

## LGPS factsheet

### Pensions Taxation - Annual Allowance

HM Revenue and Customs impose two controls on the amount of pension savings you can make without having to pay extra tax. These controls are known as the Annual Allowance and Lifetime Allowance. This is in addition to any income tax you pay on your pension once it is in payment.

This factsheet looks at the Annual Allowance which 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 information on the lifetime allowance please refer to the factsheet on our website.

#### What is the Annual Allowance?

The Annual Allowance (AA) 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. This is in addition to any income tax you pay on your pension once it is in payment.

If the value of your pension savings in any one year (including pension savings outside of the LGPS) are in excess of the annual allowance, the excess will be taxed as income.

The Government reduced the AA from £255,000 to £50,000 from 6 April 2011 and then reduced it again to £40,000 from 6 April 2014. Further changes to the annual allowance have been made for higher earners from 6 April 2016, which resulted in special transitional rules for the 2015/16 tax year. These changes are covered in more detail later in this factsheet.

Annual Allowance limit:

Pension Input Period	Annual Allowance
1 April 2011 to 31 March 2012	£50,000
1 April 2012 to 31 March 2013	£50,000
1 April 2013 to 31 March 2014	£50,000
1 April 2014 to 31 March 2015	£40,000
1 April 2015 to 5 April 2016	£80,000 (transitional rules apply)
6 April 2016 to 5 April 2017	£40,000 (unless tapering applies)
6 April 2017 to 5 April 2018	£40,000 (unless tapering applies)

#### Am I likely to be affected by the Annual Allowance?

Most people will not be affected by the AA tax charge because the value of their pension saving will not increase in a year by more than £40,000, or, if it does they are likely to have unused allowance from previous years that can be carried forward.

You are most likely to be affected if:

- you have a lot of scheme membership and you receive a significant pay increase, and/or;
- you pay a high level of additional contributions, and/or;

- you are a higher earner, and/or;
- you transfer pension rights into the LGPS from a previous public sector pension scheme<sup>1</sup> under the preferential club transfer rules and your salary (full time equivalent) upon joining the LGPS is somewhat higher than the salary you earned when you left the previous scheme, and/or;
- you combine a previous LGPS pension benefit that was built up in the final salary section of the LGPS with your current pension account and your salary (full time equivalent) has increased significantly since leaving and re-joining the scheme, and/or;
- you have accessed flexible benefits on or after 6 April 2015

We will inform you if your LGPS pension savings exceed the standard AA in any year by no later than 6 October of the following year.

### **The 50/50 section of the LGPS**

If you wish to slow down your pension build up to avoid or mitigate an AA tax charge the 50/50 section of the LGPS allows you to pay half your normal contributions and build up half your normal pension, whilst still retaining full life and ill health cover. Visit the [LGPS member website](#) for more information on this option.

Before considering any action to reduce your tax liabilities you should always seek independent financial advice from an FCA registered adviser. For help in choosing an independent financial adviser visit the [money advice website](#).

### **How is the Annual Allowance calculated?**

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 'pension input period', increasing the value by inflation and then comparing it with the value of your benefits at the end of the 'pension input period'.

The 'pension input period' (PIP) is the period over which your pension growth is measured. From 6 April 2016, PIPs for all pension schemes are aligned with the tax year – 6 April to 5 April. Prior to the 2016/17 tax year the PIP for the LGPS was 1 April to 31 March, except for the year 2015/16 when special transitional rules apply.

In the LGPS the value of your pension benefits is calculated by multiplying the amount of your annual pension by 16 and adding any lump sum you are automatically entitled to from the pension scheme plus any AVCs you or your employer has paid during the year.

If the difference in the value of pension benefits at the end of the PIP and the value of your pension benefits immediately before the start of PIP (adjusted for inflation), is more than the AA then you may be liable to pay a tax charge.

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<sup>1</sup> A public service pension scheme includes a pension scheme covering civil servants, the judiciary, the armed forces, any scheme in England, Wales or Scotland covering local government workers, or teachers, or health service workers, or fire and rescue workers or members of the police forces; or membership of a new public body pension scheme.

It is important to note that the assessment for the AA covers any pension benefits you may have where you have been an active member during the year, not just benefits in the LGPS. For example, if the increase in the value of your LGPS benefits was calculated as £30,000 in 2014/15 when the AA was £40,000, but you also had an increase in the value of other pension benefits of £15,000 in the same year, that would mean you had a total increase in pension benefits of £45,000. If you did not have any carry forward (see below for more information), you would be liable for a tax charge for the amount you exceeded the AA by, even though at face value you did not breach the AA in either scheme.

## Carry forward

You would only be subject to an AA tax charge if the value of your total pension savings for a year increase by more than the AA for that year.

However, a three year carry forward rule allows you to carry forward unused AA from the previous three years. This means that even if the value of your pension savings increase by more than the AA in a year you may not be liable to the AA tax charge.

For example, if the value of your pension savings in 2014/15 increased by £50,000 (i.e. by £10,000 more than the AA) but in the three previous years had increased by £25,000, £28,000 and £30,000, then the amount by which each of these previous years fell short of the AA for those three years would more than offset the £10,000 excess pension saving in the current year. There would be no AA tax charge to pay in this case.

To carry forward unused AA from an earlier year you must have been a member of a tax registered pension scheme in that year.

## Changes to Annual Allowance

The Finance (No 2) Act 2015 introduced two important changes to the AA with effect from 6 April 2016.

1. An annual allowance taper for high earners from 6 April 2016
2. To adjust the 'pension input period' during 2015/16 so that it becomes aligned with the tax year from 6 April 2016

### 1. Tapered Annual Allowance for higher earners

From the tax year 2016/17 the AA is tapered for members who have a 'Threshold Income' in excess of £110,000, and 'Adjusted Income' in excess of £150,000. For every £2 that your Adjusted Income exceeds £150,000, your AA is tapered down by £1 (to a minimum of £10,000).

	Definition	Limit
<b>Threshold Income</b>	Broadly your taxable income after the deduction of your pension contributions (including AVCs deducted under the net pay arrangement)	£110,000
<b>Adjusted Income</b>	Broadly your threshold income plus pensions savings built up over the tax year	£150,000

Threshold income includes all sources of income that are taxable e.g. property income, savings income, dividend income, pension income, social security income (where taxable), state pension income etc.

Please note, you are not allowed to deduct from taxable income any amount of employment income given up for pension provision as a result of any salary sacrifice made on or after 9 July 2015.

### How does the taper work?

From 6 April 2016, the taper reduces the AA by £1 for £2 of adjusted income received over £150,000, until a minimum AA of £10,000 is reached. This means that from 6 April 2016 the AA for high earners is as follows:

Adjusted Income	Annual Allowance
£150,000 or below	£40,000
£160,000	£35,000
£170,000	£30,000
£180,000	£25,000
£190,000	£20,000
£200,000	£15,000
£210,000 or above	£10,000

### Examples

#### Cerys

Gross Salary 2016/17	£120,000	
Less employee pension contributions	£13,680	11.4%
<b>Threshold Income 2016/17</b>	£106,320	Below £110,000 so the AA will not be tapered and remains at £40,000
Pensions saving in the year	£19,500	<b>Less than £40,000 so no tax charge</b>

#### Sanjay

Gross salary 2016/17	£130,000	
Less employee pension contributions	£14,820	11.4%
Plus taxable income from property	£30,000	
<b>Threshold Income 2016/17</b>	£145,180	
Plus pensions saving in the year	£30,000	
<b>Adjusted Income 2016/17</b>	£175,180	Greater than £150,000 so AA will be tapered
Tapered AA	£27,410*	
In excess of AA	£2,590	Pension saving of £30,000 less tapered AA
<b>AA tax charge</b> at marginal rate (assumed to be 40%)	<b>£1,036</b>	£2,590 x 40%

\*Taper = £175,180 - £150,000 = £25,180 / 2 = £12,590. Standard AA £40,000 less £12,590 = £27,410

Please note, the examples above make no allowance for any carry forward.

## 2. Aligning the 'Pension Input Period' with the tax year

The 'pension input period' (PIP) is the period over which your pension growth is measured. Up until 2014/15 the PIP in the LGPS ran from 1 April to 31 March. From 6 April 2016, PIPs for all pension schemes are aligned with the tax year – 6 April to 5 April. Special transitional arrangements apply for 2015/16 meaning that there are 2 PIPs in 2015/16, as set out below:

**Pre-alignment tax year:** 1 April 2015 to 8 July 2015 - the revised AA during this period is £80,000

**Post-alignment tax year:** 9 July 2015 to 5 April 2016 - the AA for this period is the amount of the £80,000 not used up from the pre-alignment tax year (subject to a maximum of £40,000) together with any carry forward available from the three previous years.

If you have flexibly accessed any benefits in a money purchase pension arrangement on or after 6 April 2015 (see below) you should contact us for information about how the pre and post alignment tax years will work as it will be different to the above.

### Annual Allowance 'Flexible Benefit' access

If you have any benefits in a money purchase (defined contribution) pension arrangement which you have flexibly accessed on or after 6 April 2015 then the Money Purchase Annual Allowance (MPAA) rules may apply. However, the MPAA will only apply if your total contributions to a money purchase arrangement in a Pension Input Period exceed the MPAA.

Generally, if you have flexibly accessed any benefits in a money purchase arrangement on or after 6 April 2015, and your subsequent contributions to a money purchase scheme exceed the MPAA your defined benefit pension (LGPS) savings will be tested against the alternative AA and you will pay a tax charge in respect of your money purchase saving in excess of the MPAA.

Tax Year	MPAA	Alternative annual allowance if MPAA is exceeded
2016/17	£10,000	£30,000
2017/18	£4,000	£36,000

Special transitional rules applied for the tax year 2015/16 – contact us for more information, if applicable.

If you access flexible benefits you will be provided with a flexible access statement; you should provide us with a copy of this statement.

Flexible access means taking a cash amount over the tax-free lump sum from a flexi-access drawdown account, taking an uncrystallised funds pension lump sum (UFPLS), purchasing a flexible annuity, taking a scheme pension from a defined contribution scheme

with fewer than 12 pensioner members or taking a stand-alone lump sum if you have primary but not enhanced protection<sup>2</sup>.

## How would I pay an Annual Allowance tax charge?

If you exceed the AA in any year you are responsible for reporting this to HMRC on your self-assessment tax return.

You may find HMRC's helpsheet - HS345 useful when completing your return. The helpsheet can be downloaded from - <https://www.gov.uk/government/publications/pensions-tax-charges-on-any-excess-over-the-lifetime-allowance-annual-allowance-special-annual-allowance-and-on-unauthorised-payments-hs345-self>

We are obliged to notify you if your LGPS benefits (plus the amount of any Additional Voluntary Contributions (AVCs) you may have paid) exceed the standard AA, or if we believe you have exceeded the MPAA, in a year. We must inform you by no later than 6 October of the following tax year. However, we are not obliged to inform you if you exceed the tapered annual allowance. Additionally, you may ask us for an AA statement even where you do not exceed the AA, which you may need to do if you have savings across multiple schemes.

If you have an AA tax charge that is more than £2,000 and your pension savings in the LGPS alone have increased in the year by more than the standard AA you may be able to opt for the LGPS to pay some or all of the tax charge on your behalf. The tax charge would then be recovered from your pension benefits. This option is known as 'scheme pays'.

If you want the LGPS to pay some or all of an AA tax charge on your behalf, you must notify<sup>3</sup> us no later than 31 July in the year following the end of the year to which the AA charge relates. However, if you are retiring (and draw all of your benefits from the LGPS) and you want the LGPS to pay some or all of the tax charge on your behalf from your benefits, you must tell us before you become entitled to those benefits.

The relevant fund, at their discretion, may also agree to pay some or all of an annual allowance charge on your behalf in other circumstances e.g. where your pension savings are not in excess of the standard AA but are in excess of the tapered or money purchase AA, or where part of the charge relates to pension savings outside of the LGPS. This option is known as 'voluntary scheme pays'. Contact us for more information. **Please note that where the fund pays the charge on a voluntary basis after the relevant self-assessment deadline, you will become liable to pay interest (which the fund would not pay). You should therefore act without delay if you are considering asking for voluntary scheme pays.**

For more information about this option (including how we would calculate the reduction to your benefits), please see the guidance from the Government Actuary's Department, which you can find on our website.

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<sup>2</sup> A stand-alone lump sum is a lump sum relating to pre 6 April 2006 where the whole amount can be taken as a lump sum without a connected pension.

<sup>3</sup> Before you make any election, you may wish to contact us first for a quotation of the reduction we would in return apply to your benefits. To do this you will need to provide us with the tax charge you wish the quotation to be based upon.

Please note that we are **also** required to tell HMRC that you have exceeded the annual allowance.

### **Am I affected?**

If you think you are affected by the AA more information is available on the Government's website - <https://www.gov.uk/tax-on-your-private-pension/annual-allowance>. If you are unsure if you will be affected by the AA use the [AA quick check tool](#) on the LGPS member website.

This factsheet provides an overview of the AA rules at April 2017. It should not be treated as a complete and authoritative statement of the law. The rules governing AA can be complex and are subject to change; if you are unsure how to proceed you are advised to obtain independent financial advice. For help in choosing an independent financial advisor visit the [money advice website](#).

### **More information**

If you have any questions about your LGPS membership or benefits, please contact:

**Your Pension Service**

**Tel: 0300 123 6717**

**Email: [AskPensions@localpensionspartnership.org.uk](mailto:AskPensions@localpensionspartnership.org.uk)**

**Website: [www.yourpensionservice.org.uk](http://www.yourpensionservice.org.uk)**

### **Disclaimer**

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