Employer Bulletin
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ERPF
East Riding Pension Fund

Annual and Lifetime Allowances

This special edition employer bulletin has been distributed to inform all scheme employers about the two controls HM Revenue and Customs (HMRC) impose on pension savings. These two controls are known as the Annual Allowance (AA) and Lifetime Allowance (LTA) - both are covered in this bulletin.

Employers may wish to share this information with employees who are members of the Local Government Pension Scheme. As always this bulletin will be available on the ERPF website http://www.erpf.org.uk/employers

Annual Allowance (AA)

The AA is the total amount of pension savings members can make each year before incurring a tax charge. All pension savings in the Fund, as well as any Additional Voluntary Contributions (AVC) or contributions to alternative arrangements should be added together each year to determine total growth. The growth is referred to as a Pension Input Amount (PIA) and this is tested against the Annual Allowance for each tax year.

Calculation of pension savings

For defined benefit arrangements such as the Local Government Pension Scheme (LGPS), the growth of the pension over each year is calculated and then multiplied by 16. This multiplier is set by the Government Actuary's Department (GAD). The growth of any lump sum is also calculated and added to the pension growth. The growth is adjusted to take account of inflation. If contributions have been made to the In House AVC scheme, then the contributions made throughout the year will also be added into the calculation for growth.

It is important to note that the assessment for the AA covers any pension benefits where the member has been an active member during the year, not just benefits in the LGPS. If the total growth in pension benefits is more than the AA, currently set at £40,000 (lower if tapering applies) then any excess will be taxed as income.

Carry forward

To help mitigate a tax charge, members can carry forward any unused AA from the previous three years. This means that even if the growth increased by more than £40,000 the member may not be liable to the AA tax charge.

Affected members

Most members will not be affected by the AA tax charge because the value of their pension saving will not increase during 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.

Members are most likely to be affected if:

- They have paid into the LGPS for a long period of time and receive a significant pay increase;
- They pay a high level of Additional Voluntary Contributions;
- They are a higher earner;

- They transfer pension rights into the LGPS from a public sector pension scheme[1] (club rules)and their new full time equivalent salary is higher than the salary on leaving the previous scheme;
- They combine a previous LGPS pension benefit that was built up in the final salary section of the LGPS with their current pension account and their salary (full time equivalent) has increased significantly since leaving and re-joining the scheme, and/or;
- They have accessed flexible benefits on or after 6 April 2015.

Changes to Annual Allowance

The Finance (No 2) Act 2015 introduced several changes to the AA with effect from 6 April 2016. The main change introduced a tapered AA for high earners.

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.

	Definition	Limit
Threshold Income	Broadly your taxable income after the deduction of your pension contributions (including AVCs deducted under the net pay arrangement)	£110,000
Adjusted Income	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, members 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.

Tapering explained

From 6 April 2016, the tapered AA reduced AA by £1 for £2 of adjusted income received over £150,000, until a minimum AA of £10,000 is reached. For example, if a member's adjusted income is £170,000 then their reduced annual allowance will be £30,000.

Annual Allowance tax charge

If members exceed the AA in any year they will incur a tax charge at their marginal income tax rate. It is a scheme member's responsibility to report this to HMRC via self-assessment tax return. If the AA tax charge is greater than £2,000, the member can elect for the ERPF (assuming this is the pension scheme under which your tax charge has arisen) to meet the charge in full and subsequently apply a reduction to their pension. The basis upon which the reduction is calculated will be determined by GAD. This is known as 'Scheme pays'.

Important Information

It is imperative that scheme members understand how to calculate AA as the ERPF can only assess the benefits held within this fund. The ERPF will only contact members whose pension savings exceed the standard AA in any year and will do so no later than 6 October of the following year.

If a scheme member thinks they may be affected by the AA more information is available on the Government's website - https://www.gov.uk/tax-on-your-private-pension/annual-allowance.

There is also an AA quick check tool on the LGPS member website.

[1] A public sector 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.

Lifetime Allowance (LTA)

The lifetime allowance is the total value of all pension benefits members can receive without triggering an additional tax charge. If the value of pension benefits (excluding any state retirement pension, pension credit or any partner's or dependant's pension that a member may be entitled) is more than the LTA, then members will have to pay tax on the excess benefits. The LTA is currently set at £1million.

The LTA covers any pension benefits members may have in all tax-registered pension arrangements - not just the pension benefits held in the East Riding Pension Fund.

Calculation of Lifetime Allowance

The LTA is calculated by establishing the capital value of member pension benefits each time a pension arrangement is put into payment. If a member has multiple pension arrangements then each time they draw pension benefits part of their LTA is used. Members should keep a record of any pensions and specifically how much of their LTA has been used up.

For pension benefits that start to be drawn on or after 6 April 2006, the annual pension is multiplied by 20 and any lump sum drawn from the scheme is added. For pension benefits in payment before 6 April 2006, the current annual pension is multiplied by 25. Any lump sum already paid is ignored in the calculation. The multipliers are set by the Government Actuary's Department (GAD).

If pension benefits exceed the LTA of £1million then the member will have to pay a tax charge on any excess.

Lifetime Allowance tax charge

If excess pension benefits are paid as a pension the charge will be 25% and income tax will be deducted on the ongoing pension payments. If excess pension benefits are taken as a lump sum they will be taxed once at 55%.

Changes to the Lifetime Allowance

The LTA was introduced in 2006 but has since been reduced by the Government on several occasions. The most recent LTA details are shown below:-

Tax Year	Lifetime Allowance	Tax Year	Lifetime Allowance
2011/12	£1.8 million	2014/15	£1.25 million
2012/13	£1.5 million	2015/16	£1.25 million
2013/14	£1.5 million	2016/17	£1.00 million

Each time the LTA is reduced members get an opportunity to protect their pension savings by applying to HMRC for a LTA protection.

Lifetime Allowance Protections

The LTA reduced from £1.25 million to £1 million with effect from 6 April 2016 therefore two new protections were introduced from 6 April 2016. These are known as Fixed Protection 2016 and Individual Protection 2016, the same in design as Fixed and Individual Protections afforded in 2014 when the LTA reduced from £1.5 million to £1.25 million.

Individual Protection 2016 (IP2016)

From 6 April 2016 members can apply for IP2016 if the value of their pension savings were more than £1 million (including taking into account past benefits already in payment) on 5 April 2016.

IP2016 gives a protected LTA equal to the value of their accrued pension benefits on 5 April 2016 - up to an overall maximum of £1.25 million. A member can continue to accrue pension benefits so when payable, only the excess of the protected lifetime allowance will be subject to a tax charge.

Fixed Protection 2016 (FP2016)

From 6 April 2016 members can apply for FP2016 if they expect their pension savings to be more than £1 million (including taking into account past benefits already in payment) when they come to draw pension benefits on or after 6 April 2016. FP2016 can be used to help reduce or mitigate the LTA charge.

With FP2016, LTA is fixed at the higher level of £1.25 million rather than the standard lifetime allowance. This protection will be lost if further accrual of pension benefits exceed the cost of living increase. The cost of living increase for the year 2016/17 was zero therefore if a member applied for and wished to keep FP2016 the member would have needed to have opted out of the LGPS with effect from 6 April 2016.

It is a member responsibility to notify the HMRC within 90 days of this situation occurring as failure to do so could result in a fine of £300 and a penalty of up to £60 per day after the initial fine has been issued until the correct notification is supplied.

Applying for 2016 Protections

HMRC have introduced a new online self-service to apply for IP2016 or FP2016. There is no application deadline for either protection, however a member must apply before pension benefits are drawn as the ERPF will require the HMRC reference to apply the protection afforded.

Important Information

Retirement planning is a long term commitment, pension benefits which may appear modest today could exceed the LTA by the time the member draws pension benefits. A member should consider:-

- An earlier retirement date than originally planned as this would lower pension benefits;
- Converting pension for lump sum at retirement as that will reduce the capital value of benefits;
- Reduce or cancel any Additional Voluntary Contribution payments;
- Slow down the benefits build up by moving into the 50/50 section of the LGPS;
- Opt out of the LGPS however if a member was to rejoin at a later date, linking the two periods of membership would not be an option;
- Retirement planning and possible implications.

If a scheme member thinks they may be affected by the LTA more information is available on the Government's website - Tax on your private pension contributions.

There is also an LTA quick check tool on the LGPS member website.

Disclaimer

This bulletin provides an overview of the Annual Allowance (AA) and Lifetime Allowance (LTA) rules at April 2017 which are complicated areas and subject to change. Therefore this bulletin should not be treated as a complete and authoritative statement of the law. Scheme members may need to obtain independent financial advice from a tax specialist if they are in any doubt about their personal circumstances. For help in choosing an independent financial advisor visit the money advice website.