12.0 HM REVENUE & CUSTOMS

As mentioned in paragraph 9.1 of this handbook, the LGPS is a registered pension scheme. This means that the Scheme is registered with HM Revenue and Customs (HMRC) in accordance with Chapter 2, Part 4 of the Finance Act 2004[1].

As a registered pension scheme tax relief is provided at source at the individual's marginal rate of income tax meaning that of the pension contributions that a scheme member pays they actually only pay the value net of tax. For example, a basic rate tax payer (20%) pays only 80 pence in every £1 of contributions made to the Scheme. A higher rate tax payer (40%) therefore only pays 60 pence in every £1 of contribution.

In addition any lump sum retirement grant and death grant paid out of the Scheme is paid free of tax as is any lump sum paid through an Additional Voluntary Contribution (AVC) arrangement. Of course, however, any annual pension payments are subject to income tax.

The 6th of April 2006 was known as A-day, the date from which a new tax regime as applied to pension schemes was introduced in the UK. Sometimes referred to as 'pension simplification' the new regime introduced new methods by which contributions payable to and benefits payable from pension schemes are subject to tax relief and also subject to tax charge.

A number of new terms were introduced including annual allowance and lifetime allowance.

12.1 Annual Allowance

The annual allowance limits the total amount of savings growth to an individual's pension benefits in each pension input period (PIP). For the LGPS, the PIP is 1 April to 31 March. If an individual builds up benefits in excess of the annual allowance during the PIP a tax charge will be applied. Scheme members need to be careful because it is not just the growth in their LGPS benefits that is assessed each year, it is also the growth in any other pension benefits they may have (excluding the State Pension).

This growth in benefits is referred to as the 'pension input amount' (PIA) and each year the PIA is compared against the annual allowance. It is important to note that, although the pension manager can provide this information to the scheme member, it is the individual's responsibility to determine if they are at risk of exceeding the annual allowance in any given year.

Table 10 sets out the annual allowance figures set by Government each year since A-day.

Table 10 – Annual allowances

Tax Year	Annual Allowance
2006/07	£215,000
2007/08	**£225,000**
2008/09	£235,000
2009/10	**£245,000**
2010/11	£255,000
2011/12	**£50,000**
2012/13	£50,000
2013/14	**£50,000**
2014/15	£40,000
2015/16	£40,000

[1] http://www.legislation.gov.uk/ukpga/2004/12/part/4/chapter/2

To calculate the PIA it is necessary to work out both the value of the pension benefits at the start (opening value) and at the end (closing value) of the PIP, the difference being the PIA. An inflationary increase is applied to the opening value and should the closing value be less than the opening value the PIA is deemed to be zero.

To calculate the opening value it is necessary to work out the value of the annual pension that would have been payable at the end of the last PIP before multiplying the resultant figure by 16. Add to this the value of any tax-free retirement grant (lump sum) that would have been payable at the same date and revalue the resultant figure by the increase in the Consumer Price Index (CPI) over the 12 months to the September before the start of the last tax year. This will be the opening value.

To calculate the closing value it is necessary to work out the value of the annual pension at the end of the PIP and multiply that by 16. Add to this the value of any tax-free retirement grant (lump sum) and the value of any Additional Voluntary Contributions (AVCs) paid by the member and the value of any additional LGPS pension purchased via Additional Pension Contributions (APCs) also multiplied by 16. The resultant figure will be the closing value and the PIA will be the figure calculated by deducting the opening value from the closing figure. If this is less than the annual allowance then no tax charge will be applied.

An example of how this works might help to clarify things and for relative ease let us assume that the member in our example only has membership of the Scheme from 1 April 2012. The pension for the 2012/13 and 2013/14 years will be based on the final salary, 1/60th, arrangement whereas the pension for the 2014/15 will be based on the CARE, 1/49th, arrangement.

Pay for the year 2012/13 and 2013/14 was, say, £40,000.

The CPI rate to September 2012 was 2.2%

Closing value March 2013:

1/60 x £40,000 = £666.67 x 16 = £10,666.67

Opening value April 2013:

£10,666.67 x 1.022 = ***£10,901.33***

Closing value March 2014:

2/60 x £40,000 = £1,333.33 x 16 = £21,333.33

PIA = £21,333.33 - £10,666.67 = ***£10,432.00***

Annual allowance = £40,000 (no tax charge as £10,432 is less than £40,000).

However, if the annual allowance is exceeded it is possible to carry forward unused allowance from up to three previous years. In our example above the unused allowance will be £29,568.

So let us move our example on one more year and assume that the member was fortunate enough to receive a £10,000 pay award, a one-off £10,000 bonus payment and also paid £15,000 in AVCs. This would provide a pensionable pay figure of £60,000 for the 2014/15 year.

Opening value April 2014:

Closing value at March 2014 plus CPI for 12 months to September 2013.

£21,333.33 x 1.027 = ***£21,909.33***

Closing value March 2015

2/60 x £60,000 = £2000.00 x 16 =	£32,000.00
1/49 x £60,000 = £1,224.49 x 16 =	£19,591.84
AVC	£15,000.00
	£66,591.84

PIA = £66,591.84 - £21,909.33 = ***£44,682.51***

Annual allowance = £40,000 (exceeded by £4,682.51).

Carry forward from 13/14 = £29,568.00.

Carry forward into 15/16 = £29,568.00 – £4,682.51 = £24,885.49.

It is possible for anyone to exceed the annual allowance especially if they receive a significant pay rise, a performance bonus or pay extra pension contributions in any given Pension Input Period. Even arrears of pay count in the year that the payment is received as opposed to being counted in the year that the pay was earned (i.e. the year actually received rather than the year to which the payment relates).

The only exemptions from the annual allowance tax charge is upon death or if a scheme member has to retire due to permanent ill health and is awarded a tier-1 ill health retirement (see paragraph 9.9).

12.2 Lifetime Allowance

The lifetime allowance (LTA) is the maximum amount of pension benefits that an individual can have in their lifetime without being subject to a tax charge. This includes pension benefits from all pension schemes other than the State Pension. So an individual will need to add together the value of their pension benefits built up in the LGPS, any other occupational pension scheme to which they have belonged (whether in the public or private sector), any personal pension scheme to which they may have contributed, any additional pension benefits purchased by way of additional contributions, the value of any AVC pot they may have, any extra pension they may have been awarded at any time and so on.

Table 11 below sets out the lifetime allowance figures set by Government each year since A-day.

Table 11 – Lifetime allowances

Tax Year	Lifetime Allowance
2006/07	£1.50m
2007/08	**£1.60m**
2008/09	£1.65m
2009/10	**£1.75m**
2010/11	£1.80m
2011/12	**£1.80m**
2012/13	£1.50m
2013/14	**£1.50m**
2014/15	£1.25m
2015/16	£1.25m

The test that is applied to a member's benefits to see if they have exceeded the LTA is to multiply the value of any accrued pension by 20 and to add to this any tax-free lump sums that the member will receive.

Before doing this though, it is important to note that the pension value to be multiplied is the figure after:

- any commutation of pension into lump;
- any actuarial reduction that may have been applied to the member's benefits to reflect their early payment; and
- the application of any pension debit following divorce.

The fact that the pension figure to be multiplied by 20 is the figure after commutation to lump sum is of particular relevance because, in some cases where the member has exceeded the LTA, they can bring the value of their benefits within the LTA by commuting part of their pension into additional tax-free cash.

For example, in the 2014/15 year the LTA is £1.25m. A scheme member with an annual pension of £56,000 and a lump sum of £140,000 will have the following LTA test undertaken:

£56,000 x 20 = £1,120,000 + £140,000 = £1,260,000 (£10,000 over LTA)

The member elects to commute £2,000 of the annual pension into tax-free cash at the conversion rate of 12 to 1 thereby reducing the annual pension to £54,000 but increasing the lump to £164,000. The LTA test will now be calculated as follows:

£54,000 x 20 = £1,080,000 + £164,000 = £1,244,000 (£6,000 below the LTA)

By converting part of the annual pension into tax-free cash the member has avoided a tax charge.

It is important to note that the tax charged is only applied to the benefits in excess of the LTA. Where the excess is taken as pension there is a 25% tax charge and where it is taken as a lump sum there is a 55% tax charge.

So in our first example where the member exceeded the LTA by £10,000, if the excess is taken as a pension, the tax will be worked out as follows:

£10,000 x £25% - £2,500

This tax charge will deducted from the member's pension by dividing the tax charge by 20 and reducing the value of the annual pension by the resultant figure:

£2,500 / 20 = £125. Annual pension = £56,000 - £125 = £55,875

12.3 Protections

Since 6 April 2006 there have been various types of protection available to scheme members in order to protect against changes to the LTA over the years. Initially, 2 types of protection were introduced, primary and enhanced protection. To have either primary or enhanced protection members had to apply to HMRC before 6 April 2009. Primary protection was awarded if a member's pension benefits were worth more than £1.5m on 5 April 2006. Enhanced protection was awarded regardless of the value of pension benefits at that date but given to members who believed the future value of their benefits would exceed the LTA at the point they retired.

Since then there has been fixed protection 2012 (FP12) and fixed protection 2014 (FP2014). These were introduced following the Government's decision to reduce the LTA from £1.8m to £1.5m in April 2012 and from £1.5m to £1.25m in April 2014. FP12 gives a scheme member a protected LTA of £1.8m whereas FP14 gives a scheme member a protected LTA of £1.5m.

An individual is not permitted to hold both FP12 and FP14. Neither can an individual hold both enhanced and fixed protection.

From 6 April 2014 the Government introduced individual protection (IP). Anyone whose pension pot was valued at £1.25m or more at 5 April 2014 could apply for IP giving a protected LTA of £1.5m. IP can be applied for until 5 April 2017 and can be held at the same time as enhanced protection and fixed protection but not at the same time as primary protection.

The various protections that have been available to individuals from various points in time has made things somewhat complicated but it is vital that members of the LGPS understand that their tax affairs are their responsibility and, whilst the pension team will help to provide certain information, no-one connected with the Berkshire Pension Fund can give financial advice to any scheme member. All members are always advised to seek independent financial advice.