Tax Controls and Your LGPS Benefits (UPDATE)

In this leaflet we look at the HM Revenue and Customs (HMRC) rules that govern pension savings.

There are controls on the total amount of contributions you can make into all pension arrangements and receive tax relief and on the pension savings you can have before you become subject to a tax charge. This is in addition to any tax due under the PAYE system on your pension once it is in payment.

You can, if you wish, pay up to 100% of your UK taxable earnings in any tax year into any number of concurrent pension arrangements of your choice (or, if greater, £3,600 to a "tax relief at source" arrangement, such as a personal pension or stakeholder pension scheme) and be eligible for tax relief on the contributions.

There are two main allowances for pension savings - an annual allowance and a lifetime allowance. There are also protections for benefits earned up to 5 April 2006 if you are a high earner affected by the introduction of the lifetime allowance from 6 April 2006.

Most people will be able to save as much as they wish with full tax relief as their pension savings will be less than the allowances.

Are there any limits on how much I can pay in contributions?

At the present time there is no overall limit on the amount of contributions you can pay, although there is a limit of £5,000 on the extra LGPS pension you can buy and the amount you can pay to the scheme's additional voluntary contribution (AVC) arrangement is limited to 50% of your pay. Although there is no overall limit on the amount of contributions you can pay to all schemes, tax relief will only be given on contributions up to a total of 100% of your taxable earnings.

What are the tax controls on my pension savings?

There are two controls - the annual allowance and the lifetime allowance.

Annual allowance

This is the amount by which the value of your pension benefits may increase in any one year without you having to pay a tax charge. For the LGPS, the pension savings year runs from 1 April to 31 March and is called the pension input period.

The annual allowance for 2011/2012 is £50,000.

Generally speaking, the assessment covers any pension savings you may have in all tax-registered pension arrangements where you have been an active member of the scheme during the tax year i.e. you have paid contributions during the tax year (or your employer has paid contributions on your behalf). This includes any AVCs you have chosen to pay.

What if my pension savings exceed the annual allowance?

If your pension savings exceed the annual allowance a special tax charge is payable (at your marginal rate)

Any tax paid will effectively cancel out the tax relief you receive when you make pension savings. Therefore, as the pension you are paid in retirement is taxable, it will usually not be tax-efficient to make pension savings above the annual allowance.

However, if you exceed the annual allowance in any one year, you may offset the potential tax payable by carrying forward any unused allowance from the previous three years (using the reduced allowance of £50,000 a year to determine the amount which can be carried forward from the tax years 2008/09, 2009/10 and 2010/11). See Generic LGPS Examples below:-

It is important to note that the assessment covers any pension benefits you may have where you have been an active member during the tax year, not just benefits in the LGPS

If you exceed the tax allowance in any year you will be notified by the Pensions Team in sufficient time for you to notify HMRC as part of your self assessment tax return. This will cover your membership in the Haringey Pension Fund. It will not cover pension benefits with other funds not transferred to Haringey Council

Working out whether you are affected by the annual allowance is quite complex, but a guide to help you work out your general position is attached as Appendix 1.

Where the tax charge exceeds £2000 you will have the choice of either paying it directly to HMRC or asking the Fund to pay the charge in return for a reduction in your retirement benefits. (Details are awaited from the Government Actuary on how the reductions will be calculated).

Are there situations when the annual allowance does not apply?

All benefits earned will be subject to the annual allowance, except in the cases of death or retirement in "severe ill health". This means ill-health such that the individual is unlikely to be able to undertake significant gainful employment in any capacity at any time in the future. In the LGPS context, this suggests Tier 1 ill-health retirement may be exempt from the annual allowance test, but Tier 2 ill-health may not be exempt, although this is still to be confirmed.

The application of the annual allowance will apply in every year that pension savings are made, including:

- The year in which benefits are drawn
- If a member retires early or is made redundant

From 6 April 2011 the exemption from the annual allowance for the relatively small number of scheme members who applied to HMRC for, and received, an enhanced protection certificate will cease. (See section on Fixed Protection below)

Pension Tax - Generic LGPS Examples

Here are some generic examples illustrating the impact for some sample LGPS members based on different salary and service profiles:.

	Case 1	Case 2	Case 3	Case 4	Case 5
Salary at beginning of year	80,000	100,000	120,000	150,000	40,000
Service at beginning of year	20	20	25	25	40
Pre-2008 service at beginning of year	17	17	22	22	37
Increase in Pay	6.25%	10%	8.33%	6.66%	15%
Salary at end of year	85,000	110,000	130,000	160,000	46,000
Service at end of year	21	21	26	26	41
Pre-2008 service at end of year	17	17	22	22	37
Inflation over year (CPI)	2.5%	2.5%	2.5%	2.5%	2.5%
Pension accrued at beginning of year	21,000	26,250	39,000	48,750	20,500
Lump sum accrued at beginning of year	51,000	63,750	99,000	123,750	55,500
Pension accrued at end of year	23,729	30,708	44,417	54,667	24,342
Lump sum accrued at end of year	54,188	70,125	107,250	132,000	63,825
Value of “pension savings”	37,179	65,615	76,842	80,323	60,204
Excess over annual allowance of £50k	0	15,615	26,842	30,323	10,204
Tax charge if 40% tax rate	0	6,246	10,737	12,129	4,082
Tax charge if 50% tax rate	0	7,807	13,421	15,161	5,102

Case 5 above shows that members on a salary of £40,000 or lower could be impacted if they have a long period of LGPS service and receive a noticeable pay rise, say, due to a change in role.

It may be possible for members to carry forward any unused annual allowance from the previous 3 tax years to reduce, or even eliminate, the tax charge. See the example below.

Carry forward of unused Annual Allowance – an example

Suppose the value of “pension savings” in 2014/15 is £66,500, but there are unused allowances from previous years as follows:

Year	Value of “pension savings”	Annual Allowance (AA)	Unused AA
2011/12	£30,000	£50,000	£20,000
2012/13	£35,000	£50,000	£15,000
2013/14	£40,000	£50,000	£10,000
Unused AA	-	-	£45,000

So Annual Allowance for 2014/15 = £50,000 + £45,000 = £95,000.

There is an excess of AA (£95,000) over the value of “pension savings” (£66,500) in 2014/15.

Hence tax due in 2014/15 = Nil.

Residual AA carried forward to 2015/16 = £95,000 – £66,500 = £28,500.

Lifetime Allowance

The lifetime allowance is the total value of all pension benefits you can have without triggering an excess benefits tax charge. If the value of your pension benefits when you draw them (not including any state retirement pension, state pension credit or any spouse's, civil partner's or dependant's pension you may be entitled to) is more than the lifetime allowance, or more than any primary lifetime allowance protection or enhanced protection you may have (see below), you will have to pay tax on the excess benefits. The lifetime allowance covers any pension benefits you may have in all tax-registered pension arrangements - not just the LGPS.

The lifetime allowance for 2011/2012 is £1.8million and is reducing to £1.5 million in 2012/13.

When any LGPS benefit, or any other pension arrangement you may have, is put into payment you use up some of your lifetime allowance - so you should keep a record of any pensions you receive. If you have a pension in payment before 6 April 2006, this will be treated as having used up part of your lifetime allowance.

If your LGPS benefits are more than your lifetime allowance you will have to pay tax on the excess. If excess benefits are paid as a pension the charge will be 25%, with income tax deducted on the ongoing pension payments; if the excess benefits are taken as a lump sum they will be taxed once only at 55%.

There are protections called primary lifetime allowance or enhanced protection for benefits earned up to 5 April 2006. To have this protection you must have registered with HM Revenue and Customs by 5 April 2009. If you already have primary or enhanced protection you will be unaffected by the reduction in the lifetime allowance from 2012/13. (See Appendix 2 for more information about Primary or Enhanced Protection.

From 6 April 2011 the exemption from the annual allowance for the relatively small number of scheme members who applied to HMRC for, and received, an enhanced protection certificate has ceased. (See section on Fixed Protection below)

Fixed Protection

Because the lifetime allowance is reducing to £1.5 million in 2012/13 there is a new form of protection called fixed protection. With fixed protection your lifetime allowance will be fixed at £1.8 million rather than the new standard lifetime allowance of £1.5 million. However, if in the future the standard lifetime allowance rises to be more than £1.8 million your lifetime allowance will then be the higher standard lifetime allowance.

You will lose fixed protection if you start a new pension arrangement, other than to accept a transfer of existing pension rights, or if your benefits increase by more than the cost of living increases, or if you pay contributions into a money purchase pension arrangement other than to a life assurance policy providing death benefits that started before 6 April 2006. You will also be subject to restrictions on where and how you can transfer benefits.

Deciding on whether or not to apply for Fixed Protection is a complicated process and you may wish to take independent financial advice.

To apply for fixed protection you have to make an application to HM Revenue & Customs (HMRC) in their prescribed form on or before 5 April 2012.

The HMRC Form can be downloaded from :-

http://search.hmrc.gov.uk/kb5/hmrc/hmrc/results.page?qt=Fixed+Protection

The Notes on the completion of the HMRC Form can be downloaded from:-

http://www.hmrc.gov.uk/pensionschemes/apss227-notes.pdf

Disclaimer

The information in this leaflet applies to individuals who were contributing members of the Local Government Pension Scheme on 1 April 2008 or who have since joined. This leaflet is for employees in England and Wales and was up-to-date at the time of publication in November 2011 and reflects the current provisions of the LGPS. Changes to the scheme may be made by the Government in the future after consultation with interested parties. This leaflet is for general use and cannot cover every personal circumstance nor does it cover specific protected rights that apply to a very limited number of employees. In the event of any dispute over your pension benefits, the appropriate legislation will prevail as this leaflet does not confer any contractual or statutory rights and is provided for information purposes only.

More Information

For more information on the LGPS including links to the Scheme Regulations and Leaflets or if you have a problem or question about your LGPS membership or benefits, please see below:

The Pensions Team	Alexandra House 10 Station Road Wood Green N22 7TR Tel: 0208 489 5916 Fax: 0208 489 3986 Email: Pensions.Mailbox@haringey.gov.uk
On-line Guide to the LGPS	www.lgps.org.uk
Haringey Council Pension Page (Leaflets and Policy Statements)	www.haringey.gov.uk/pensionfund
Harinet (Leaflets and Policy Statements)	Click Personnel>Pay and Pensions>Local Government Pension scheme
Continued overleaf:	

Appendix 1

How the Annual Allowance is worked out

In general terms, the increase in the value of your pension savings in the LGPS in a year is calculated by working out the value of your benefits immediately before the start of the input period (1 April), increasing them by inflation, and comparing them with the value of your benefits at the end of the input period (31 March). In a defined benefit scheme like the LGPS the value of your benefits is calculated by multiplying the amount of your pension by 16 and adding any lump sum you are automatically entitled to from the pension scheme. If the difference between:

a) the value of your benefits immediately before the start of the input period (the opening value) and

b) the value of your benefits at the end of the input period (the closing value) plus any contributions you have paid into the scheme's Additional Voluntary Contribution (AVC) arrangement in the year or that you and your employer have paid into the scheme's Shared Cost AVC arrangement in the year is more than £50,000, you may be liable to a tax charge.

The method of valuing benefits in other schemes may be different to the method used in the LGPS.

Worked example based on Case 2 of the Generic LGPS examples above :-

Step 1 Calculate opening pensions values.

Annual Pension is (17yrs x £100,000/ 80) + (3) yrs x £100,000 /60) = £26,250.x 2.5% (CPI) = **£26,906.**

Lump Sum is 17yrs x £100,000/80 = £21,250 x 3 = £63,750 x 2.5% (CPI) = **£65,344**

Step 2 Calculate the closing pension values.

Annual Pension is (17yrs x £110,000 / 80) + (4yrs x £110,000 /60) = **£30,708**

Lump Sum is 17yrs x £110,000 / 80 = £23,375 x 3 = **£70,125**

Step 3 Calculate pension saving for the year.

Opening Pension value is **(£30,708 - £26,906) x 16. + (£70,125 - £65,344) = £65615**

Step 4 Calculate excess saving for the year.

The excess for the year is £65613 - £50000 = **£15615**. This is subject to a tax charge at your marginal rate. (At 40% this would incur a tax charge of £6246)

It may be possible for members to carry forward any unused annual allowance from the previous 3 tax years to reduce, or even eliminate, the tax charge.

Please note:

If you have elected to transfer pension rights from another scheme into the LGPS, the value of the benefits relating to the transfer does not count towards your pension savings in the LGPS in the year in which the transfer payment is received.

If your pension benefits in the LGPS are reduced following a Pension Sharing Order (issued as a result of a divorce or dissolution of a civil partnership) then, for the purposes of calculating the value of your pension savings in the LGPS, the reduction in your benefits is ignored in the year that the Pension Sharing Order is applied to your benefits.

If you retire on grounds of permanent ill health and an independent registered medical practitioner certifies that you are suffering from ill-health which makes it unlikely that you will be able (otherwise than to an insignificant extent) to undertake gainful work (in any capacity) before reaching State pension age, there is no annual allowance tax charge on the ill health retirement benefits.

It is important to note that the assessment covers any pension benefits you may have where you have been an active member during the tax year, not just benefits in the LGPS.

Appendix 2

Transitional Protections at 6th April 2006

Primary lifetime allowance protection

Primary protection is aimed at protecting benefits earned up to 5 April 2006 for those high earners affected by the introduction of the lifetime allowance from 6 April 2006 i.e. those whose benefits at 5 April 2006 already had a capital value in excess of the 2006/2007 lifetime allowance of £1.5 million.

If the value of your pension benefits at 5 April 2006 was more than the 2006/2007 lifetime allowance of £1.5million and you have registered for primary protection, you have an individual lifetime allowance based on how much your benefits at 5 April 2006 exceeded the value of the 2006/2007 standard lifetime allowance. Your individual lifetime allowance increases at the same rate as the standard lifetime allowance. So, if your benefits at 5 April 2006 exceeded the 2006/2007 standard lifetime allowance by 10%, your individual lifetime allowance will always be 10% higher than whatever the standard lifetime allowance is in future years.

If your pension rights are shared on divorce or dissolution of a civil partnership this will result in the individual lifetime allowance being reduced (or lost if it reduces to below the standard lifetime allowance).

Enhanced protection

You could register for enhanced protection (as well as primary protection) if the value of your pension benefits at 5 April 2006 was more than the 2006/2007 lifetime allowance of £1.5million. You could also register for enhanced protection if you believed the value of those benefits might in the future be more than the standard lifetime allowance or if you believed your pension benefits in any one year would increase by more than the annual allowance. Under enhanced protection you will not pay tax on benefits in excess of the lifetime allowance provided your benefits at retirement do not exceed the value of your benefits at 5 April 2006 as increased after then, in general terms, by the greater of 5% per annum, the increase in the cost of living or increases in your pensionable pay. If the limit is exceeded you will pay tax on the excess. You will lose enhanced protection if you pay contributions into a money purchase pension arrangement (e.g. pay into the LGPS arranged AVC facility) or if you start a new pension arrangement, or if you transfer your LGPS benefits to another defined benefit pension scheme. You can also voluntarily give up enhanced protection by giving notice that you no longer wish to keep it.

If you lose enhanced protection you must notify HMRC within 90 days. Failure to do so could result in a fine of up to £3,000.