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Changes to the tapered annual allowance

Pensions tax changes from April 2020 mean that fewer members will be impacted by the tapered annual allowance, but some will be impacted more.

The Chancellor has announced a significant increase to the income thresholds from which the annual allowance starts to reduce (or taper) but has also reduced the tapered annual allowance that is granted to the highest earners.

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What are the changes?

Each year, pension savings must be assessed against the annual allowance. Where the allowance is exceeded (after considering unused allowances carried forward from earlier tax years) the member will incur a tax charge. The standard annual allowance is £40,000 but some individuals may have a lower annual allowance, either because they are a higher earner or because they have flexibly accessed benefits under the pensions freedoms introduced in 2015.

Prior to this year's Budget, the annual allowance for an individual could reduce (or taper) to anywhere between £10,000 and £40,000, dependent on that individual's total income over the tax year. The changes announced in the Budget increase the income level at which this tapering comes into force, but also increases the maximum reduction to the annual allowance (i.e. reducing the level of the annual allowance for the highest earners.)

With effect from **the 2020/21 tax year,** the income thresholds will change as follows:

Limit / threshold	Explanation	Current regime	Regime from April 2020
Level of **threshold income** beneath which the taper can be disregarded	Members whose **threshold income** is lower than this level will have an annual allowance of £40,000 (and they do not need to consider their **adjusted income** below). **Threshold income** is broadly all taxable income, *excluding* pension savings.	£110,000	£200,000

Limit / threshold	Explanation	Current regime	Regime from April 2020
Level of **adjusted income** at which the annual allowance starts to taper	The tapered annual Allowance is calculated based on **adjusted income**, which is broadly all taxable income, *including* pension savings. Once **adjusted income** exceeds this level, the annual allowance reduces by £1 for every £2 of **adjusted income**.	£150,000	£240,000
Minimum annual allowance under the taper	The tapered annual allowance cannot reduce below this amount. Under the current regime this minimum annual allowance is reached when **adjusted income** is £210,000 or more. Under the regime from April 2020, the annual allowance will be £10,000 when **adjusted income** reaches £300,000 and will reach the minimum of £4,000 where **adjusted income** exceeds £312,000.	£10,000	£4,000

What does this mean for members?

The higher thresholds mean that fewer individuals are expected to have a tapered annual allowance, and those that are impacted will generally have lower tax charges. The exception will be those with adjusted income over £300,000, who could see their tapered annual allowance reduce by up to £6,000 (which would translate to an additional tax charge of £2,700 for someone at this income level with pension savings of £10,000 or more).

For some members the tax reductions could be significant, as set out in the examples below for an individual making pension savings of £40,000 (i.e. in line with the annual allowance before any taper):

Total income (excluding pension savings)	£140,000	£220,000	£300,000
Tapered annual allowance (current regime)	£25,000	£10,000	£10,000
Amount subject to tax (current regime)	£15,000	£30,000	£30,000
Tapered annual allowance (from April 2020)	£40,000	£30,000	£4,000
Amount subject to tax (from April 2020)	£0	£10,000	£36,000
Change in amount subject to tax	**Reduction of £15,000**	**Reduction of £20,000**	**Increase of £6,000**

**Assumes £40,000 of annual pension saving and no unused annual allowance available to carry forward from previous tax years. Adjusted income will, therefore, be £40,000 higher than the total income figure shown above.*

Where individuals are aware of this change, this may lead them to revisit past decisions to opt out of defined benefit accrual or restrict their contributions to defined contribution schemes. This in turn may result in more individuals being impacted by the lifetime allowance over time.

Where next?

Employers and trustees should review their policies relating to the tapered annual allowance, for example:

- Should members be allowed to re-join pension schemes if they have previously opted out?
- Do rules / policies that restrict the value of pension accrual need to be revisited in view of the reduction to the minimum tapered annual allowance?
- Do past communications need to be reviewed and are further communications necessary to alert affected members to the change?
- Does the change have wider implications for an organisation's pensions policy as higher earners are once again able to make more meaningful contributions to their pension?

The changes are expected to be to the benefit of most members, and employers and trustees may view the change as an opportunity to review and re-invigorate pensions policy.

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