Pensions taxation in the LGPS

Annual Allowance and Lifetime Allowance

Cardiff & Vale of Glamorgan Pension Fund
9 December 2019
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Prepared by Aon

QAS Institute and Faculty of Actuaries ®
Quality Assurance Scheme

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Agenda

Session 1:
A brief overview of the LGPS

Session 2:
Annual Allowance

Session 3:
Lifetime Allowance

- Nothing in these slides can override the requirements of the LGPS or other legislation.
- These slides provide a high level overview only of the LGPS benefits and associated matters.
- Each scheme member will be considered individually when assessing entitlement to benefits.

…and we or Cardiff CC are not financial advisers.

Session 1

A brief overview of the LGPS

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An evolving benefit structure

- **Apr 2008** LGPS changes to 1/60th
- **Oct 2010** Hutton Review (interim report)
- **Oct 2010** HMT spending review
- **Mar 2011** Hutton Review (final report)
- **Jul 2011** Chief Sec to Treasury – equiv 3.2% ee conts
- **Oct 2011** CLG consult on alternative options
- **Dec 2011** LGPS 2014 design agreement
- **2012** Public Service Pensions Bill
- **Dec 2012** LGPS 2014 Draft Benefit Regulations
- **Apr 2013** Public Service Pensions Act
- **Apr 2013** LGPS draft (2) Regulations
- **2013** Auto enrolment
- **Jun 2013** LGPS draft (3) Regulations
- **Late 2013** Main LGPS 2014 Regulations
- **Mar 2014** LGPS 2014 Transitional Regulations
- **Apr 2014** LGPS changes to CARE
- **Apr 2015** New governance arrangements
- **2015** Freedom and choice

LGPS 2014 main points

CARE scheme (Career Average Revalued Earnings)

No longer a final salary scheme

Came into force on 1 April 2014

Affects benefits built up from 1 April 2014

Benefits accrued to 31 March 2014 protected and retain final salary link

Key changes to the LGPS

	LGPS 1997	LGPS 2008	LGPS 2014
Basis of pension	Final salary	Final salary	Career Average Revalued Earnings (CARE)
Accrual rate	$1/80^{th}$ (plus $3/80^{th}$ lump sum)	$1/60^{th}$	$1/49^{th}$
Revaluation rate	Based on final year's pay	Based on final year's pay	Consumer Prices Index (CPI)
Pensionable pay	Pay excluding non-contractual overtime	Pay excluding non-contractual overtime	Pay including non-contractual overtime
Contributions	6% (5% for some)	5.5% to 7.5%	5.5% to 12.5% (average 6.5%)
Normal Pension Age	65 (plus Rule of 85 until 2006)	65	State Pension Age
Entitlement to benefits after	2 years (until 2004)	3 months	2 years
Reduced contributions for reduced benefits	Not available	Not available	50/50 section provides half the benefits for half the contributions

Contribution flexibility - the 50/50 section

- Pay half your normal contributions
- Get half your normal pension ($1/98^{th}$ instead of $1/49^{th}$)
- Retain full life and ill-health cover
- Short-term option – maximum three years
- Any member can join – must complete an election form
- Can elect to return to the Main section at any time
- Contributions calculator at lgpsmember.org

Contribution rates

Pay band as at 1 April 2019	Contribution rate in the Main section	Contribution rate in the 50/50 section
Up to £14,400	5.5%	2.75%
£14,401 to £22,500	5.8%	2.9%
£22,501 to £36,500	6.5%	3.25%
£36,501 to £46,200	6.8%	3.4%
£46,201 to £64,600	8.5%	4.25%
£64,601 to £91,500	9.9%	4.95%
£91,501 to £107,700	10.5%	5.25%
£107,701 to £161,500	11.4%	5.7%
£161,501 or more	12.5%	6.25%

- 9 pay bands and contribution rates
- Employer determines contribution band each April (and may review if pay changes)
- Rate is based on actual pensionable pay, not full time equivalent
- Part-time workers may pay less than in earlier schemes
- Higher paid workers may pay more
- Pay bands are updated each scheme year

Increasing your pension benefits

AVCs

Additional Voluntary Contributions

- Pay up to 100% of pay into AVC plan
- Take up to 100% as tax-free cash (subject to HMRC limits)
- Use to purchase additional pension at retirement
- Employer can also contribute – shared-cost AVCs

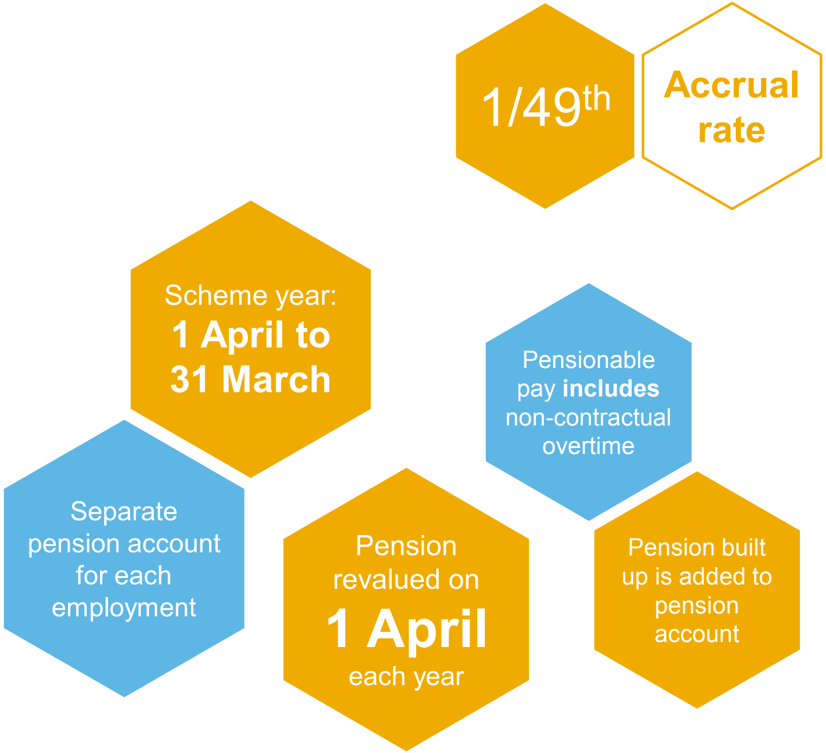
APCs

Additional Pension Contributions

- Buy up to £7,026 of additional pension for yourself only
- Make regular payments or pay in a lump sum
- Not available if you are in the 50/50 section
- Additional amount purchased each year is added to pension account

How is my pension worked out?

- Pension is worked out every scheme year
  - 1 April to 31 March
- Pension is 1/49th of pensionable pay
  - Half that (1/98th) if in the 50/50 section
- Pensionable pay based on 2014 definition
  - Includes non-contractual overtime
- Pension built up is added to pension account
- Separate pension account for each employment
- Pension account is revalued each year in line with the cost of living



Example pension account

Scheme year	Pensionable pay	Cost of living increases
1. 1 April 2014 to 31 March 2015	£24,500	1.2%
2. 1 April 2015 to 31 March 2016	£24,745	-0.1%
3. 1 April 2016 to 31 March 2017	£24,990	1%

Member is in the Main section of the scheme

Example pension account

Scheme year	Opening balance at 1 April	Pension built up in year	Closing balance at 31 March	Cost of living adjustment	Updated pension account
1. 2014-15	£0	£24,500 / 49 = £500	£500	1.2% = £6	£506
2. 2015-16	£506	£24,745 / 49 = £505	£1,011	-0.1% = -£1	£1,010
3. 2016-17	£1,010	£24,990 / 49 = £510	£1,520	1% = £15	£1,535

In this example the total pension built up in the account after three years was **£1,535** including £20 cost of living increases

When can I voluntarily retire?

- Pension can be paid at any time between age 55 and age 75
- Normal Pension Age (NPA) is equal to State Pension Age
- Pension is unreduced at NPA
- Reductions applied if paid **before** NPA
- Increases applied if paid **after** NPA

Check your State Pension Age here: www.gov.uk/calculate-state-pension

Other types of retirement

Ill-health retirement

- Payable at any age once member has met the two-year vesting period
- Different levels of benefit:
  - Tier 1 – 100% enhancement
  - Tier 2 – 25% enhancement
  - Tier 3 – no enhancement
- Any enhancements are worked out to NPA

Flexible retirement

- Payable from age 55 but must have employer consent
- Possible to draw all or some of your pension
- Remain in work on lower grade or fewer hours – see your employer's policy
- Continue to build up further pension benefits

Redundancy/Efficiency retirement

- Payable from age 55 onwards
- No reductions for early payment
- Employer has no discretion
- Likely to be a cost to the employer

Pre-1 April 2014 benefits

- All benefits built up in previous schemes are fully protected
- Membership up to 31 March 2014 is based on final pay when you leave
- Final pay protected against reduction or restriction in pay
- Protected NPA of 65 for almost all members
- All pension (pre and post 1 April 2014) must be paid at the same time

Depending on when you joined, can be up to three different calculations when working out your pension…

Three different calculations

	Membership to 31 March 2008	Membership from 1 April 2008 to 31 March 2014	Membership from 1 April 2014
Pension	Membership x final pay / 80	Membership x final pay / 60	Pensionable pay in each year / 49 (half that if in 50/50 section)
Lump sum	3 x Pension	No automatic lump sum	No automatic lump sum
Can convert pension into additional lump sum			
Normal Pension Age	65 or Rule of 85 date if active member on 1 October 2006	65 for most members Protections if born before 1 April 1960 and active member on 30 September 2006	State Pension Age Protections to 2020 if born before 1 April 1960 and active member on 30 September 2006

Full example

John Smith	Membership details
Date of birth	1 April 1962
Date joined scheme	1 April 1990
Retirement date	31 March 2019 (voluntary at age 57 without employer consent)
Pre 1 April 2008 membership	18 years
1 April 2008 to 31 March 2014 membership	6 years
Final pay (pre-2014 definition)	£40,000
CARE pension account at date of leaving	£4,000

Full example

	Membership to 31 March 2008	Membership from 1 April 2008 to 31 March 2014	Membership from 1 April 2014 to 31 March 2019	Total
Pension	18 x £40,000 / 80 = £9,000	6 x £40,000 / 60 = £4,000	£4,000 in pension account	**£17,000**
Lump sum	£9,000 x 3 = £27,000	£0	£0	**£27,000**

Early retirement reductions must be applied based on different NPAs

Full example

	Membership to 31 March 2008	Membership from 1 April 2008 to 31 March 2014	Membership from 1 April 2014 to 31 March 2019	Total
NPA	Rule of 85 = 55 but reductions based on 60 as no employer consent	65	67	
Pension	3 years early: £9,000 - 14.3% = £7,713	8 years early: £4,000 - 32.1% = £2,716	10 years early: £4,000 - 37.7% = £2,492	**£12,921**
Lump sum	3 years early: £27,000 - 6.9% = £25,137	£0	£0	**£25,137**

Other benefits

Sick leave cover

Parental leave cover

Lump sum death grant

Partner's pension

Children's pensions

Questions

Session 2

Annual Allowance

Prepared by Aon

Overview of pensions taxation

Tax exempt	Taxable
▪ Pension contributions ▪ Pension investment returns ▪ Other pension build up	Pension income – at normal rate of income tax
But subject to: 1. Annual Allowance – each year 2. Lifetime Allowance – at retirement	But possible to take up to 25% of the value of pensions as a tax-free lump sum

If limits or allowances are breached then tax may be due

Pensions tax relief

	Contributions	Cost to member	Cost to HMT
20% tax payer	£500	£400	£100
40% tax payer	£500	£300	£200
45% tax payer	£500	£275	£225

Pensions tax relief set to cost government almost £40bn

Pensions tax relief will cost the government almost £40bn this year, up more than £2bn on the previous year, illustrating the growing cost of subsidising retirement saving.

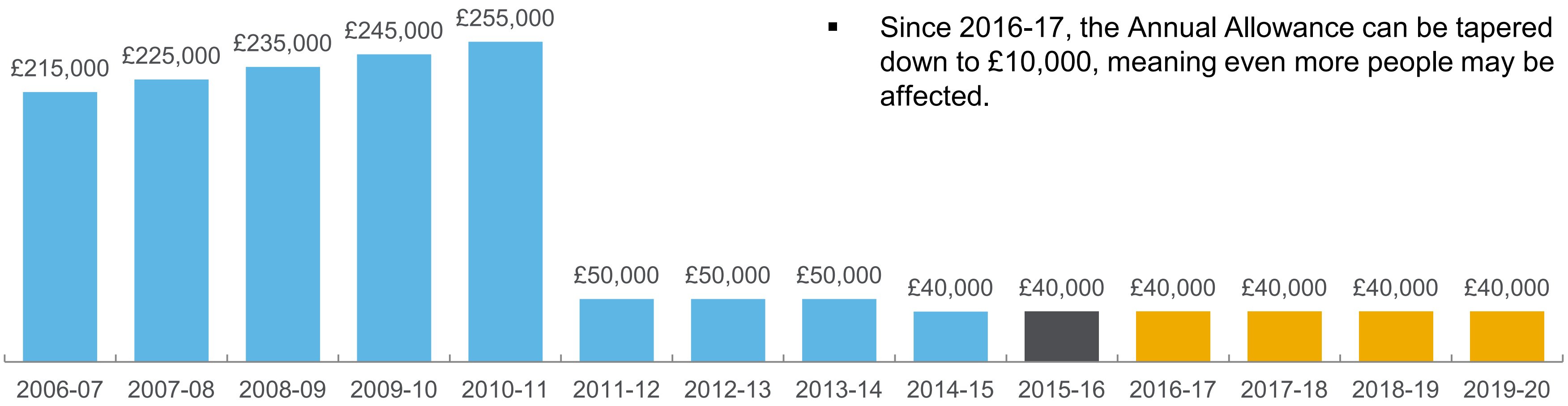
The Guardian, 10 October 2019

What is the Annual Allowance?

- The Annual Allowance is the maximum amount of pension savings an individual can make each year **with the benefit of tax relief**.
- Includes pension savings that individuals make plus any made by someone else on behalf of the individual – e.g. their employer.
- No limit on the amount of pension savings an individual can make each year but there is a limit in respect of the tax relief for those pension savings.
- Tax charge applied when the Annual Allowance is exceeded.
- Tax charge broadly recoups the amount of tax relief given to the increase in pension savings that is over the Annual Allowance.

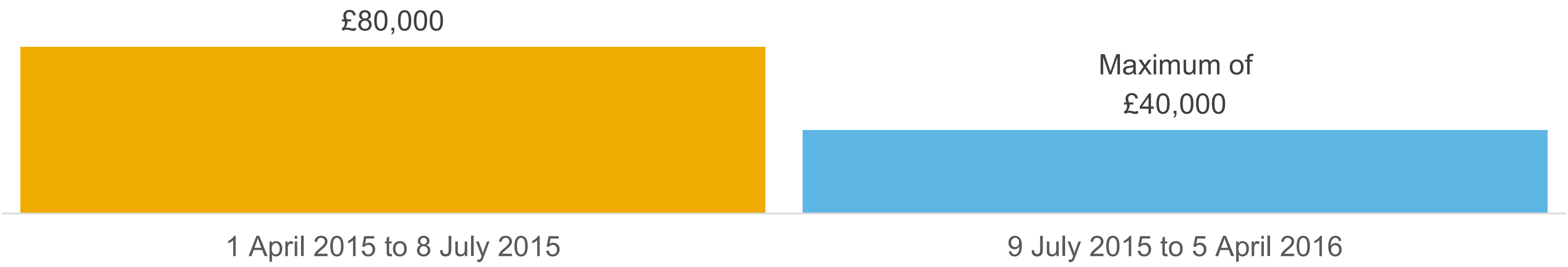
Changes to the Annual Allowance

- Used to impact mostly on highest earners but now many more people affected, including those who get promoted.
- Unused allowance from previous three years may be carried-forward.
- in 2015-16 the Annual Allowance was split into two Pension Input Periods – potential allowance of £80,000
- Since 2016-17, the Annual Allowance can be tapered down to £10,000, meaning even more people may be affected.

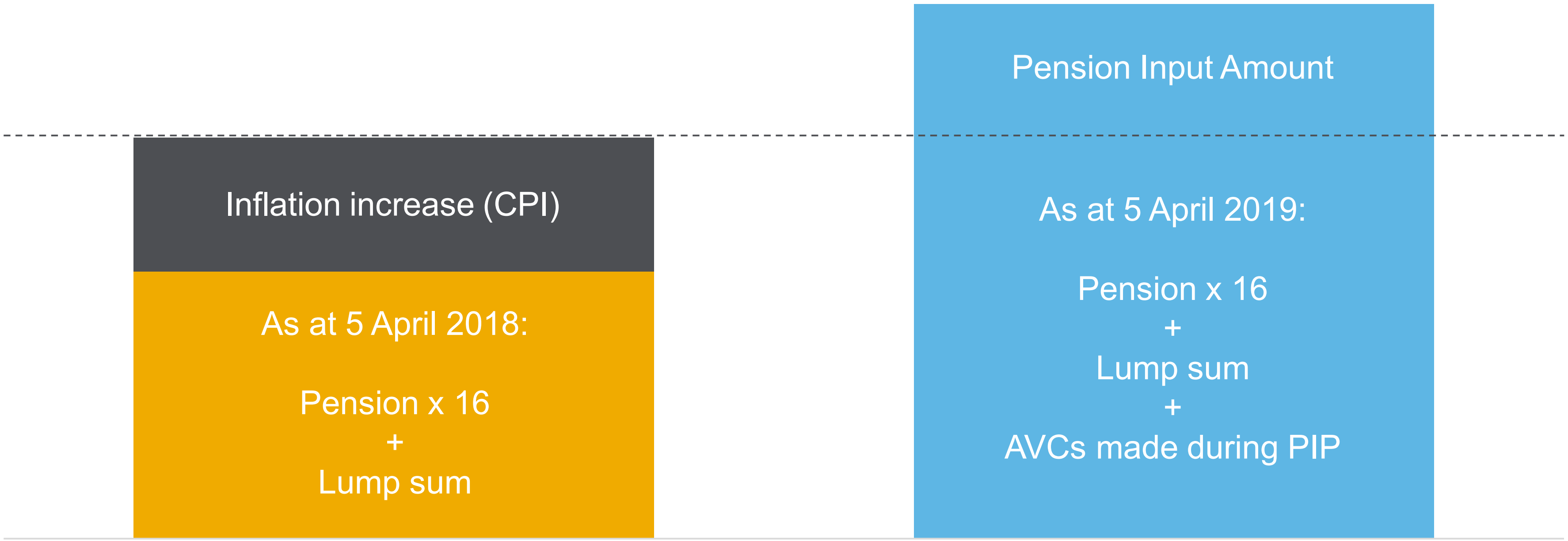


Pension Input Period for 2015-16

- PIP in the LGPS was previously 1 April to 31 March each year
- Announced in July 2015 that the PIP for all schemes would align with the tax year
- From 2016-17 the PIP has been from 6 April to 5 April
- 2015-16 PIP as split into pre-alignment period and post-alignment period, but no-one was worse off
- Maximum of £40,000 could be carried over from pre-alignment period to post-alignment period



Calculating the Pension Input Amount



Opening value **Closing value**

Carry-forward – example 1

PIP	PIA	Annual Allowance	Excess PIA	Unused Annual Allowance	(Rolling) Available carry-forward
2016-17	£30,000	£40,000	£0	£10,000	£10,000
2017-18	£30,000	£40,000	£0	£10,000	£20,000
2018-19	£15,000	£40,000	£0	£25,000	£45,000
2019-20	£50,000	£40,000	£10,000	£0	£35,000

- PIA of £50,000 in 2019-20, meaning member exceeded Annual Allowance by £10,000
- But member can use part of the £45,000 available carry-forward to offset the excess PIA
- This leaves carry-forward of £35,000 available for 2020-21 onwards

Carry-forward – example 2

PIP	PIA	Annual Allowance	Excess PIA	Unused Annual Allowance	(Rolling) Available carry-forward
2016-17	£30,000	£40,000	£0	£10,000	£10,000
2017-18	£30,000	£40,000	£0	£10,000	£20,000
2018-19	£55,000	£40,000	£15,000	£0	£5,000
2019-20	£50,000	£40,000	£10,000	£0	-£5,000

- PIA of £55,000 in 2018-19, meaning member exceeded Annual Allowance by £15,000
- PIA of £50,000 in 2019-20, meaning member exceeded Annual Allowance by £10,000
- All available carry-forward has been used to offset the excess PIA which leaves taxable input of £5,000

Tapered Annual Allowance

NHS pension shake-up unveiled to tackle 'tax trap' staffing crisis

The Guardian, September 2019

UK health leaders urge Boris Johnson to fix NHS pension crisis

Financial Times, November 2019

Patients facing longer waits for surgery this winter as surgeons cut their hours in pensions crisis

The Telegraph, October 2019

Tapered Annual Allowance

- Introduced for the 2016-17 PIP
- Annual Allowance will be tapered (reduced) for anyone whose:

  ‘Threshold income’ is over £110,000, and

  ‘Adjusted income’ is over £150,000

- Annual Allowance is reduced by £1 for every £2 of adjusted income over £150,000
- Minimum Annual Allowance is £10,000 – for individuals whose adjusted income is over £210,000

Measuring threshold income and adjusted income

Threshold income

> £110,000?

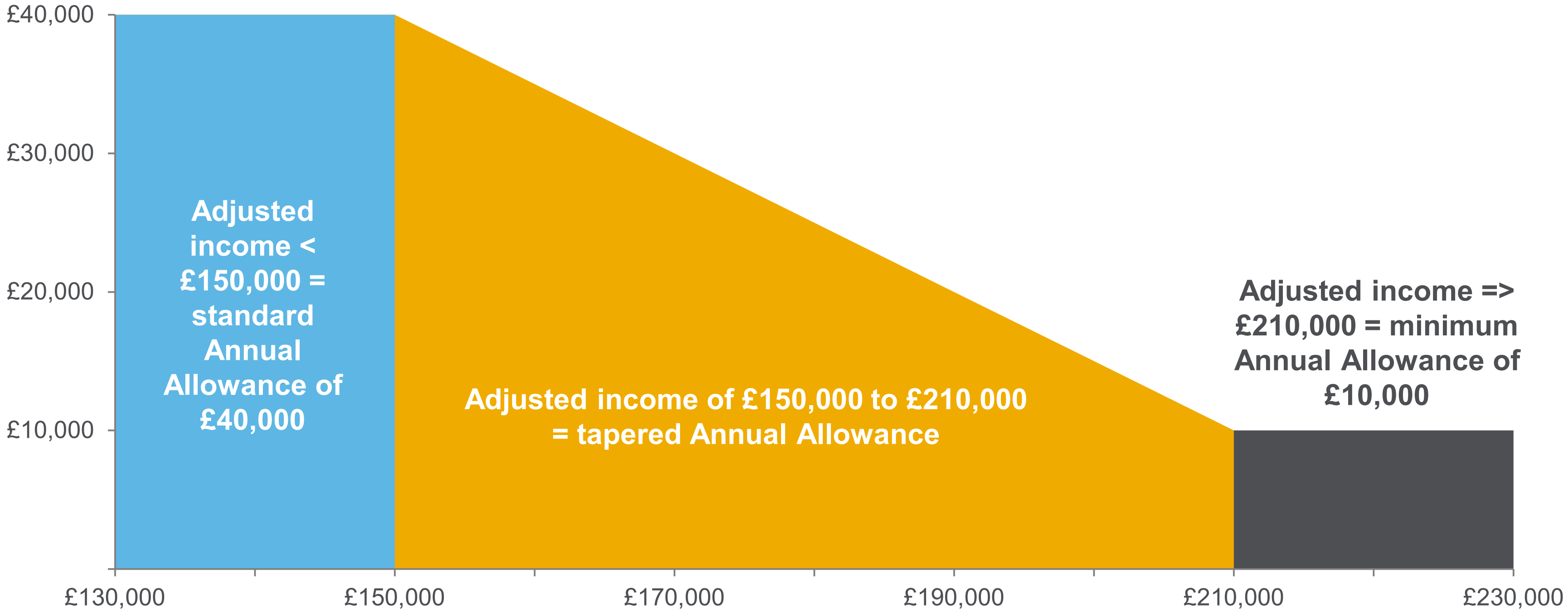
- Taxable income – excludes pension contributions but includes salary, other employment income, taxable benefits, property income, investment income, pension income, etc.
- If less than £110,000, standard Annual Allowance applies
- If more than £110,000, adjusted income must be tested

Adjusted income

> £150,000?

- Threshold income plus PIA – so must calculate PIA before taper can be calculated
- If less than £150,000, standard Annual Allowance applies
- If more than £150,000, tapered Annual Allowance applies

Effect on the Annual Allowance



Tapered Annual Allowance examples

Taxable income (excludes contributions)	Threshold income	PIA	Adjusted income	Annual Allowance
a. £100,000	£100,000	£10,000	£110,000	£40,000
b. £109,000	£109,000	£45,000	£154,000	£40,000
c. £130,000	£130,000	£15,000	£145,000	£40,000
d. £130,000	£130,000	£30,000	£160,000	£35,000
e. £160,000	£160,000	£5,000	£165,000	£32,500
f. £200,000	£200,000	£15,000	£215,000	£10,000

Tapered Annual Allowance ‘cliff-edge’

Example to illustrate how tax charge can change significantly by being just £1 over the threshold income of £110,000

	Jane	John
Threshold income	**£109,999**	**£110,001**
PIA	£85,000	£85,000
Adjusted income	N/A	£195,001
Annual Allowance	£40,000	£17,500
Excess PIA	£45,000	£67,500
Tax at 40%	£18,000	£27,000
Additional tax		**£9,000**

Paying an Annual Allowance tax charge

Excess PIA is taxed as income, so at marginal rate of income tax – 20%, 40%, 45%

Directly to HMRC	Mandatory Scheme Pays (MSP)	Voluntary Scheme Pays (VSP)
Member fills in Self-Assessment tax return	**Must** be offered by the pension scheme	**May** be offered by the pension scheme (check their policy)
HMRC will use that information to calculate your income tax	Tax charge must be more than £2,000	Could be offered for tax charges of less than £2,000
Tax charge is recouped through your tax code	Tax charge must relate to excess PIA over the **standard** Annual Allowance	Could be offered for tax charges over the **tapered** Annual Allowance
	Tax charge must relate to that scheme only	Could be offered for tax charges in relation to other schemes
	Member and scheme are jointly and severally liable for tax charge	Liability for tax charge remains with the member only

Scheme Pays

Pension is actuarially reduced in relation to the amount of tax paid by the scheme and the amount of deduction will be increased by CPI up to retirement.

Example: Taxable PIA of £10,000 at age 58, retires at age 60, NPA is 65	
Tax charge (assumes 40% tax rate)	£10,000 x 40% = £4,000
Scheme Pays factor	15.62 (age 58, NPA 65)
Scheme Pays debit	£4,000 / 15.62 = **£256 pa**
Inflation increases (assumes CPI of 2% for 2 years)	£256 + 2% + 2% = £266
Early retirement reduction (age 60, 5 years before NPA)	£266 - 22.2% = **£207 pa**

Annual Allowance timeline for 2018/19

5 April 2019
End of Pension Input Period

6 October 2019
Members notified of any breach of the Annual Allowance by their pension scheme

31 December 2019
Online Self-Assessment tax return deadline if HMRC is to collect tax through tax code

31 January 2020
Final online Self-Assessment tax return deadline

31 July 2020
Deadline for MSP elections to be received by pension scheme

14 February 2021
Tax charge under MSP must be paid by the pension scheme to HMRC

No deadline for VSP but interest payable by member if scheme does not pay HMRC by 31 January 2020

Considerations in the year of retirement

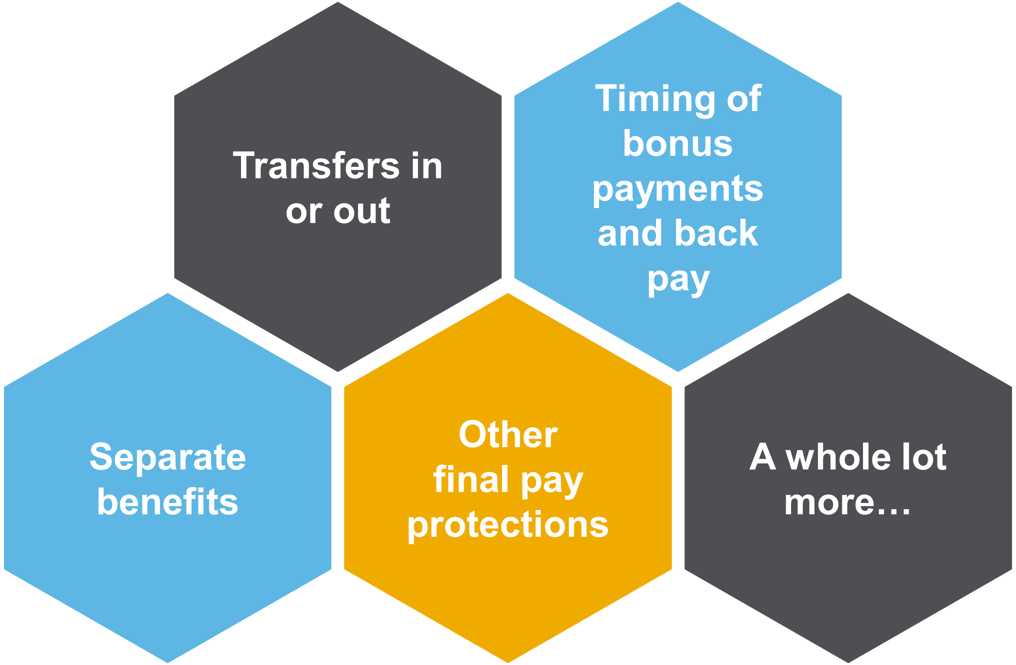
Closing value will take into account:

- Pay protection (such as regulation 10) for pre-14 benefits
- Additional pension awarded by employer (e.g. redundancy)
- Ill-health enhancement (apart from cases of serious ill-health, when no Annual Allowance test occurs)
- Actuarial reductions or increases (for early or late retirement)
- Conversion of pension to lump sum (so smaller pension and larger lump sum)

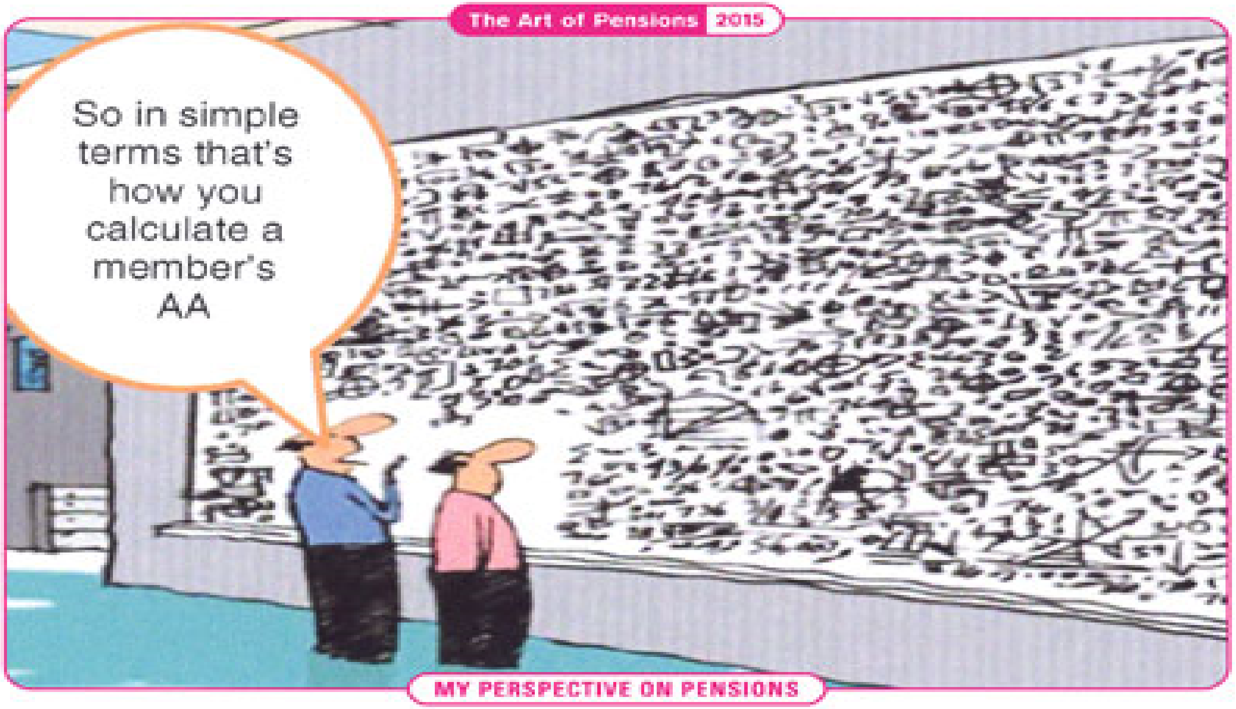
Note – timing of enhancements can make significant difference to Annual Allowance calculations:

- For example, retirement on 31 March v 30 April
- If enhancement expected, may be beneficial to wait for new tax year
- Tax charge could be reduced by converting pension to lump sum – but disputed with HMRC!

What we haven't considered



Questions on Annual Allowance



Pendragon's Art of Pensions 2015

"Best Overall Entry" winner

Mark Beck of RPMI

Session 3
Lifetime Allowance

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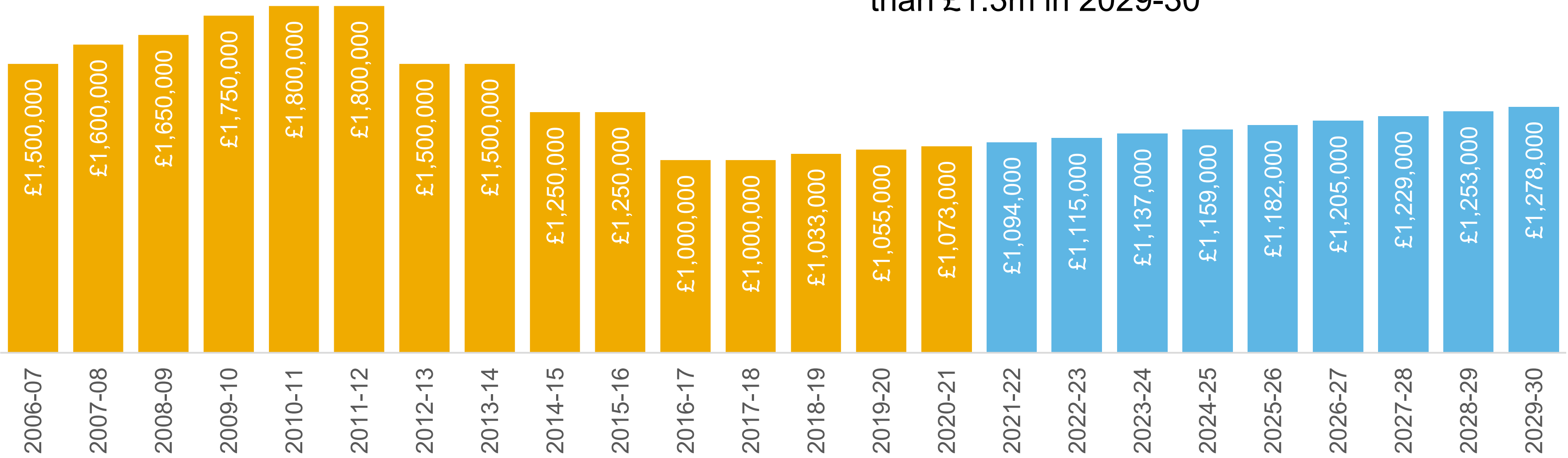
What is the Lifetime Allowance?

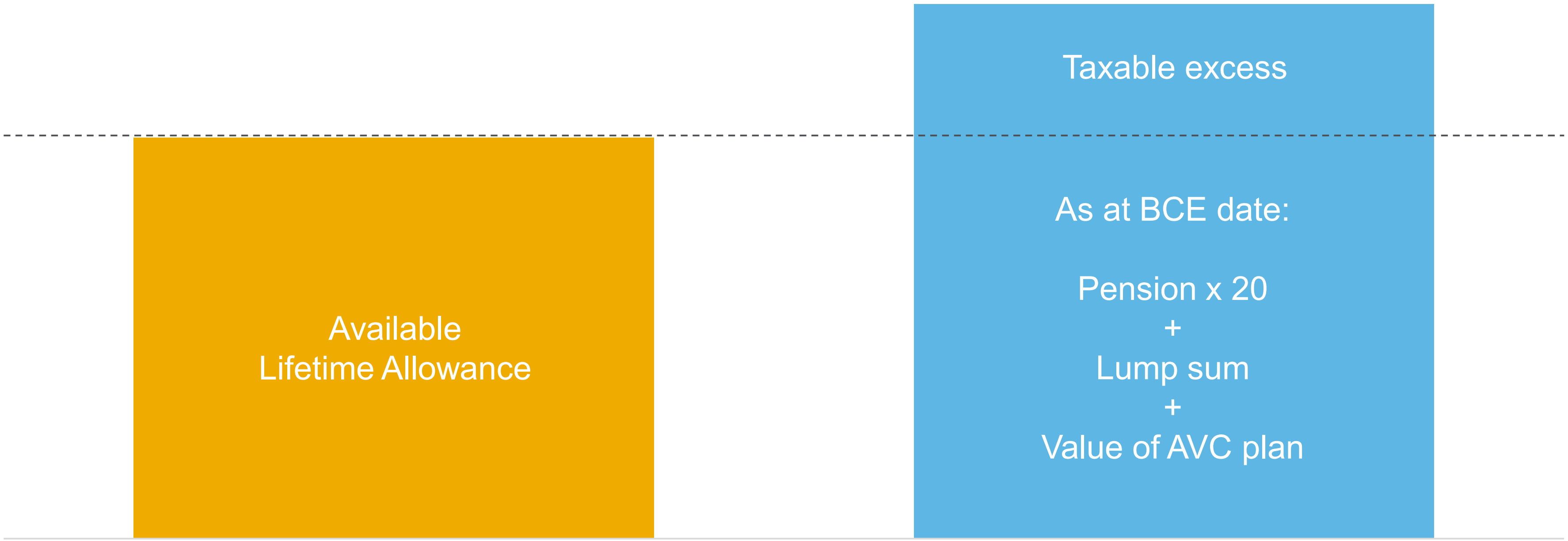
- Lifetime Allowance is the total value of all pension benefits a member can have **with the benefit of tax relief**.
- If the total value of a member's pension benefits (calculated as 20 x pension plus lump sum) is over the Lifetime Allowance threshold, the excess will be taxed.
- Lifetime Allowance is tested at the point benefits are paid – Benefit Crystallisation Event (BCE)
- Excess will be taxed at special rates (and deducted from the "pension pot"):
    - 55% if taken as lump sum
    - 25% if taken as pension
    - Can use 'Scheme Pays'

Changes to the Lifetime Allowance

- Like Annual Allowance, many more people now affected following reductions from 2012-13
- Lifetime Allowance increases in line with CPI since 2018-19
- Projected forward with 2% CPI, will still be less than £1.3m in 2029-30



Measuring pension savings against the Lifetime Allowance



Options available when exceeding the Lifetime Allowance

1. Excess lump sum	2. Excess pension	3. Scheme Pays
Value of benefits in excess of the available Lifetime Allowance is paid as a **lump sum**	Value of benefits in excess of the available Lifetime Allowance is paid as a **pension**	Value of benefits in excess of the available Lifetime Allowance is paid as a **pension**
Tax charge of 55% is due and is deducted from the lump sum	Tax charge of 25% is due and can be deducted from the lump sum (if there is one) or settled directly by the member	Tax charge of 25% is due and is settled by the pension fund with a Scheme Pays debit applied to the pension

Possible to take a combination of options 1, 2 and 3

Example

- Capital value is: (20 x pension) + lump sum
- Assumes available Lifetime Allowance of £1,055,000
- Maximum lump sum is 25% of the available Lifetime Allowance

	Pension	Lump sum	Capital value	Taxable excess
Standard benefits	£58,000	£125,000	£1,285,000	£230,000
Maximum conversion	£46,438	£263,750	£1,192,500	£137,500

Example

	Pension	Lump sum	Member tax charge	Lump sum less tax
Standard benefits (£230,000 excess)	**£58,000**	**£125,000**		
Option 1 – Commute excess pension for lump sum	£46,500	£263,000	£75,900	£187,100
Option 2a – Member pays tax on excess pension	£58,000	£125,000	£57,500	£67,500
Option 2b – Scheme pays tax on excess pension	£54,594	£125,000	£0	£125,000
Maximum conversion (£137,500 excess)	**£46,438**	**£263,750**		
Option 1 – Commute excess pension for lump sum	£39,563	£346,250	£45,375	£300,875
Option 2a – Member pays tax on excess pension	£46,438	£263,750	£34,375	£229,375
Option 2b – Scheme pays tax on excess pension	£44,401	£263,750	£0	£263,750

Scheme Pays debits (£3,406 and £2,036) assume member is age 67 at retirement – factor of 16.88

Lifetime Allowance previous protections

Protection	Apply until	Conditions	Protects	Restrictions
Primary Protection (PP)	5 April 2009	£1.5m+ at 5 April 2006	2006 value + SLA increases	None
Enhanced Protection (EP)	5 April 2009	None	2006 value + min 5% pa	Can't pay AVCs
Fixed Protection 2012 (FP12)	5 April 2012	None	Lifetime Allowance of £1.8m	Can't already have PP or EP and generally must opt out
Fixed Protection 2014 (FP14)	5 April 2014	None	Lifetime Allowance of £1.5m	Can't already have PP, EP or FP12 and generally must opt out
Individual Protection 2014 (IP14)	5 April 2017	£1.25m+ at 5 April 2014	2014 value up to £1.5m	Can't already have PP

Lifetime Allowance current protections

Protection	Apply until	Conditions	Protects	Restrictions
Fixed Protection 2016 (FP16)	Still open	None	Lifetime Allowance of £1.25m	Can't already have PP, EP, FP12 or FP14 and generally must opt out
Individual Protection 2016 (IP16)	Still open	£1m+ at 5 April 2016	2016 value up to £1.25m	Can't already have PP

- If the standard Lifetime Allowance is greater than the protected Lifetime Allowance under either form of protection, members automatically revert to having the standard Lifetime Allowance
- Individuals are able to apply for both forms of protection
- Possibly no deadlines for application

www.gov.uk/guidance/pension-schemes-protect-your-lifetime-allowance

Pensions tax responsibility

Personal tax responsibility – pension tax is an individual's responsibility and we cannot advise individuals on what to do:

- Pension funds must not stray into giving financial or pensions advice
- We must restrict our comments to UK pension tax – we are not tax experts and cannot comment on other tax issues (e.g. inheritance tax or overseas tax issues)
- However, it is a complex area and providing answers to factual questions (i.e. guidance) within our area of expertise is perfectly fine.
- You will need to add together all pension savings when determining any tax charges

HMRC self assessment – it is an individual's responsibility to declare if pensions allowances are breached and report the associated tax charges

Reporting charges via self-assessment tax return

- **Even if scheme pays a tax charge**, member still needs to report it on their self-assessment tax return

Pension Savings Tax Charges

Please read the notes.

7 Value of pension benefits in excess of your Available Lifetime Allowance, taken by you as a lump sum
£ . 0 0

8 Value of pension benefits in excess of your Available Lifetime Allowance, not taken as a lump sum
£ . 0 0

9 Lifetime Allowance tax paid by your pension scheme
£ . 0 0

10 Amount saved towards your pension, in the period covered by this tax return, in excess of the Annual Allowance
£ . 0 0

11 Annual Allowance tax paid or payable by your pension scheme
£ . 0 0

12 Pension scheme tax reference number - read the notes
PSTR

13 Amount of unauthorised payment from a pension scheme, not subject to surcharge
£ . 0 0

14 Amount of unauthorised payment from a pension scheme, subject to surcharge
£ . 0 0

15 Foreign tax paid on an unauthorised payment (in £ sterling)
£ . 0 0

16 Taxable short service refund of contributions (overseas pension schemes only)
£ . 0 0

17 Taxable lump sum payment (overseas pension schemes only)
£ . 0 0

18 Foreign tax paid (in £ sterling) on boxes 16 and 17
£ . 0 0

Source: Self-assessment tax return form SA101 2017 – Additional Information

What options are available?

- Hopefully you are now more aware
- Be careful not to throw the baby out with the bath water
- If you have flexibility over when or how payments are made, consider your options
- Think about whether you could or should move your retirement date
- Lump sum commutation may help reduce tax charge (but be aware of the legal risk)
- 50/50 may reduce tax charge – but it's because you'll reduce your benefits
- Think about impact of flexible retirement on Lifetime Allowance tax charge (for certain groups)
- Speak to an independent financial adviser about other tax-efficient means of saving

Possible changes to pensions tax regime

- Scrap the tapered Annual Allowance
- Reduce the standard Annual Allowance
- Scrap either the Annual Allowance or Lifetime Allowance
- Reduce (or abolish) tax-free cash allowance
- Annual Allowance for DC schemes only
- Lifetime Allowance for DB schemes only
- Flat rate of tax relief for everyone

Possible changes to the LGPS

More flexibility in the accrual rate

Option to remain in scheme for life cover only

Ability to break the final salary link

Make certain pay elements non-pensionable

DC section alternative

Questions

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