

## Pensions April 2014 tax changes - LGPS, PPS and FPS

In 2009, the government announced its intention to restrict pensions tax relief from April 2011. The original proposals targeted higher earners (typically those earning £180,000 per year or more), but further restrictions to pensions tax relief effective from 6 April 2014 will catch a wider group of people. This information sheet provides an indication of who may be affected, explains what the allowances are and what protections may be available. It covers high level issues only and further detail applies.

### Overview

Do you currently, or have you recently:

- earn/earned over £75,000 per year in gross pay;
- earn/earned new benefits of over £2,500 in a year in the Local Government Pension Scheme (LGPS), Police Pension Scheme (PPS) or Firefighters Pension Scheme (FPS);
- receive/received any 'special' one-off or regular pensionable payments such as a bonus or make/made additional contributions such as additional voluntary contributions (AVCs).

Or have you:

- accrued pension benefits in your current scheme of over £50,000 plus a lump sum; or
- sizeable benefits in any other UK registered pension scheme?

If you can answer 'yes' or 'maybe' to any of the above questions, you may:

- be asked to pay a tax charge, either now or at retirement;
- need to consider whether to apply for new pensions tax protections and possibly consider opting out of your current scheme before 5 April 2014;
- need to think about taking specialist advice before 5 April 2014.

You may be affected even if your circumstances don't seem to have changed much from last year.

*N.B. Everyone is different and different combinations of pensionable salary, service accrued in the scheme and increases in pay in any one year can cause pension tax allowances to be exceeded.*



## The annual allowance

The annual allowance (AA) is the maximum annual amount of:

- extra pension earned over the year in a defined benefit (DB) scheme such as LGPS, PPS and FPS; and
- pension contributions paid into a defined contribution (DC) scheme such as AVCs

before a UK tax charge is triggered.

**From 6 April 2014 the AA will reduce from £50,000 per year to £40,000 per year.**

The test against the allowance is made over a specific twelve-month period called the Pension Input Period. The value of extra pension earned under (a) and any contributions paid under (b) above are added together. If the resulting amount is bigger than the AA, you may be charged tax on the excess over the AA.

In summary, the amount of extra pension earned in a year under (a) above is calculated as the difference in your accrued pension at the start and end of any Pension Input Period, but ignoring the impact of inflation-proofing on your benefits. The amount of extra annual pension is converted into a monetary value by multiplying the extra pension amount by 16 – see the example to the right.

Each pension arrangement has its own Pension Input Period. Contributions and benefit accrual are measured over that period for comparison with the AA. If you are a member of more than one pension arrangement, all Pension Input Periods ending in a particular tax year are aggregated when comparing against the AA for that tax year. The Pension Input Period for the LGPS, PPS and FPS is 1 April to 31 March.

Before an AA tax charge is triggered, a carry-forward rule exists which enables any unused AA from the previous three tax years to first be used. Once any available carry-forward is used up, an AA tax charge will be triggered. The amount of the charge depends on the member's highest marginal rate of income tax, treating savings in excess of the AA as the top slice of an individual's income.

## Example

Consider the following LGPS member:

- Pensionable salary at start of Pension Input Period: £75,000
- Pensionable salary at end of Pension Input Period: £80,000
- Accrued pension at start of Pension Input Period: £30,937.50 (based on 25 years' service 80ths accrual and 6 years 60ths accrual) plus compulsory scheme lump sum £70,312.50
- Accrued pension at end of Pension Input Period: £34,333.33 (based on 25 years' service 80ths accrual and 7 years 60ths accrual) plus compulsory scheme lump sum £75,000
- Additional Voluntary Contributions made during Pension Input Period: £6,000 (£500 per month)
- Assumed Consumer Price Index (CPI) inflation over period immediately preceding Pension Input Period: 2.7%
- Has no AA to carry forward from the previous years.

AA calculation:

$$((£34,333.33 - (£30,937.50 \times 1.027)) \times 16) + (£75,000 - (£70,312.50 \times 1.027)) + £6,000 = £49,757.38$$

As the value of benefits earned exceeds the new £40,000 AA, a tax charge will be payable on the £9,757.38 excess, charged at the individual's marginal rate of tax. At the 40% tax rate, this would mean a £3,902 charge.

Members must declare any excess benefits on their self-assessment tax return.

The government recognises that people may not have cash to pay large AA tax charges, so for charges over £2,000, you can ask your scheme to meet some or all of the charge on your behalf in return for a reduction in your future pension benefits. This is called 'Scheme Pays', and you should talk to your scheme administrators as soon as possible if you think you will be affected as strict deadlines apply.



## The lifetime allowance

The lifetime allowance (LTA) is the overall maximum capital amount of pension savings that you can build up in all UK registered pension arrangements over your lifetime before a LTA tax charge is triggered.

**From 6 April 2014, the LTA will reduce from £1.5 million to £1.25 million.**

In a DB scheme such as the LGPS, PPS and FPS, each £1 of annual pension brought into payment at retirement has a value of £20 for LTA purposes. Retirement cash sums are taken at face value.

In a DC arrangement the fund value at the point that a pension is brought into payment is assessed at face value against the LTA.

Pensions brought into payment after 6 April 2014 that exceed a LTA value above £1.25 million will incur tax charges, subject to any protection in place.

In addition, there is a limit to the amount of tax free lump sum that may be received upon retirement. This is the lower of 25% of the value of the benefits being crystallised or 25% of the LTA, subject to any protection in place.

**From 6 April 2014, the maximum tax free lump sum will reduce from £375,000 to £312,500.**

### Example

Consider the following LGPS member:

- Pensionable Salary at retirement: £130,000
- Retirement pension: £57,417
- Compulsory scheme lump sum: £126,750

Lifetime allowance calculation:

$$£57,417 \times 20 + £126,750 = £1,275,090$$

As the value of benefits earned exceeds the £1,250,000 LTA, a tax charge will be payable on the £25,000 excess. However, commutation of pension to lump sum would, in this case, reduce the value of the benefits below the LTA and avoid a tax charge arising.

Excess pension benefits are taxed at 25% and excess lump sum at 55%. Tax charges can be met by the pension scheme in return for reductions to your benefits.

## Protecting yourself against some of the impact of the changes

To reduce the impact of the new LTA tax charges on people who are approaching retirement, and whose plans have suddenly been affected, the government has created two special mechanisms, called 'protections'. People with pension savings with a value over £1.25 million currently are likely to be those most affected.

The first, known as **Individual Protection 2014 (IP14)**, is only relevant for people whose total pension arrangements (using the LTA formula above) have a value of £1.25 million or above at 2014. If you are in this category, you have until April 2017 to take advice if required and consider whether to apply for IP14. In broad terms, IP14 will mean that the monetary value of your pension arrangements at 5 April 2014 (up to a maximum of £1.5 million) is protected from tax charges. You can still accrue further pension benefits. However, you could still be taxed on amounts above that monetary value, so this may have an impact on what pension provision you want to make in future.

The second, known as **Fixed Protection 2014 (FP14)**, would give you an enhanced LTA of £1.5 million, but in order to get FP14 if required and to avoid invalidating it in future:

- You should take advice as required.
- Apply for FP14 by the deadline of 5 April 2014.
- Check that any further pension accrued in your defined pension scheme after 5 April 2014 will not exceed the strict limits allowed. You may need to opt-out of the scheme to avoid losing your FP14.
- Make no contributions to a DC scheme including AVCs.
- If you are automatically enrolled into any other pension arrangements under auto-enrolment legislation, you must opt-out of those arrangements immediately.

*N.B. Opting out of the pension scheme is a significant step, and will have an impact on your death grant cover and other arrangements. You should take financial advice before making any decisions.*

You will be able to apply for both types of protection as long as you meet the government's eligibility criteria. If you are considering FP14 or IP14, we recommend that you take financial advice.

## What can I do if I am likely to be affected?

If you do not have the details of all your pensions savings over the last four years, your projected pension benefits payable on retirement from any pension schemes you are or have been a member of in the past, you should now request this information from your current and previous scheme providers.

If you are affected by the reductions of the AA and/or LTA, it is important that you seek appropriate advice on the impact of these changes and whether to register for either or both Fixed Protection 2014 and Individual Protection 2014.



### Contact

You can contact Annemarie Allen of Barnett Waddingham for specialist pensions advice by e-mailing [annemarie.allen@barnett-waddingham.co.uk](mailto:annemarie.allen@barnett-waddingham.co.uk).

Please note that charges apply for the advice and quotes will be provided.

*This information sheet does not constitute financial advice and it is strongly recommended that you take independent financial, tax or legal advice before making any decisions or taking any action in relation to your own personal financial circumstances.*

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively contact us via the following:

@ [annemarie.allen@barnett-waddingham.co.uk](mailto:annemarie.allen@barnett-waddingham.co.uk)

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