Basic Overview of Pension Allowances

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Background

Tax registered pension schemes have the benefit of tax relief, the main areas are:

- Pension contributions are deducted before income tax
- Retirement lump sums are tax free

Due to these tax advantages, the HMRC introduced a new tax Regime effective from 6 April 2006. This is known as “A-Day”.

- Annual Allowance (AA) £215,000 rising to £255,000
- Lifetime Allowance (LTA) £1.5million rising to £1.85million

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What is the Annual Allowance?

- The Annual Allowance limits the total amount of “pension growth” in relation to an individual member’s pension benefits during a year.

- Benefits in excess of the Annual Allowance will be subject to a tax charge.

- This assessment covers ALL pension benefits accrued in ALL tax registered pension arrangements – not just the LGPS.

- The thresholds are set by the Government.

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Annual Allowance levels

Levels were significantly reduced in line with October 2010 Comprehensive Spending Review.

Tax Year	Annual Allowance
2006/2007	£215,000
2007/2008	£225,000
2008/2009	£235,000
2009/2010	£245,000
2010/2011	£255,000
2011/2012	£50,000
2012/2013	£50,000
2013/2014	£50,000
2014/2015	£40,000
2015/2016	£40,000

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Annual Allowance terminology

- Pension Input Period (PIP) – 1st April to 31 March
- Pension Input Amount (PIA) – the growth in pension benefits over the year
- Opening Value (OV) – value of benefits at the start of the year
- Closing Value (CV) – value of benefits at the end of the year
- Consumer Price Increase (CPI) – measurement of inflation

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Annual Allowance Calculation

Simple formula to assess growth is:

Closing Value – [Opening Value + Consumer Price Increase]

Simplified example of an active member of the LGPS

Pension benefits at 31 March 2013 Pension **£6,500** Lump Sum **£19,000**
Pension benefits at 31 March 2014 Pension **£9,500** Lump Sum **£23,500**
Assumed CPI increase of 5%

CV **£9,500** less [**£6,500 + £325**] = **£2,675** growth in annual pension

CV **£23,500** less [**£19,000 + £950**] = **£3,550** growth in lump sum

£2,675 x 16 * = **£42,800 + £3,550** = **£46,350** total growth

* 16 is a factor determined by the Government Actuary's Department (GAD)
(under the old regime the factor was 10)

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Points to note in previous calculation

- This is not a real member – just demonstrates growth.
- Member would be unaffected in 2013/2014 as the growth was less than £50,000. No tax charge.
- If same growth occurred in the following year 2014/2015 then the member would have infringed the reduced £40,000 allowance. Tax would be payable on £6,350.
- The calculation takes no account of Additional Voluntary Contributions – the contributions paid during the year would be added in the same way to lump sum growth.
- Does not include any growth in other tax registered pension schemes.

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Annual Allowance continued ......

- Unused AA from previous 3 years, known as carry forward can be used to negate the impact of tax charges. Example below.

Tax Year	Growth	Allowance	Unused AA	Carry Fwd
2011/2012	£55,000	£50,000	Nil	Nil
2012/2013	£30,000	£50,000	£20,000	£20,000
2013/2014	£46,350	£50,000	£3,650	£23,650
2014/2015	£46,350	£40,000	Nil	

The £6,350 excess in 2014/2015is offset against the carry forward for 2012/2013 so there is no tax charge. £17,000 (£23,650 - £6,350) can be carried forward to 2015/2016.

- Prior to 2011/2012 a notional AA of £50,000 can be used for carry forward (not the higher amounts).
- Any negative accruals will be treated as zero.

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Exceeding the AA – Tax Charge

- Member must aggregate growth of ALL Registered Pension Schemes.
- All excesses, whether tax is due on not must be reported to the HMRC
- If growth exceeds AA after all carry forward, there will be a tax charge
- Any tax charge will be assessed on the member's marginal tax rate
- Any tax charge will need to be assessed by the HMRC
- If the HMRC confirms the tax payable is greater than £2,000 then the member can elect for Scheme Pays
- Scheme pays is a mandatory facility where the ERPF will pay the relevant tax charge on behalf of the member
- In return, the scheme will calculate a deduction to the member's pension which will be applied when payment of benefits are made. The factor to calculate the deduction is issued by the Government Actuary's Department (GAD).

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Responsibilities for Annual Allowance

<u>Annual Allowance is the responsibility of the member</u>

However the member can only begin to assess AA implications when the employer and the fund have met their obligations.

<u>Employer</u>

- imperative that employers supply timely and accurate pay information by the deadlines stated.

<u>Fund</u>

- only when accurate pay information is received can the Annual Benefit Statements provided which in essence gives the member their opening and closing values
- where the member exceeds the AA, the scheme <u>must</u> provide the member with details within 6 months of the end of the tax year ie. 6 October.

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Implications for employers

- Statutory requirement to provide details to the ERPF, whether this is HR or Payroll
- Provides general reassurance to staff
- HR implications on recruitment and promotion

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What is the Lifetime Allowance (LTA)?

- The Lifetime Allowance is the total amount of pension saving that can be provided to an individual without incurring an extra tax charge.
- The capital value of benefits must be check against LTA whenever a Benefit Crystallisation Event (BCE) occurs.
- A member can have more than one BCE.
- This assessment covers ALL pension benefits accrued in ALL tax registered pension schemes.
- The thresholds are set by the Government.

Lifetime Allowance levels

Tax Year	Lifetime Allowance
2006/2007	£1.50m
2007/2008	£1.60m
2008/2009	£1.65m
2009/2010	£1.75m
2010/2011	£1.80m
2011/2012	£1.80m
2012/2013	£1.50m
2013/2014	£1.50m
2014/2015	£1.25m
2015/2016	£1.25m
2016/2017	Reducing to £1million

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Lifetime Allowance Calculation

Simple formula to assess capital value of benefits:

[20 x pension] + Lump Sum + AVC Fund

<u>Simplified example of a retiring member of the LGPS</u>

Date of retirement	**4th May 2015**
Annual pension payable at retirement	**£35,000**
Lump sum at retirement	**£90,000**
AVC fund at retirement	**£20,000**

20 x £35,000 = £700,000 + £90,000 + £20,000

Capital Value = <u>£810,000</u>

As £810,000 is below the current LTA threshold at retirement (£1.25million), there is no tax charge to pay.

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Lifetime Allowance continued …….

- If the retiree had exceeded the LTA then a tax charge on the excess would be payable.
- When LTA thresholds are reduced, protections are made available.
- The main protections are Fixed Protection and Individual Protection.
- Fixed Protection is easy to lose as further benefit accrual is restricted.
- Individual Protection can only be applied for if the capital value of your benefits exceeded £1.25 million at 5 April 2014.

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Thank you for listening.

Any questions, please visit my workshop.

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