

September 2015

Pension Tax Changes Newsletter

The Summer 2015 Budget introduced further changes to the rules governing taxation and pension savings. These changes, along with changes already announced in the 2014 Budget, will affect people in different ways. We explain the various changes in this newsletter. It is important that you read this carefully to understand how you might be affected.

Are you affected by the latest tax changes?

The last two Budgets have introduced two significant changes to the taxation of pensions.

Lifetime Allowance

In his 2014 Budget the Chancellor announced that the Lifetime Allowance would reduce with effect from 6 April 2016 from its current value of £1.25 million to £1 million.

However, it will be indexed so that it will rise with Consumer Price Inflation from 2018. Transitional protections will be available for those already with large pension rights, but at the time of writing details of these protections are still unknown. Even if you are not close to this limit you may need to consider your overall position in light of this change.

Annual Allowance

The Summer 2015 Budget announcement confirmed a number of changes to the Annual Allowance, specifically aimed at "higher earners", by reducing the amount of tax relief they can receive on their pension contributions. These changes will come into effect from 6 April 2016.

The Annual Allowance will be reduced from the current £40,000 p.a. if both of the following criteria apply:

1. Your net income is over £110,000; and
2. Your net income plus the value of your pension growth over the tax year is over £150,000.

Your net income for these purposes is described as "threshold income".

Your net income plus the value of your pension growth is referred to as your "adjusted income" and you will probably need assistance from your pensions team to calculate your pension growth, in order to determine your adjusted income.

If net income is over £110,000 and adjusted income is over £150,000 then the Annual Allowance will be reduced by £1 for every £2 that adjusted income exceeds £150,000. However, the maximum reduction that can apply to Annual Allowance is £30,000, which leaves a reduced Annual Allowance of £10,000 available.

Threshold income (net income)	Adjusted income (net income plus annual pension growth)	Annual Allowance
Below £110,000	N/A	£40,000
Above £110,000	Below £150,000	£40,000
Above £110,000	Above £150,000 and below £210,000	The original £40,000 Annual Allowance is reduced by £1 for every £2 by which threshold income exceeds £150,000
Above £110,000	Above £210,000	£10,000

Carry forward of unused Annual Allowance

If you do trigger an Annual Allowance tax charge in any given year you may be able to bring forward any unused Annual Allowance from the three preceding tax years. Your pension team will be able to advise you further.

Pension input Period (PiP) changes

In advance of the changes to the Annual Allowance the Government is also making changes to the accrual period of PiPs from 6 April 2016 onwards. From this date PiPs will be aligned to tax years for all pension schemes (i.e. 6 April to 5 April). Previously within the LGPS PiPs ran from 1 April to 31 March.

Transitional rules to achieve this are being introduced from 9 July 2015. As a result you may have an opportunity to make more than £40,000 of pension savings for 2015/16. It could be that you will effectively have an Annual Allowance for 2015/16 of £80,000 and this may give an opportunity for you to make additional tax efficient pension contributions.

In order to align pension input periods to 6 April the 2015/16 tax year will be split into two "mini tax years", which are summarised below.

Pre-alignment tax year – the period for any pension savings during the period ending between 6 April 2015 and 8 July 2015. The revised Annual Allowance during this period is £80,000, together with any carry forward available from the previous three full tax years.

Post-alignment tax year – the period for any pension savings during the period between 9 July 2015 and 5 April 2016. The Annual Allowance for this period is the amount of the £80,000 not used up from the pre-alignment tax year, subject to a maximum of £40,000, together with any carry forward available from the previous three full tax years.

Where someone has no pre-alignment tax year savings the Annual Allowance for the post-alignment period will be £40,000.

Do I need to do anything now?

It will be necessary for schemes to undertake two PiP checks during the 2015/16 tax year, split between the pre and post-alignment periods. Currently the PiP used across the LGPS runs from 1 April to 31 March, so there will be two checks done covering the periods 1 April 2015 to 8 July 2015 and 9 July 2015 and 5 April 2016.

We won't be carrying out separate PiPs for the pre and post-alignment tax years though. We will instead carry out a single assessment, apportioning Annual Allowance and pension savings across the two mini tax years, as at the financial year end in 2016. Only at that point will we be able to confirm if you have exceeded the transitional Annual Allowance limits for 2015/16.

For example

LGPS PiP previously ran from 1 April 2015 to 31 March 2016, but new PiP arrangements extends this to 5 April 2016.

Pre-alignment tax year covers 1 April 2015 to 8 July 2015 (99 days)	Post-alignment tax year covers 9 July 2015 to 5 April 2016 (272 days)
--	--

Assume pension growth for the combined period equals £50,000.

Post-alignment PiP =	Pre-alignment PiP =
£50,000 x 272 ÷ 365 + 5) =	£50,000 - £36,757 =
£36,757	£13,243

Are there any further changes expected?

The Government has launched a review of the current pensions tax-relief structure – entitled "Strengthening the incentive to save". It is too early to say what the outcome of this review will be, but it is possible it could lead to fundamental changes in due course to the way the Government provides tax breaks to pension savers. We will of course keep you updated on anything that comes out of this review and what it might mean for you in the LGPS.

Am I affected by the Annual Allowance changes and what is the cost?

Whether or not you are affected will depend on number of things, including your level of pay, the size of any pay rises, increases in the cost of living and how much service you have in the LGPS.

Everyone's circumstances will be different of course, but within the LGPS everyone earning £110,000 or more is already likely to be close to seeing their Annual Allowance begin to be tapered away. Certainly anyone on £112,000 or more is likely to be affected, even with modest annual increases in pension growth.

Someone earning a little less than £160,000, with 30 years' membership of the scheme who receives a 1% pay rise is likely to see the maximum tapering apply and be left with an Annual Allowance of £10,000.

The table below provides some other broad examples of how various income levels might affect the Annual Allowance:

Threshold income	Adjusted income	Tapered Annual Allowance
£100,000	N/A	N/A
£110,000	£147,000	N/A
£113,000	£150,600	£39,700
£150,000	£200,000	£15,000
£170,000	£227,000	£10,000

Based on LGPS membership of 30 years, with CPI and salary inflation both at 2%.

You are considering making use of the new pension freedoms with another pension.

You should also be aware that if you intend to make use of the new pension freedoms by accessing defined contribution pension benefits, there may be a further impact on your Annual Allowance arrangements. If you do have defined contribution benefits and intend to use them to draw down cash, then you should seek further advice.

Definitions

Adjusted Income if you have a threshold income above £110,000 your adjusted income figure will include the pensions input amount in assessing if you exceed the £150,000 limit. Where this is the case you will then be subject to a tapering of your Annual Allowance.

Annual Allowance is the value of annual pension savings you can make each year and receive tax relief on. If the value of your pension benefits in any one year grows by more than the Annual Allowance then you will become subject to a tax charge.

Your pension growth includes:

- Your pension benefits in the LGPS Pension Scheme including additional voluntary contributions (AVCs); and
- Any other pension savings you make, for example to a personal pension arrangement.

The Annual Allowance is currently £40,000 (for the tax year 2015/16).

Lifetime Allowance is the overall limit on the amount of pension saving you can have during your working life without incurring a tax charge. It is currently set at £1.25 million, but will reduce from 6 April 2016 to £1 million.

Pension Input Period is the period for measuring the "growth" in pensions to test against the Annual Allowance. For the Local Government Scheme this has historically been from 1 April to 31 March each year, but is now changing so it goes from 6 April to 5 April each year.

Threshold Income is used to determine if you will be subject to the tapered Annual Allowance and includes basic salary (accounting for earnings sacrificed for pension provision) as well as any other income from investments and property. If you have a threshold income of £110,000 or less you will not be subject to any reduction in the Annual Allowance (it will remain at £40,000).

Disclaimer

This Newsletter is provided as a high level overview of the latest tax changes announced in recent Budgets. The details of the changes are complex and are not fully covered here. It is, therefore, essential that you seek individual financial advice before taking any irreversible actions in relation to your pension benefits.