Pensions Taxation – Lifetime and Annual Allowance

Pensions Taxation - Lifetime Allowance

HM Revenue and Customs impose two controls on the amount of pension savings you can make without having to pay extra tax. These controls are known as the annual allowance and lifetime allowance. This is in addition to any income tax you pay on your pension once it is in payment.

This section of this factsheet looks at the Lifetime Allowance (LTA) which is the total value of all pension benefits you can have without triggering an excess benefits tax charge.

For information about the Annual Allowance please refer to the section on the Annual Allowance starting on page 6.

What is the lifetime allowance?

The lifetime allowance is the total value of all pension benefits you can have without triggering an excess benefits tax charge. If the value of your pension benefits when you draw them (not including any state retirement pension, pension credit or any partner's or dependant's pension you may be entitled to) is more than the lifetime allowance, or more than any protections you may have, you will have to pay tax on the excess benefits.

The lifetime allowance covers any pension benefits you may have in all tax-registered pension arrangements - not just the Local Government Pension Scheme (LGPS).

The lifetime allowance was introduced in 2006 and was reduced in 2012, 2014 and again in 2016. Each time the lifetime allowance reduced, if you had already planned your pension savings on the basis of the higher lifetime allowance, you have been able to protect your pension savings by applying to HMRC for a lifetime allowance protection. These protections are covered in more detail later in this factsheet.

The lifetime allowance has been steadily reducing from 2012/13, as below:

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

The lifetime allowance will be increased in line with inflation from 2018 onwards.

How is the lifetime allowance calculated?

For pensions that start to be drawn on or after 6 April 2006, the capital value of those pension benefits is calculated by multiplying your annual pension by 20 and adding any lump sum you draw from the pension scheme.

For pensions already in payment before 6 April 2006, the capital value of these is calculated by multiplying the current annual rate, including any pensions increase, by 25. Any lump sum already paid is ignored in the valuation.

When any LGPS benefit, or any other pension arrangement you may have, is put into payment you use up some of your lifetime allowance - so even if your pensions are small and individually will not be more than the lifetime allowance you should keep a record of any pensions you receive. If you have a pension in payment before 6 April 2006, this will be treated as having used up part of your lifetime allowance.

If your LGPS benefits are more than your lifetime allowance you will have to pay tax on the excess. If your excess benefits are paid as a pension the charge will be 25%, with income tax deducted on the ongoing pension payments; if the excess benefits are taken as a lump sum they will be taxed once only at 55%.

You can choose to pay the tax charge immediately by a reduction to your lump sum or you can ask the scheme to pay the charge for you in return for a permanent reduction to your pension – this is called a lifetime allowance debit.

Examples

Sarah retires on 31 May 2016	
LGPS annual pension	£20,000
LGPS lump sum	£45,000
AVC taken as lump sum	£200,500
Capital Value of benefits	**£645,500**
(£20,000 x 20 + £45,000 + £200,500)	

Sarah has not drawn any pension benefits previously; the capital value of her benefits is less than the LTA for 2016/17 of £1million. She has used 64.55% of the available LTA.

Patrick retires on 31 May 2016	
LGPS annual pension	£45,000
LGPS lump sum	£150,000
AVC taken as lump sum	£20,000
Capital Value of benefits	**£1,070,000**
(£45,000 x 20 + £150,000 + £20,000)	
Tax charge payable on benefits in excess of £1m (£70,000 x 55%)	**£38,500 Tax charge**

This example assumes Patrick has not applied for any lifetime allowance protection and that he has opted to be paid the benefits in excess of the LTA as lump sum. He has used 100% of the available LTA.

Changes to the lifetime allowance

The lifetime allowance reduced from £1.25 million to £1 million with effect from 6 April 2016.

Two new protections have been introduced from 6 April 2016 and are known as Fixed Protection 2016 and Individual Protection 2016. These protections are the same in design as Fixed and Individual Protections 2014 which were introduced when the lifetime allowance reduced from £1.5 million to £1.25 million in 2014.

Individual Protection 2016 (IP2016)

You can apply for Individual protection 2016 from 6 April 2016 if you have pension savings valued at over £1 million (including taking into account past benefits already in payment) on 5 April 2016. However, if you have primary protection or individual protection 2014 you can’t apply for IP2016.

IP2016 gives a protected lifetime allowance equal to the value of your pension rights on 5 April 2016 - up to an overall maximum of £1.25 million. You will not lose IP2016 by making further savings in to your pension scheme but any pension savings in excess of your protected lifetime allowance will be subject to a lifetime allowance charge.

Fixed Protection 2016 (FP2016)

You can apply for Fixed Protection 2016 from 6 April 2016 if you expect your pension savings to be more than £1 million (including taking into account past benefits already in payment) when you come to take them on or after 6 April 2016. FP2016 can be used to help reduce or mitigate the lifetime allowance charge.

You can't have FP2016 if you already have primary, enhanced, fixed protection 2012 or fixed protection 2014.

With FP2016 your lifetime allowance is fixed at £1.25 million rather than the standard lifetime allowance. The maximum tax free lump sum you can take on retirement is the lesser of:

- 25% of the capital value of your LGPS benefits, or
- 25% of the lifetime allowance which, for those with fixed protection, is £312,500 (i.e. 25% of your lifetime allowance of £1.25million) less the value of any other pension rights you have in payment.

FP2016 is lost if your benefits increase by more than the cost of living increase. As the cost of living increase for the year 2016/17 is zero, any pension build up, however small, will lead to your pension increasing by more than zero. Therefore, members wishing to keep FP2016 must have opted-out of the LGPS with effect from 6 April 2016.

FP2016 will also be lost if you start a new pension arrangement, other than to accept a transfer of existing pension rights, or if you pay contributions into a money purchase pension arrangement, other than to a life assurance policy providing death benefits that started before 6 April 2006. You will also be subject to restrictions on where and how you can transfer benefits.

Applying for Fixed and Individual Protection 2016
HMRC have introduced a new online self-service for pension scheme members to apply for individual protection 2016 (IP2016) or fixed protection 2016 (FP2016). There is no application deadline for IP2016 or FP2016, however, you must apply before you take your retirement benefits as you will need to provide the HMRC reference number to your pension fund administrator if you want to rely on the protection.

You will no longer receive a lifetime allowance protection certificate, instead once you have successfully applied for protection the online service will provide you with a reference number which you will need to keep.

Individual Protection 2014 (IP2014)
You can still apply for protection from the 2014 reduction in lifetime allowance by applying for Individual Protection 2014 if your pension savings at 5 April 2014 are valued at over £1.25 million.

IP2014 gives a protected lifetime allowance equal to the value of your pension rights on 5 April 2014 - up to an overall maximum of £1.5 million. You will not lose IP2014 by making further savings in to your pension scheme but any pension savings in excess of your protected lifetime allowance will be subject to a lifetime allowance charge.

Your application for IP2014 must be received by HMRC no later than 5 April 2017. Applications can be made on-line.

Your pension savings may already be protected
As mentioned, the lifetime allowance was introduced in 2006 and was reduced in 2012, 2014 and again more recently in 2016. Each time the lifetime allowance reduced, if you had already planned your pension savings on the basis of the higher lifetime allowance you could protect your pension savings by applying to HMRC. If you have applied for a previous protection i.e. enhanced protection, primary protection, fixed protection 2012, individual protection 2014 or fixed protection 2014 you should have received a certificate to confirm your protection.

However you may still be subject to the lifetime allowance charge if you lose this protection.

You can find more information about these protections and when they may be lost at Tax on your private pension contributions.

I think I might be affected – what should I do?
Before considering any action to reduce your tax liabilities you should always seek independent financial advice from an FCA registered adviser. For help in choosing an independent financial adviser visit the money advice website.

There are certain considerations that you may wish to take into account:

- Converting annual pension for lump sum at retirement can reduce the capital value of your pension benefits
- If you wish to slow down your pension build up the 50/50 section of the LGPS allows you to pay half your normal contributions and build up half your normal pension whilst still retaining full life and ill health cover

- If you opt out of the LGPS with the right to a deferred benefit you will not be able to aggregate your benefits should you re-join the LGPS at a later date

More information

If you have any questions about your LGPS membership or benefits, please contact:

The Greater Gwent (Torfaen) Pension Fund
Torfaen County Borough Council
Civic Centre
Pontypool
Torfaen, Gwent NP4 6YB

pensions@torfaen.gov.uk
01495 766266

This factsheet provides an overview of the LTA rules at September 2016. It should not be treated as a complete and authoritative statement of the law. The rules governing LTA can be complex and are subject to change; if you are unsure how to proceed you are advised to obtain independent financial advice.

Pensions Taxation - Annual Allowance

HM Revenue and Customs impose two controls on the amount of pension savings you can make without having to pay extra tax. These controls are known as the Annual Allowance and Lifetime Allowance. This is in addition to any income tax you pay on your pension once it is in payment.

This section of this factsheet looks at the Annual Allowance which is the amount by which the value of your pension benefits may increase in any one year without you having to pay a tax charge.

For information on the lifetime allowance please refer to the section on the Lifetime Allowance starting on page 1.

What is the Annual Allowance?

The Annual Allowance (AA) is the amount by which the value of your pension benefits may increase in any one year without you having to pay a tax charge. This is in addition to any income tax you pay on your pension once it is in payment.

If the value of your pension savings in any one year (including pension savings outside of the LGPS) are in excess of the annual allowance, the excess will be taxed as income.

The Government reduced the AA from £255,000 to £50,000 from 6 April 2011 and then reduced it again to £40,000 from 6 April 2014. Further changes to the annual allowance have been made for higher earners from 6 April 2016, which resulted in special transitional rules for the 2015/16 tax year. These changes are covered in more detail later in this factsheet.

Annual Allowance limit:

Pension Input Period	Annual Allowance
1 April 2011 to 31 March 2012	£50,000
1 April 2012 to 31 March 2013	£50,000
1 April 2013 to 31 March 2014	£50,000
1 April 2014 to 31 March 2015	£40,000
1 April 2015 to 5 April 2016	£80,000 (transitional rules apply)
6 April 2016 to 5 April 2017	£40,000 (unless tapering applies)

Am I likely to be affected by the Annual Allowance?

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

You are most likely to be affected if:

- you have a lot of scheme membership and you receive a significant pay increase, and/or;
- you pay a high level of additional contributions, and/or;
- you are a higher earner, and/or;

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

The Greater Gwent (Torfaen) Pension Fund will inform you if your LGPS pension savings exceed the standard AA in any year by no later than 6 October of the following year.

How is the Annual Allowance calculated?

The increase in the value of your pension savings in the LGPS in a year is calculated by working out the value of your benefits immediately before the start of the 'pension input period', increasing the value by inflation and then comparing it with the value of your benefits at the end of the 'pension input period'.

The 'pension input period' (PIP) is the period over which your pension growth is measured. From 6 April 2016, PIPs for all pension schemes are aligned with the tax year – 6 April to 5 April. Prior to the 2016/17 the PIP for the LGPS was 1 April to 31 March, except for the year 2015/16 when special transitional rules apply.

In the LGPS the value of your pension benefits is calculated by multiplying the amount of your annual pension by 16 and adding any lump sum you are automatically entitled to from the pension scheme plus any AVCs you or your employer has paid during the year.

If the difference in the value of pension benefits at the end of the PIP less the value of your pension benefits immediately before the start of PIP (adjusted for inflation), is more than the AA then you may be liable to pay a tax charge.

It is important to note that the assessment for the AA covers any pension benefits you may have where you have been an active member during the year, not just benefits in the LGPS. For example, if the increase in the value of your LGPS benefits was calculated as £30,000 in 2014/15 when the AA was £40,000, but you also had an increase in the value of other pension benefits of £15,000 in the same year, that would mean you had a total increase in pension benefits of £45,000. If you did not have any carry forward (see below for more information), you would be liable for a tax charge for the amount you exceeded the AA by, even though at face value you did not breach the AA in either scheme.

[1] A public service 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.

Carry forward

You would only be subject to an AA tax charge if the value of your total pension savings for a year increase by more than the AA for that year. However, a three year carry forward rule allows you to carry forward unused AA from the previous three years. This means that even if the value of your pension savings increase by more than the AA in a year you may not be liable to the AA tax charge.

For example, if the value of your pension savings in 2014/15 increased by £50,000 (i.e. by £10,000 more than the AA) but in the three previous years had increased by £25,000, £28,000 and £30,000, then the amount by which each of these previous years fell short of the AA for those three years would more than offset the £10,000 excess pension saving in the current year. There would be no AA tax charge to pay in this case.

To carry forward unused AA from an earlier year you must have been a member of a tax registered pension scheme in that year.

Changes to Annual Allowance

The Finance (No 2) Act 2015 introduced two important changes to the AA with effect from 6 April 2016.

1. An annual allowance taper for high earners from 6 April 2016
2. To adjust the ‘pension input period’ during 2015/16 so that it becomes aligned with the tax year from 6 April 2016

1. 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. For every £2 that your Adjusted Income exceeds £150,000, your AA is tapered down by £1 (to a minimum of £10,000).

	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, you 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.

How will the taper work?

From 6 April 2016, the taper reduces the AA by £1 for £2 of adjusted income received over £150,000, until a minimum AA of £10,000 is reached. This means that from 6 April 2016 the AA for high earners is as follows:

Adjusted Income	Annual Allowance
£150,000 or below	£40,000
£160,000	£35,000
£170,000	£30,000
£180,000	£25,000
£190,000	£20,000
£200,000	£15,000
£210,000 or above	£10,000

Examples

Cerys		
Gross Salary 2016/17	£120,000	
Less employee pension contributions	£13,680	11.4%
Threshold Income 2016/17	£106,320	Below £110,000 so the AA will not be tapered and remains at £40,000
Pensions saving in the year	£19,500	**Less than £40,000 so no tax charge**
Sanjay		
Gross salary 2016/17	£130,000	
Less employee pension contributions	£14,820	11.4%
Plus taxable income from property	£30,000	
Threshold Income 2016/17	£145,180	
Plus pensions saving in the year	£30,000	
Adjusted Income 2016/17	£175,180	Greater than £150,000 so AA will be tapered
Tapered AA	£27,410*	
In excess of AA	£2,590	Pension saving of £30,000 less tapered AA
AA tax charge at marginal rate (assumed to be 40%)	**£1,036**	£2,590 x 40%

*Taper = £175,180 - £150,000 = £25,180 / 2 = £12,590. Standard AA £40,000 less £12,590 = £27,410

Please note, the examples above make no allowance for any carry forward.

2. Aligning the 'Pension Input Period' with the tax year

The 'pension input period' (PIP) is the period over which your pension growth is measured. Up until 2014/15 the PIP in the LGPS ran from 1 April to 31 March. From 6 April 2016, PIPs for all pension schemes are aligned with the tax year – 6 April to 5 April. Special transitional arrangements apply for 2015/16 meaning that there are 2 PIPs in 2015/16, as set out below:

Pre-alignment tax year: 1 April 2015 to 8 July 2015 - the revised AA during this period is £80,000

Post-alignment tax year: 9 July 2015 to 5 April 2016 - the AA 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 three previous years.

If you have flexibly accessed any benefits in a money purchase pension arrangement on or after 6 April 2015 (see below) you should contact The Greater Gwent (Torfaen) Pension Fund for information about how the pre and post alignment tax years will work as it will be different to the above.

Annual Allowance 'Flexible Benefit' access

If you have any benefits in a money purchase (defined contribution) pension arrangement which you have flexibly accessed on or after 6 April 2015 then the Money Purchase Annual Allowance (MPAA) rules may apply. However, the MPAA will only apply if your total contributions to a money purchase arrangement in a Pension Input Period exceed £10,000.

Generally, if your contributions to a money purchase scheme exceed £10,000 your defined benefit pension (LGPS) savings will be tested against a reduced AA of £30,000 and you will pay a tax charge in respect of your money purchase saving in excess of £10,000.

If you access flexible benefits you will be provided with a flexible access statement; you should provide the Greater Gwent (Torfaen) Pension Fund with a copy of this statement.

Flexible access means taking a cash amount over the tax-free lump sum from a flexi-access drawdown account, taking an uncrystallised funds pension lump sum (UFPLS), purchasing a flexible annuity, taking a scheme pension from a defined contribution scheme with fewer than 12 pensioner members or taking a stand-alone lump sum if you have primary but not enhanced protection[2].

How would I pay an Annual Allowance tax charge?

If you exceed the AA in any year you are responsible for reporting this to HMRC on your self-assessment tax return.

The Greater Gwent (Torfaen) Pension Fund is obliged to notify you if your LGPS benefits (plus the amount of any Additional Voluntary Contributions (AVCs) you may have paid) exceed the standard AA[3], or if they believe you have exceeded the Money Purchase AA, in a year. They must inform you by no later than 6 October of the following tax year.

If you have an AA tax charge that is more than £2,000 and your pension savings in the LGPS alone have increased in the year by more than the standard AA you may be able to opt for the LGPS to pay some or all of the tax charge on your behalf. The tax charge would then be recovered from your pension benefits.

If you want the LGPS to pay some or all of an AA tax charge on your behalf, you must notify the Greater Gwent (Torfaen) Pension Fund no later than 31 July in the year following the end of the year to which the AA charge relates. However, if you are retiring (and draw all of

[2] A stand-alone lump sum is a lump sum relating to pre 6 April 2006 where the whole amount can be taken as a lump sum without a connected pension

[3] Your pension fund is not obliged to inform you if you have exceeded the Tapered Annual Allowance

your benefits from the LGPS) and you want the LGPS to pay some or all of the tax charge on your behalf from your benefits, you must tell your pension fund before you become entitled to those benefits.

Am I affected?

If you think you are affected by the AA more information, including an AA checking tool, is available on the Government's website - https://www.gov.uk/tax-on-your-private-pension/annual-allowance.

This factsheet provides an overview of the AA rules at September 2016. It should not be treated as a complete and authoritative statement of the law. The rules governing AA can be complex and are subject to change; if you are unsure how to proceed you are advised to obtain independent financial advice. For help in choosing an independent financial advisor visit the money advice website.

More information

If you have any questions about your LGPS membership or benefits, please contact:

The Greater Gwent (Torfaen) Pension Fund
Torfaen County Borough Council
Civic Centre
Pontypool
Torfaen, Gwent NP4 6YB

pensions@torfaen.gov.uk
01495 766266

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