

# Pension taxation changes

On 14 October 2010 the Government announced its proposed changes to the amount of pension savings that can be made and benefit from tax relief. This leaflet explains how these changes may affect you.



# Changes to the annual allowance

The annual allowance is the amount your pension benefits can grow, in any tax year, and benefit from full tax relief. This includes:

- your pension benefits in the Local Government Pension Scheme (LGPS) including additional voluntary contributions (AVCs); and
- any other pension savings you make, for example to a personal pension arrangement.

The annual allowance is currently £255,000 but will be reduced to £50,000 from April 2011. If, after allowing for inflation, your pension growth is above this level, the excess will be treated as income and taxed at your marginal rate of income tax.

However, the proposals allow for the 'carry forward' of any unused allowance from the previous 3 years. So, if for example you are affected because you received a one off large pay increase, following a promotion or re-grading, this could reduce the tax charge or may remove it altogether.

## How is my pension growth towards the annual allowance calculated?

Your pension growth for these purposes (known as the Pension Input Amount) is:

- the difference in your pension and lump sum over a given year (known as the Pension Input Period); less
- an allowance for the increase in the value of benefits due to inflation.

The difference in pension is multiplied by a factor of 16 (a figure that HMRC has determined) and added to the difference in lump sum.

For example:

### Example 1

Jessica's pension benefits at 31 March 2011 are:

A pension of £24,000. Allowing for inflation (of 2%) this is £24,480

A lump sum of £60,000. Allowing for inflation (of 2%) this is £61,200

Jessica's pension benefits at 31 March 2012 are:

A pension of £27,500.

A lump sum of £65,100.

The difference between the benefits at 31 March 2011 and at 31 March 2012 is:

Pension £27,500 - £24,480 = £3,020

Lump sum £65,100 - £61,200 = £3,900

Her total pension growth is:

$(£3,020 \times 16) + £3,900 = £52,220$

In this example, Jessica's pension growth is greater than the annual allowance of £50,000 so she will need to pay a tax charge on the excess of £2,220.

If you make pension savings into any other pension arrangements, the growth from these pensions must be included. If you pay into a defined contribution scheme, including a LGPS AVC scheme, it is the amount of contributions you or your employer pay that must be included.



## Could this affect me?

These changes are most likely to affect people with higher levels of pay – particularly employees earning over £150,000. You may also be affected if your pay is lower than £150,000 and you have a long period of pensionable service.

The table below gives an example of how this could affect employees in the LGPS after April 2011.

		Pensionable salary at start of tax year £								
		80,000	90,000	100,000	110,000	120,000	130,000	140,000	150,000	160,000
Pensionable service at start of tax year	10	26,340	29,633	32,925	36,218	39,510	42,803	46,095	49,388	52,680
	15	28,240	31,770	35,300	38,830	42,360	45,890	49,420	52,950	56,480
	20	30,140	33,908	37,675	41,443	45,210	48,978	52,745	56,513	60,280
	25	32,040	36,045	40,050	44,055	48,060	52,065	56,070	60,075	64,080
	30	33,940	38,183	42,425	46,668	50,910	55,153	59,395	63,638	67,880
	35	35,840	40,320	44,800	49,280	53,760	58,240	62,720	67,200	71,680
	40	37,740	42,457	47,175	51,892	56,610	61,327	66,045	70,762	75,480

■ pension growth above reduced annual allowance

■ pension growth below reduced annual allowance

The table shows which employees may be affected if pay increases by 5% and inflation is 3%. Different levels of pay increases and inflation will result in different people being affected.

If your pay is much lower and you receive a promotion or above average pay rise, the increase in your pension and lump sum values (due to your higher salary) might take you over the annual allowance.

Here's an example of how that might work:

### Example 2

John has been a member of the LGPS for 25 years. He has a promotion that takes his salary from £80,000 a year to £105,000 a year.

Although his salary is still under £150,000 this is quite a significant pay rise which will mean that John's pension benefits increase significantly for the tax year. If there was no carry forward of unused allowance, a calculation indicates that John's tax bill would be around £54,000.

However, even after allowing for the carry forward of the previous three years' unused annual allowance, (based on 0.5% below inflation pay rises in the previous 3 years) the calculation indicates that John could still be liable for a tax charge of around £10,000.

You may also find that you will be affected if you are topping up your pension, generally by large amounts. For example, you may be buying lots of additional pension or pensionable service over a short period of time.

## How is the tax charge paid?

If your pension growth takes you over the annual allowance limit it must be reported on your self-assessment tax return at the end of the tax year. If you exceed the annual allowance in the LGPS, your LGPS administrator will automatically provide you with information to help with this. In any other circumstance you can request the annual allowance information from your LGPS administrator.

The Government has consulted on how the tax charge will be paid. It has suggested that any tax charge could be paid in two steps:

- Step 1** An immediate payment by the member of the first £2,000 to £6,000 of any charge.
- Step 2** The Scheme would pay the remainder of the tax charge on the member's behalf. The member's benefits would then be reduced for the remainder of their life to offset this payment.

The Government will confirm exactly how the payment will be applied in due course.

## Are there any exceptions?

There are some cases when the annual allowance restrictions will not apply. These are complicated but you may be entitled to an exemption for the following:

- Increases to deferred pensions (i.e. you no longer work for your employer but have a pension with them which will be paid when you reach normal pension age).
- Pensions paid in the event of your death.
- Pension payments awarded on ill-health (in some cases).
- Payments made when you transfer your pension benefits from one pension scheme to another.

# Changes to the lifetime allowance

The lifetime allowance is the maximum amount of pension benefits you can build up without incurring a tax charge. It is currently £1.8 million but will reduce to £1.5 million from April 2012.

Some members may already have benefits that are at or above these levels and they may also have registered for transitional protection (known as primary and enhanced protection). The Government has confirmed that members with primary or enhanced protection are not affected by the reduced lifetime allowance. They have also announced that members who do not have either of these protections and have benefits that exceed the new £1.5 million limit can apply for the new 'fixed protection'.

By applying for fixed protection by 5 April 2012, members can retain the current £1.8 million lifetime allowance. Members with fixed protection are unlikely to be able to increase the value of their pension benefits beyond the rise in inflation, although exact details are still to be confirmed.

For more information about primary and enhanced protection you can visit the HMRC website [www.hmrc.gov.uk](http://www.hmrc.gov.uk)

## Could this affect me?

Generally it is just people with higher levels of pay and long periods of pensionable service that will be affected.

The value of your pension benefits for these purposes is:

- your pension at retirement multiplied by 20; plus
- your lump sum at retirement.

### Example 3

Adam's pension benefits at retirement are:

A pension of £25,000  
A lump sum of £70,000

The total value of his pension benefits for the lifetime allowance test would be:

$$(\text{£}25,000 \times 20) + \text{£}70,000 = \text{£}570,000$$

The value of Adam's pension benefits is well below the lifetime allowance amount.

## More information

### Anti-forestalling – a reminder

Anti-forestalling aims to prevent people taking advantage of the current pension taxation arrangements before the new system is introduced. The anti-forestalling measures announced in the 22 April 2009 Budget are still in place until 5 April 2011:

- If you have a relevant income of more than £130,000 in the 2010/2011 tax year, or either of the two previous tax years, and you make any pension savings above your 'normal' level you may be subject to the Special Annual Allowance charge of 30%.

You can read more about anti forestalling online at [www.hmrc.gov.uk/manuals/rpsmmanual/RPSM15200000.htm](http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM15200000.htm)

### What happens next?

The changes are still being finalised and will be passed in legislation in early 2011.

The first period your benefits will be measured for the reduced annual allowance is the 2011/2012 tax year.

If your pension growth is over the reduced annual allowance in that period you will be contacted by your LGPS administrator. This process and how the tax charge would be paid are still being finalised. More details will be made available to you nearer the time if you are affected.

If you think you might be affected by the reduced annual allowance, the reduced lifetime allowance or anti-forestalling, you may wish to take financial advice.

**This note is intended to provide a high-level overview of the proposed tax changes. More details can be obtained from your LGPS administrator. If you are thinking of making any changes to your pension arrangement you should consider seeking independent financial advice (for more information visit [www.unbiased.co.uk](http://www.unbiased.co.uk)).**