount for the arrangement for the tax year less the total of any member contributions.

For other money purchase (defined contribution) arrangements, this will therefore be the actual value of any employer contributions paid in the tax year for that arrangement.

For defined benefits and cash balance arrangements, this will require working out the actual pension input amount for the arrangement for the tax year, using the normal annual allowance rules, and then subtracting from this figure the total of any member contributions to that arrangement paid in the tax year.

Threshold Income (£110,000)

For this purpose the threshold income definition will be;

- the individual's net income for the tax year as calculated under steps 1 and 2 of section 23 of the Income Tax Act 2007, less
- the amount of any lump sum death benefits accruing to the individual in the tax year mentioned in section 636A(4ZA), plus
- the amount of any employment income given up for pension provision as a result of any salary sacrifice made on or after 9 July 2015.

Money Purchase Annual Allowance

Where an individual flexibly accesses their pension savings they are subject to the money purchase annual allowance. See PTM056500 for more information about the money purchase annual allowance rules.

Where an individual is subject to the taper and the money purchase annual allowance rules, the rules will continue to apply as at present but references to the annual allowance will mean the reduced annual allowance following any reduction under the taper.

Individuals who have flexibly accessed their pension savings will therefore continue to have a money purchase annual allowance of £10,000. But where this applies, the alternative annual allowance (normally £30,000 at present), against which their defined benefit savings are tested, will be restricted by the same taper. This means that for those with incomes of £210,000 or more, they will have an alternative annual allowance of £0 although any available carry forward can be added to this.