Changes to tax relief on occupational pensions - 2014

The Finance Act 2011 introduced revised arrangements that restricted tax relief on occupational pensions, including a reduced “annual allowance” (AA) and a reduced “lifetime allowance” (LTA). Reductions to these allowances will continue in 2014. This briefing explains the tax restrictions and highlights the information you will need to assess whether you will be affected, and what other action you may take. It covers England, Wales, Scotland and Northern Ireland.

NB – this briefing is for guidance purposes only and is not intended to provide readers with advice on their individual circumstances.

The RCN is aware of a number of NHS Trusts organising seminars with companies such as KPMG to provide advice on how staff may be affected by these taxation restrictions. You may find it beneficial to attend such a seminar, but be aware that the company providing the advice may charge a fee for an individual consultation. RCN members can seek independent financial advice through RCN Xtra and Lighthouse Temple –

🌐 www.rcn.org.uk/xtra or www.lv.com/rcn/advice
📞 08000 85 85 90 (if using textphone, first dial 18001)

Changes to Annual Allowance (AA)

Annual allowance – Is an upper limit placed on the total value of contributions that can be paid into your pension scheme in any one year and benefit from tax relief. The limit set by HM Revenue & Customs for 2011/12 is £50,000, reduced from £255,000 in 2010/11 and includes your employer’s contributions as well as your own personal contributions. The limit will reduce further to £40,000 from April 2014.

You are likely to be affected by the reduction of AA if your pension contributions or the value of your pension increase significantly in any given year. This could be because of a promotion or pay award, the purchase of additional pension, receiving a pension enhancement (e.g. if retiring on ill health grounds) or benefiting from mental health officer “doubling”. Guidance on AA changes indicating that employees earning less than £100,000 pa will be unaffected is not necessarily accurate as it does not take into account the many complexities of the NHS Pension Scheme.

In order to calculate the annual allowance it is necessary to compare the value of the pension benefit before and after any salary change or pension increase. Flat rate values are used to do this. Unused allowances from the previous three tax years can be used to offset any tax due. (For this purpose, the AA in the years prior to 2014 is assumed to be £50,000)
Illustrative case study

Gerry was promoted from a band 8a role to a band 9 senior post and his pensionable salary increased from £41,772 to £77,079. He is accruing benefits in the NHS Pension Scheme (1995 Section) and has completed 10 years’ membership at the start of the relevant year.

**Step 1:** Calculate pension benefit value at start of the year and “inflation proof” (using a factor of CPI)

\[
Pension = (£41,772 \times 10/80) \times 1.02 = £5,221\times 1.02 = £5,326
\]

**Lump sum = 3 x £5,326 = £15,978**

**Step 2:** Calculate pension benefit at end of the year:

\[
Pension = (£77,079 \times 11/80) = £10,598
\]

**Lump sum = 3 x £10,598 = £31,794**

**Step 3:** Calculate increase in pension benefit value over the year:

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Pension = (£10,598 - £5,221) \times 16 = £86,032
\]

**Lump sum = (£31,794 - £15,978) = £15,816**

**Step 4:** Test against Annual Allowance:

Annual Allowance exceeded by: (£86,032 + £15,816) - £50,000 = £101,848 - £50,000 = £51,848.

Unless Gerry has any unused allowance from the previous 3 years to offset against this increase, he will have to pay tax on the £51,848 difference. This would be at his usual tax rate – most probably 40%.

Pension scheme members will be expected to declare their pension benefits on their Income Tax self-assessment form and calculate whether an additional tax payment is due. NHS Pensions will be able to provide this information automatically for scheme members who exceed their AA in any given year but will only be able to do so from July 2013. The information required for 2011/12 tax year was only available on request from them from July 2012 (i.e. it will not have been sent automatically and members mustn’t assume that because they have not received anything there is no additional tax to pay).

Your HR department, payroll or pensions officer should be able to help in identifying which staff may be affected by these changes. NHS Employers has produced a ready reckoner to help in this process but it should only be used as a guide not definitive advice.

**ACTION POINT** – If you think you will be affected by this change you MUST request this information from NHSP in time to complete your self assessment form and calculate any tax due. Do not incur financial penalty by not acting quickly on this. The first self-assessment tax returns affected were due 31 January 2013 but NHSP have not automatically sent out information to affected scheme members until July 2013.

*Paying the tax liability* – for some people the amount of tax due will mean that they are unable to pay it as a one off charge. The tax rules say that members can make an election requiring their pension scheme to pay their annual allowance charge liability. This is known as “Scheme Pays” and is achieved by an actuarial reduction of scheme benefits and payment of the tax bill “in-year”. But members have this right only if the following conditions are met:
The members annual allowance charge liability for the tax year has exceeded £2,000, and

- The total amount of the member’s pension savings in their pension scheme for the same tax year has exceeded the annual allowance.

There is a maximum amount of annual allowance charge members are allowed to put in an election requiring the scheme to pay.

If you do not or cannot make use of the “Scheme pays” you will need to pay your charge through the self assessment process as normal.

Further information can be found on the [HMRC website](https://www.hmrc.gov.uk) and this [NHS Pensions webpage](https://www.nhsepensions.com).

**Changes to Lifetime Allowance (LTA)**

**Lifetime allowance** – Is an upper limit placed on individuals’ maximum retirement benefits by HM Revenue & Customs (HMRC). Benefits that exceed the allowance will incur a tax charge. The Lifetime Allowance for the tax year 2013/14 is £1.5 million and will reduce further to £1.25 million from April 2014.

The reduction to AA from April 2011 described above was accompanied by a reduction from April 2012 in the “Life Time Allowance” (LTA) for all pension savings, from £1.8m to £1.5m. The LTA is the limit, set by HMRC and the Treasury, on the capital value of benefits an individual can take without incurring a tax charge. The LTA is normally tested at the point at which you take your benefits; this is called “crystallisation” of your benefits. If you have a number of pension arrangements you may have a number of “crystallisation events” and your LTA will be tested at each one.

LTA applies to the total amount of your pension savings - whether in pension schemes such as the NHS Pension Scheme or personal pensions and stakeholder pensions. It does not however, apply to your State Retirement Pension.

Money purchase pensions such as personal pensions, stakeholder pensions and the NHS Money Purchase Additional Voluntary Contribution Scheme have a fund value associated with them. The capital value of these pensions is simply the fund value. In ‘defined benefit’ schemes, like the NHS Pension Scheme (NHS PS), there is no simple capital fund value so a special calculation is used to assess the equivalent or “deemed” value of employee and employer contributions. This is usually done by multiplying the annual pension amount by a factor of 20 and adding it to any lump sum received. However, there can be different arrangements for those commuting pension for lump sum so members are advised to seek advice from their pension providers and NHS Pensions to find their correct value.

RCN members with long service and/or high earnings may be at risk of exceeding the LTA.
NHS Pensions will calculate the LTA for all those retiring from the NHS Pension Scheme, but will expect you to provide them with details of any other pension you are claiming or already in receipt of.

If your total pension value exceeds the LTA a charge will be payable. NHSP will pay this charge directly to HMRC and recoup the money from you by deducting an amount from your pension. The Lifetime Allowance charge is 55% on any lump sum above your personal LTA and 25% against any pension in excess of your personal LTA.

Fixed protection, which will enable benefits up to £1.5 million to be taken without any additional tax charge, will be available from summer 2013 but applications for this must be received by HMRC by 5 April 2014.

Fixed protection will allow you to take benefits worth up to £1.5 million without paying the lifetime allowance charge, but does still limit your ability to accrue benefits.

Those who were previously protected by either Primary, Enhanced of Fixed Protection (2012) will continue to receive the protection previously in place.

**NB – If you have been granted fixed protection you must provide your certificate to your pension provider at the time you claim your pension. Otherwise an LTA charge may be deducted.**

**ACTION POINT** – If you think your pension value will exceed £1.25 million, you should consult a financial or taxation adviser as soon as possible.

Where to get further information –

**NHS Pensions** *(England and Wales)* have a number of factsheets covering this issue.

**Scottish Public Pensions Agency** *(SPPA)* have a range of resources on the taxation of the NHS pension

**HSC Pension Scheme** *(Northern Ireland)* has an Annual Allowance factsheet

**NHS Employers** have issued information and guidance for NHS organisations on this matter including a risk assessment tool

**The Pensions Advisory Service** have an advice service that can provide advice and information.

**HMRC** have information on both Annual Allowance and Lifetime Allowance including applications for Fixed Protection.

(all webpages accessed 7/10/13)