

## LOCAL GOVERNMENT PENSION SCHEME (LGPS)

### CHANGES TO PENSION TAX RELIEF FROM 6 APRIL 2011



The Government has announced significant changes to the way in which tax relief is given to pension savings that could potentially affect anyone who contributes to a pension scheme regardless of their age, their expected retirement date or, to some extent, the amount that they earn.

Whilst it is ultimately a *scheme member's responsibility* to work out whether or not they are liable for an annual allowance tax charge, scheme administrators will need to provide members with details of the increase in value of their pension savings for the tax year but only where they have savings that exceed the annual allowance or at the member's request.

The changes are to do with the amount of tax relief a scheme member can receive and the maximum they can contribute to a pension scheme before having to pay any tax charges. With effect from 6 April 2011 the Annual Allowance (AA) is reducing from £255,000 to £50,000 and from 5 April 2012 the Lifetime Allowance (LTA) is reducing from £1.8 million to £1.5 million.

Whilst the majority of LGPS members may be unaffected by these changes it is important that you are at least made aware of them. To decide whether or not you may be affected and if so, to what extent, you need to work out how much your pension savings are for a tax year.

Remember, the LGPS is a defined benefit pension scheme so your pension entitlement is not simply based on the contributions that you and your employer pay, as is the case for a defined contribution pension scheme. Instead you receive benefits based on your length of scheme membership and your final pay.

For example, a full-time scheme member with 20 years membership as at 31 March 2011 and pensionable pay of £20,000 will have built up the following benefits: (NOTE: Up until 31 March 2008 an LGPS pension built up at a rate of 1/80<sup>th</sup> of final pay for each year of scheme membership plus a lump sum of 3/80<sup>ths</sup> of final pay. From 1 April 2008, LGPS benefits build up at a rate of 1/60<sup>th</sup> of final pay for each year of scheme membership with no automatic lump sum)

Based on 17 years at 1/80<sup>th</sup> of pay and 3 years at 1/60<sup>th</sup> of pay:

<i>Annual Pension</i>	<i>Retirement Lump Sum</i>
$17 \div 80 \times \pounds 20,000 = \pounds 4,250.00$	$17 \div 80 \times \pounds 20,000 \times 3 = \pounds 12,750.00$
$3 \div 60 \times \pounds 20,000 = \pounds 1,000.00$	$\pounds \quad \quad 0.00$
<b>Total Pension</b> <u><b>£5,250.00</b></u>	<b>Total Lump Sum</b> <u><b>£12,750.00</b></u>

The amount of pension savings allowed under a scheme such as the LGPS is defined as the increase in the value of pension benefits over the Pension Input Period (PIP) i.e. from 1 April to 31 March each year. Therefore, a comparison has to be made between the value of benefits at the start of the year (the opening value) and the value of benefits at the end of the year (the closing value). If the difference is zero, or a negative figure, then the pension savings are deemed to be nil.

The opening value of benefits can be thought of as the amount of money needed in the pension fund to provide the level of benefits that you would expect to receive. It is a notional 'capital' value and calculated, from the pension and lump sum example above, it would be follows:

Annual Pension	$\pounds 5,250 \times 16 = \pounds 84,000$	(16 is a factor calculated by the Government Actuary)
Plus Retirement Lump Sum	<u><math>\pounds 12,750</math></u>	
Running total	$\pounds 96,750$	
Increased by CPI (3.1% for 2010) - $\pounds 96,750 \times 1.031 = \pounds 99,749.25$ (CPI = Consumer Price Index)		
Opening value for 2011/12 is <b>£99,749.25</b>		

By 31 March 2012 the member will, of course, have one more year of scheme membership and may also have received a pay increase from 1 April 2011 or at some point during the year. For the purposes of our example let us assume that the member received a 2% pay increase from 1 April 2011 and therefore the pay figure as at 31 March 2012 is £20,400.

The value of the pension benefits built up to 31 March 2011 will be:

Based on 17 years at 1/80 <sup>th</sup> of pay and 4 years at 1/60 <sup>th</sup> of pay:			
<b>Annual Pension</b>		<b>Retirement Lump Sum</b>	
17 ÷ 80 x £20,400 =	£4,335.00	17 ÷ 80 x £20,400 x 3 =	£13,005.00
4 ÷ 60 x £20,400 =	<u>£1,360.00</u>		<u>£ 0.00</u>
<b>Total Pension</b>	<b><u>£5,695.00</u></b>	<b>Total Lump Sum</b>	<b><u>£13,005.00</u></b>

The closing value of benefits as at 31 March 2012 will be:

Annual Pension	£5,695 x 16 =	£ 91,120
Plus Retirement Lump Sum		<u>£ 13,005</u>
Running total		£104,125
Closing value for 2011/12 is <b>£104,125.00</b>		

Total Pension Saving for 2011/12 Pension Input Period:

Closing value	£104,125.00	Annual Allowance	£50,000.00
Less Opening value	<u>£ 99,749.25</u>	less	<u>£ 4,375.75</u>
<b>Total Pension Saving</b>	<b><u>£ 4,375.75</u></b>	<b>Unused allowance</b>	<b><u>£45,624.25</u></b>

Let us now assume that our member is promoted from 1 April 2012 to a pay level of £30,000 and also starts to pay an Additional Voluntary Contribution (AVC) of £250 per month. The opening value of benefits will be the closing value from 2011/12 multiplied by CPI to September 2011 (assumed for the purpose of this example to be 3%).

Opening value for 2012/13:	
£104,125.00 x 1.03 =	<b>£107,248.75</b>

The value of the pension benefits built up to 31 March 2013 will be:

Based on 17 years at 1/80 <sup>th</sup> of pay and 5 years at 1/60 <sup>th</sup> of pay			
<b>Annual Pension</b>		<b>Retirement Lump Sum</b>	
17 ÷ 80 x £30,000 =	£6,375	17 ÷ 80 x £30,000 x 3 =	£19,125.00
5 ÷ 60 x £30,000 =	<u>£2,500</u>		<u>£ 0.00</u>
<b>Total Pension</b>	<b><u>£8,875</u></b>		<b><u>£19,125.00</u></b>

The closing value of benefits as at 31 March 2013 will be:

Annual Pension	£8,875 x 16 =	£142,000
Plus Retirement Lump Sum	£19,125 =	<u>£ 19,125</u>
Running total		£161,125
Plus AVCs of £250 x 12 = £3,000		
Closing value for 2012/13:		
£161,125 + £3,000 = <b>£164,125.00</b>		

Total Pension Saving for 2012/13 Pension Input Period:

Closing value	£164,125.00	Annual Allowance	£50,000.00
Less Opening value	<u>£107,248.75</u>	less	<u>£56,876.25</u>
<b>Total saving</b>	<b><u>£ 56,876.25</u></b>	<b>Allowance exceeded by</b>	<b><u>£ 6,876.25</u></b>

As the annual allowance is £50,000 the total pension saving for 2012/13 has exceeded this amount by £6,876.25 and might be subject to a tax charge at the member's marginal rate.

However, it is possible to carry forward any unused allowance from the two previous years so that over any three year period you have effectively an annual allowance of £150,000 (i.e. 3 x £50,000).

Allowance for 2010/11	£ 50,000.00
Allowance for 2011/12	£ 50,000.00
Allowance for 2012/13	<u>£ 50,000.00</u>
<b>Total Allowance for 2012/13</b>	<b><u>£150,000.00</u></b>

Used Allowance for 2010/11	£ 50,000.00 (assumed for the purpose of this example)
Used Allowance for 2011/12	£ 4,375.75
Used Allowance for 2012/13	£ 50,000.00
Excess 2012/13	<u>£ 6,876.25</u>
<b>Total Used Allowance</b>	<b><u>£111,252.00</u></b>

Balance Remaining	£150,000.00
	less <u>£111,252.00</u>
<b>Unused allowance over 3 years</b>	<b><u>£ 38,748.00</u></b>

No tax charge will be incurred as a balance of £38,748 will be carried over to 2013/14 in this example. If, however, in 2011/12 the member had used up the full allowance of £50,000, a tax charge would be incurred on the excess amount of £6,876.25 and would be calculated at the member's marginal rate of tax. So, a basic rate tax payer would receive a tax charge of £1,375.25 (£6,876.25 x 20%). A higher rate tax payer who pays tax at 40% would therefore receive a tax charge of twice this amount.

It is worth noting that the annual allowance for the tax years 2008-09, 2009-10 and 2010-11 is deemed to be £50,000 for pension input period calculation purposes so in the short term it may be necessary to look back over previous years to see if you have exceeded the annual allowance.

#### ***What if I have transferred pension rights from another scheme into the LGPS during the Pension Input Period (PIP)?***

The amount of the transfer is simply deducted from the closing balance.

#### ***Can I contact my pension scheme administrators for this information?***

Scheme administrators will be required to provide scheme members who exceed the annual allowance with details of by how much the allowance has been exceeded. Any scheme member can request this information at any time regardless of whether or not you have actually exceeded the annual allowance.

#### ***Other points to consider***

- The annual allowance test will not be applied in the year of death.
- The Government is considering exempting ill health benefits from the annual allowance regime.
- Exemptions will not be granted in cases of redundancy where the employer awards augmented membership or additional pension.

**It is highly recommended that scheme members seek independent financial advice if they feel that they may be affected by this change to HMRC rules. Further information can be found at the HMRC website as follows:**

<http://www.hmrc.gov.uk/pensionschemes/annual-allowance/changes.htm>

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