Note for LGPS Scheme Members:

Changes to Pension Tax Relief

The Government has announced changes to limits on the amount of tax relief given on pension savings to take effect from April 2014. The limits will be applied by reductions to both the Annual Allowance and the Lifetime Allowance.

This note is an outline summary of how the limits will work but if you feel that you may be affected by the changes and require further information the Government's full proposals can be found on the HM Treasury website http://www.hmrc.gov.uk/pensionschemes/tax-basics.htm#3.

The revised limits should not affect the vast majority of LGPS members but the Fund felt it would be useful to produce this note to help those who are, or think they might be, affected in order that they can seek their own taxation/financial advice.

So, what are the changes?

Annual Allowance

The Annual Allowance (AA) is the amount the value of 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 will be reduced to £40,000 from April 2014. If your pension grows by more than this amount, after allowing for inflation, the excess will be subject to a tax charge at your marginal rate of income tax.

Could I be affected?

These changes are most likely to affect people with higher levels of pay – particularly employees earning over £80,000. You may also be affected if your pay is lower than £80,000, you have a significant period of LGPS membership and you receive a substantial increase in pay (for example by promotion).

QUICK CHECK (if you only pay into the LGPS)
If your annual pension at 31 March has increased by less than £2,500 p.a. when compared to the previous year's 31 March figure then you are unlikely to be affected. You will find these amounts in your annual benefit statements.

Carry forward of unused AA from previous 3 years

The proposals allow any unused allowance from the previous 3 years to be carried forward which may reduce any tax charge or remove it altogether if, for example, you are affected because you received a one-off large pay rise following a promotion or re-grading.

How is my pension growth towards the annual allowance calculated?

Pension growth for these purposes is the increase in the capital value of your pension and any lump sum over the given year. The capital value of your pension is arrived at by multiplying the annual pension by a factor of 16 and adding any basic tax free lump sum value. Allowance for inflation is made on the value of pension benefits at the end of the previous year.

If you pay into any other pension arrangements then the growth from these pensions must also be included.

If you pay into any defined contribution scheme, including an LGPS AVC arrangement, it is the amount of contributions you and your employer make which must be included.

Example 1 - Modest pay rise

- Member has 20 years LGPS membership
- Pay increases by 5% from £20,000 to £21,000
- Inflation is 3%

Pension benefits at 31 March 2014 are:
- A pension of £4,916.67 - allowing for inflation of 3% this becomes £5,064.17
- A lump sum of £12,750.00 - allowing for inflation of 3% this becomes £13,132.50

Pension benefits at 31 March 2015 are: (for the purpose of the example)
- A pension of £5,512.50
- A lump sum of £13,387.50

Difference between the benefits at 31 March 2014 and at 31 March 2015 is:

Pension	£5512.50 - £5,064.17	=	£448.33
Lump sum	£13,387.50 - £13,132.50	=	£255.00

Total pension growth is:

£448.33 x 16	=	£7,173.28
	+	£ 255.00
	=	£7,428.28

Pension growth is well within the £50,000 AA so there will be no tax charge (assuming no other pension savings in the year)

Also, the member can carry forward the unused AA of £42,571.72 into the next tax year.

Example 2 - Significant pay rise (e.g. promotion)

- Member has 30 years LGPS membership
- He has a promotion that takes his salary from £50,000 p.a. to £60,000 p.a.
- Inflation is 3%

Pension benefits at 31 March 2014 are:
- A pension of £18,541.67 - allowing for inflation of 3% this becomes £19,097.92
- A lump sum of £50,625.00 - allowing for inflation of 3% this becomes £52,143.75

Pension benefits at 31 March 2015 are:
- A pension of £23,250.00
- A lump sum of £60,750.00

Difference between the benefits at 31 March 2014 and at 31 March 2015 is:

Pension	£23,250.00 - £19,097.92	=	£4,152.08
Lump sum	£60,750.00 - £52,143.75	=	£8,606.25

Total pension growth is:

£4,152.08 x 16	=	£66,433.28
	+	£ 8,606.25
	=	£75,039.53

Pension growth of £75,039.53 exceeds the AA of £40,000 by £35,039.53 and it would appear he may have to pay an AA tax charge of £14,038.12 at his marginal rate of 40%.

However, he did not have such large pay rises in the previous 3 years and was so able to apply any unused AA from those years and, as they exceeded the £35,039.53, he did not suffer a tax charge

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, Pensions Services will automatically provide you with information to help with this. In any other circumstance relevant information can be provided on request by Pensions Services.

To prevent individuals being provided with excessive tax bills, it is possible to instead have the tax bill paid by the pension fund and pay this back by having your pension reduced. Information on this is available from HMRC at - http://www.hmrc.gov.uk/pensionschemes/annual-allowance/scheme-member-guide.pdf

Other main main points are as follows:-

- Tax charge to be paid immediately on a year by year basis
- Member has to pay whole amount if tax charge is £2,000 or below;
- If tax charge is above £2,000, member can elect for the scheme to pay the whole amount (no direct payment by member), with an appropriate ongoing reduction to the member's accrued benefit;
- Scheme only obliged to pay if the whole tax charge relates to their scheme. Scheme may elect to pay if the tax charge covers more than one scheme;
- Method of benefit reduction to be determined by 'trustee' having taken advice from actuary (probably GAD in Public Sector);
  - Deadline for 'irrevocable decision' for electing for scheme to pay is 31 July following the Self Assessment.
- In year benefits are taken, the annual allowance test is done at retirement. Any election for the scheme to pay the charge must be done before retirement date. Any subsequent reduction to benefits must be made before they are put into payment.

Are there any exemptions?

There are some instances where the annual allowance restrictions will not apply. These are the following:

- Increases to deferred pensions
- Pensions paid in the event of your death.
- Pension benefits awarded on ill-health grounds (in some cases).
- Payments made when you transfer your pension benefits from one pension scheme to another.

Lifetime Allowance

The Lifetime Allowance (LTA) is the maximum amount of pension benefits (in terms of capital value) you are allowed to build up without incurring a tax charge. It is currently set at £1.5 million for the tax year 2013/14 but will reduce to £1.25 million from April 2014.

Generally speaking, only people with higher levels of pay and long periods of pension scheme membership will be affected. The value of your LGPS pension benefits for Lifetime Allowance purposes is:

- Pension at retirement multiplied by 20, plus
- Lump Sum at retirement.

Example 3
A person would need to be entitled to a pension of £62,501 a year to exceed the new lifetime allowance, i.e.

Value for Lifetime Allowance: £62,501 x 20 = £1,250,020

There is protection for employees who have already made pension saving decisions based on the current lifetime allowance limit please contact Pensions Services for details

What happens next?

Although this is primarily a taxation matter for the individual scheme member, the Essex Pension Fund will continue to make scheme members aware of relevant information which we receive. <u>However, please note our staff are unable to offer individual advice to scheme members because they are neither taxation experts nor registered to give financial advice</u>.

Pension schemes are required to provide certain details to scheme members who have exceeded the annual allowance within 6 months of the end of the tax year concerned.This will be provided with your annual benefit statement.
If you think you might be affected by the reduced annual allowance, the reduced lifetime allowance, you may wish to take your own taxation/financial advice.

This note is intended to provide a high-level overview of the tax changes and if you are thinking of making any changes to your pension arrangements you should consider seeking independent financial advice (for more information visit www.unbiased.co.uk).