Local Government Pension Scheme (LGPS) factsheet

A guide to Pensions Taxation - Annual Allowance and Lifetime Allowance

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PENSION FUND

Local Government Pension Scheme (LGPS) factsheet Pensions Taxation - Annual Allowance and Lifetime Allowance

View the section of Lifetime Allowance here

Annual Allowance

HM Revenue and Customs(HMRC) imposes 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 being paid to you.

What is the Annual Allowance?

The Annual Allowance (AA) is the amount by which the value of your pension benefits may increase in a year without you having to pay a tax charge.

If the value of your pension savings in a year (including pension savings outside of the LGPS) is more than 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 were made for higher earners from 6 April 2016. These changes are covered in more detail later in this factsheet.

Table 1 - Annual allowance rates since 2011

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 onwards	£40,000 (unless tapering applies)

Will I be affected by the Annual Allowance?

Most people will not be affected by the AA tax charge because the value of their pension savings 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 one or more of the statements below applies to you:

- You have membership of the L G P S that was built up in the final salary section and you receive a significant pay increase. Final salary membership is membership built up before 1 April 2014 in England and Wales, or before 1 April 2015 in Scotland.
- You combine a previous L G P S pension benefit that was built up in the final salary section of the L G P S with your current pension account and your salary (full time equivalent) has increased significantly since you left the Scheme.
- You transfer pension rights into the L G P S from a previous public service pension scheme under the preferential Club transfer rules and your salary (full time equivalent) on joining the L G P S is higher than the salary you earned when you left the previous scheme. Public service pension schemes are schemes covering civil servants, any scheme in England, Wales or Scotland covering local government workers, teachers, health service workers, fire and rescue workers or members of the police force, or a new public body pension scheme.
- In the past you transferred in membership from another public service pension scheme which retains a final salary link and you receive a significant pay increase.
- You pay a high level of additional contributions.
- You are a higher earner
- You have accessed flexible benefits on or after 6 April 2015.

If your L G P S pension savings exceed the standard A A in any year ending 5 April, we will contact you by 6 October to let you know.

The 50/50 section of the LGPS

If you wish to slow down your pension build up to avoid or reduce an AA tax charge, you may wish to consider joining the 50/50 section. In the 50/50 section of the LGPS you pay half your normal contributions and build up half your normal pension, but you retain full life cover and ill health cover. You can find out more about Paying less – the 50/50 section on the LGPS member website.

Before taking 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 service website.

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 that value by inflation, and
- 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. Before the 2016/17 year, the PIP for the LGPS was 1 April to 31 March. Special transitional rules applied in the 2015/16 year.

In the LGPS, the value of your pension benefits is calculated by:

- multiplying the amount of your annual pension by 16
- adding any lump sum you are automatically entitled to from the pension scheme, and
- adding any additional voluntary contributions (AVCs) you or your employer has paid during the year.

If 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 you may have to pay a tax charge.

The assessment for the AA covers any pension benefits you 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 £30,000 in 2020/21 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, you would be liable for a tax charge on the amount you exceeded the AA by, even though you did not breach the AA in either scheme. You can find out more about carry forward in the next section.

Carry forward

You may be subject to an Annual Allowance tax charge if the value of your total pension savings for a year increases by more than the Annual Allowance 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 increases by more than the AA in a year, you may not have to pay an AA tax charge.

For example, the value of your pension savings in 2020/21 increased by £50,000 (ie by £10,000 more than the AA) but in the three previous years had increased by £25,000, £28,000 and £30,000. The amount by which the increase in your pension savings fell short of the AA for those three years would more than offset the £10,000 excess pension saving in the current year. You would not have to pay an AA tax charge.

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 the Annual Allowance

Two important changes to the A A were introduced from 6 April 2016:

1. An annual Allowance taper for high earners
2. ‘Pension input period’ aligned with the tax year from 6 April 2016.

1. Tapered Annual Allowance for higher earners

From the tax year 2016/17 onwards, the A A is tapered for high earning individuals. The A A will be reduced if your ‘Threshold Income’ and ‘Adjusted Income’ exceed the limits in a year. For every £2 that your Adjusted Income exceeds the limit, your A A is tapered down by £1. Your A A cannot be reduced below the minimum that applies. The limits changed from the 2020/21 year. Table 2 shows the limits that apply.

Table 2 – tapered annual allowance limits

	Definition	Limit 2016/17 to 2019/20	Limit in 2020/21 onwards
Threshold Income	Broadly your taxable income after the deduction of your pension contributions (including AVCs deducted under the net pay arrangement)	£110,000	**£200,000**
Adjusted Income	Broadly your threshold income plus pensions savings built up over the tax year	£150,000	**£240,000**
Minimum AA	**If your AA is tapered, the minimum AA that can apply**	**£10,000**	**£4,000**

Threshold income includes income from all sources that is taxable eg property income, savings income, dividend income, pension income, social security income (where taxable), state pension income etc.

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 does the taper work?

In the 2020/21 year, the taper reduces the AA by £1 for £2 of adjusted income received over £240,000, until a minimum AA of £4,000 is reached. This means that from 6 April 2020 the AA for high earners is as follows:

Table 3 - The tapered AA from 2021/22

Adjusted Income	Annual Allowance
£240,000 or below	**£40,000**
£250,000	**£35,000**
£260,000	**£30,000**
£270,000	**£25,000**
£280,000	**£20,000**
£290,000	**£15,000**
£300,000	**£10,000**
£312,000 or above	**£4,000**

Table 4 shows the effect of the tapered annual allowance in the years up to 2019/20.

Table 4 – The tapered AA from 2016/17 to 2019/20

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

Example 1 – Sanjay

djusted Income is more than £150,000.

Gross salary ***2019/20***	*£130,000*
Less employee pension contributions	*(11.4%)£14,820*
Plus taxable income from property	*£30,000*
Threshold income 2019/20	*£145,180*
Plus pension savings in the year	*£42,449*
Adjusted income 2019/20	***£187,629***

Tapered AA £21,186*

In excess of AA £21,263 (£42,449 - £21,186)

AA tax charge at marginal rate £8,505.20 (marginal rate of 40% assumed)

* Taper = £187,629 - £150,000 = £37,629 ÷ 2 = £18,814 (rounded down)
Standard AA £40,000 - £18,814 = tapered AA £21,186

Example 2 – Cerys

Gross salary **2020/21** £220,000

Less employee pension contributions (12.5%) £27,500

Threshold income 2020/21 £192,500

Pension savings in the year £71,837

Cerys's Threshold income is less than £200,000. Her AA will not be tapered in 2020/21. Cerys's pension savings will be measured against the standard AA of £40,000.

Standard AA £40,000

Pension savings in excess of AA £31,837

AA tax charge at marginal rate £14,327 (marginal rate of 45% assumed)

Example 3 – Huang	
Gross salary ***2020/21***	*£210,000*
Less employee pension contributions (12.5%)	*£26,250*
Plus taxable income from property	*£30,000*
Threshold income 2020/21	*£213,750*
Plus pension saving in the year	*£68,571*
Adjusted income 2020/21	***£282,321***

We have made no allowance for any carry forward in the examples above. In working out the pension savings in the year we have assumed:

- Inflation adjustment of zero
- the members have no final salary benefits in the L G P S, and
- the members are not paying any additional contributions.

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. 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 applied for 2015/16:

Annual Allowance 'Flexible Benefit' access

If you have 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. The MPAA will only apply if your total contributions to a money purchase arrangement in a Pension Input Period exceed the MPAA.

Generally, if you have flexibly accessed any benefits in a money purchase arrangement on or after 6 April 2015, any further contributions you make to a money purchase scheme in subsequent tax years will be tested against the MPAA. If your contributions exceed the MPAA your defined benefit pension (LGPS) savings will be tested against the alternative AA and you will pay a tax charge in respect of your money purchase saving in excess of the MPAA.

Table 5: The Money Purchase Annual Allowance (MPAA)

Tax Year	MP AA	Alternative Annual Allowance If MPAA is exceeded
2016/17	£10,000	£30,000
2017/18 onwards	£4,000	£36,000

Special transitional rules applied for the tax year 2015/16 – contact us for more information, if applicable.

If you access flexible benefits, you will be provided with a flexible access statement; you should provide your us 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
- 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. 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.

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.

Lothian must notify you if your pension savings in the LGPS (plus the amount of any AVCs you have paid) exceed the standard AA in a year, or if they believe you have exceeded the MPAA in a year. They must inform you by no later than the 6 October which follows the end of the PIP. However, we are not obliged to inform you if you exceed the tapered annual allowance.

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.

If you want the LGPS to pay some or all of an AA tax charge on your behalf, you must notify you 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 take all of 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.

Your employer, at their discretion, may also agree to pay some or all of an annual allowance charge on your behalf in other circumstances, eg where your pension savings are not in excess of the standard AA but are in excess of the tapered or money purchase AA, or where part of the charge relates to pension savings outside of the LGPS. Contact us for more information.

Am I affected?

If you think you are affected by the AA, you can find more information about pension tax and the annual allowance on the Government's website. If you are unsure if you will be affected by the AA, use the AA quick check tool on the LGPS member website.

Lifetime Allowance

This section of the 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.

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 take them (not including any state retirement pension, state pension credit or any partner's or dependant's pension you are 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 have in all tax-registered pension arrangements - not just the 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 were 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 steadily reduced from 2012/13 to 2017/18. From 2018/19 to 2020/21 the lifetime allowance increased each year in line with inflation. The Government has announced that the lifetime allowance will remain at its current level until the end of the 2025/26 financial year.

Table 3 - the lifetime allowance from 2011/12

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
2017/18	£1.00 million
2018/19	£1.03 million
2019/20	£1,055,000
2020/21 to 2025/26	£1,073,100

How is the lifetime allowance calculated?

For pensions that you first take on or after 6 April 2006, the capital value is worked out by multiplying your annual pension by 20 and adding any lump sum you take from the pension scheme.

Each time you take payment of a pension benefit, the capital value of the benefits you are taking is expressed as percentage of the lifetime allowance limit that applies on that date and is deducted

from your available 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 that was paid before 6 April 2006, this will also be treated as having used up part of your lifetime allowance. For these pensions, the capital value 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 you take your LGPS benefits, if the capital value of those benefits is more than your available lifetime allowance you will have to pay tax on the excess. If your excess benefits are paid as a pension, the tax charge will be 25% of the capital value of the excess; the ongoing pension payments be will also be subject to income tax. 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, pay the tax directly to HMRC yourself, 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.

Example 1 – Sarah

Sarah retires on 31 May 2020:	
LGPS annual pension	*£25,000*
LGPS lump sum	*£45,000*
AVC taken as a lump sum	*£116,375*
Capital value of benefits (£25,000 × 20) + £45,000 + £116,375	*£661,375*
Sarah has not drawn any pension benefits previously	*The capital value of her benefits is less than the LTA for 2020/21 of £1,073,100. She has used 61.63% of the available LTA.*

Example 2 – Patrick

Patrick retires on 31 May 2020:	
LGPS annual pension	*£50,000*
LGPS lump sum	*£120,000*
Capital value of benefits	*£1,120,000*

(£50,000 × 20) + £120,000

Tax charge payable on benefits in excess of £1,073,100: £46,900 ÷ 20 × 12 × 55%
£15,477 tax charge
Patrick has not drawn any pension benefits previously He has not applied for any lifetime allowance protection.

He has opted to be paid the benefits in excess of the LTA as a 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 from 6 April 2016. Two new protections were introduced called 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 IP2016 if your pension savings were valued at over £1 million (including pensions already in payment) on 5 April 2016. However, if you have primary protection you can't apply for I P2016.
IP2016 gives a protected lifetime allowance equal to the value of your pension rights on 5 April 2016 - up to a maximum of £1.25 million. You will not lose IP2016 by making further savings in 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 FP2016 if you expect your pension savings to be more than £1 million (including pensions already in payment) when you come to take them on or after 6 April 2016. FP2016 can be used to reduce or mitigate the lifetime allowance charge.

FP2016 is lost if your benefits increase by more than the cost of living increase in any one tax year. If you apply for and wish to keep FP2016 you must have opted out of the LGPS before 6 April 2016. The cost of living increase in 2016/17 was zero. Any increase in your benefits on or after 6 April 2016 will result in the loss of FP2016.

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.

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.

If you lose FP2016 you must electronically notify HMRC within 90 days of the day on which you could first reasonably be expected to have known that you had lost this protection. Failure to do so could result in a fine of £300 and a penalty of up to £60 per day after the initial fine has been issued until you supply HMRC with the required notification.

Taking a tax-free lump sum

The maximum tax-free lump sum you can have when you take your LPGS pension is the lowest of the following:

- 25% of the capital value of your LGPS benefits, or
- 25% of the lifetime allowance which, for those with FP2016, is £312,500 (i.e. 25% of your lifetime allowance of £1.25million), or
- 25% of your remaining lifetime allowance if you have previously taken payment of (crystallised) pension benefits as you will have already used up some of your lifetime allowance.

Applying for Fixed and Individual Protection 2016

HMRC has introduced an online service for you to protect your pension lifetime allowance by applying for IP2016 or FP2016. There is no application deadline for IP2016 or FP2016. To apply for IP2016, you will need to inform HMRC of the value of your pension savings on 5 April 2016 and your pension administrator was only obliged to provide you with this information up to 5 April 2020. You must apply before you take your retirement benefits as you will need to provide the HMRC reference number to your pension administrator if you want to rely on the protection. Once you have successfully applied for protection, the online service will provide you with a reference number which you will need to keep.

Your pension savings may already be protected

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 could protect your pension savings by applying to HMRC. If you have applied for a previous protection such as 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 Tax on your private pension contributions, these protections and when they may be lost on the Government's website.

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 a Financial Conduct Authority registered adviser. For help in choosing an independent financial adviser visit the money advice website.

You may also 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 while retaining full life and ill health cover.

If you have any questions about your LGPS membership or benefits, please contact use the contact details at the end of this newsletter.

Disclaimer

This factsheet provides an overview of the LTA rules at June 2021. 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 specialist independent financial advice.

email: pensions@lpf.org.uk web: www.lpf.org.uk