MERCER
MAKE TOMORROW, TODAY

TAXATION AND THE LOCAL GOVERNMENT PENSION SCHEME

SUMMER BUDGET 2015 CHANGES

In the 2015 Summer Budget on 8 July, the Government announced significant changes to pension savings which will take effect from 6 April 2016. In particular there will be changes made to the Annual Allowance and the Lifetime Allowance which mean that certain employees may pay more tax. This note provides some information on these changes and will allow you to consider whether these changes might affect you.

ANNUAL ALLOWANCE

What is it?

The Annual Allowance (AA) is the maximum amount of pension savings you can make in any one tax year that benefit from tax relief. The value of pension savings made over the year, including pension savings outside of the Local Government Pension Scheme, in excess of the AA will be taxed as income (and then again when you take your benefits).

For the current tax year, the AA is £40,000. However, from April 2016, those with annual incomes of over £150,000 will have their AA reduced gradually so that those with annual incomes in excess of £210,000 will have a reduced AA of £10,000.

INCOME	
Less than £150,000	£40,000
£150,000 to £210,000	Earnings related, between £40,000 and £10,000
Greater than £210,000	£10,000

TWO NEW PAY DEFINITIONS HAVE BEEN BROUGHT INTO THE PENSION TAX ENVIRONMENT:

Threshold income: This is broadly taxable income before any member contributions or salary sacrifice is deducted, and does not include the value of any pension benefits. The reduced AA will not apply for someone with income less than this threshold (which is set initially at £110,000).

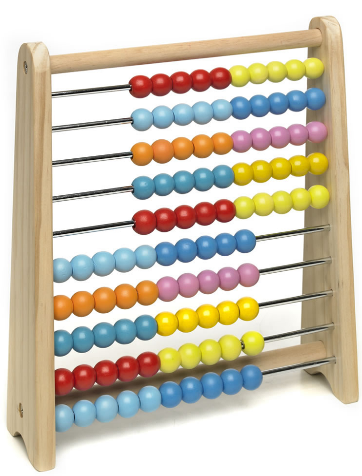
Adjusted income: This is broadly total taxable income over the tax year, plus the value of any pension benefits built up over the year. This will be used to calculate the reduced AA for anyone with taxable income in excess of £110,000.

SO HOW IS THE AA CALCULATED?

For AA purposes, your LGPS pension savings are calculated as the value of any new benefits built up plus the amount of any Additional Voluntary Contributions (AVCs) made in the tax year. You will then need to add any additional pension savings to other pension arrangements (such as a personal pension) you have made.

If you exceed the AA in a particular year, you may be able to use any unused AA from the previous three tax years to reduce your liability to this tax. This is known as ***'carry forward'***.

Note that the minimum AA will be £10,000 which is equal to the "Money Purchase Annual Allowance" and you will be subject to this Money Purchase Annual Allowance if you have accessed some of your pension benefits after 5 April 2015 under the Freedom and Choice flexibilities announced in the 2014 Budget.



Adjusted Income

Jo has a salary of £100,000 and also receives a bonus of £20,000 on 5 April 2017. Hence her total taxable income is £120,000 for the 2016/17 tax year.

She is a member of the LGPS, and the value of the increase in the benefit is £35,000 in the tax year. Hence her Adjusted Income is £155,000 and so she has an AA of £37,500.

Threshold Income

Mel has a salary of £100,000, and receives a bonus of £9,000. His total taxable income is £109,000 and so his income is below the income threshold. Hence he has an AA of £40,000 irrespective of the level of his pension savings over the tax year.

WHAT DOES THIS MEAN?

The majority of LGPS members will not have savings that will exceed the Annual Allowance although you should consider your own circumstances. Three simple examples are provided below.

	JOHN	
Basic salary 2016/17	£50,000 p.a.	
Threshold Income 2016/17	£60,000	As this is less than £110,000, John's Annual Allowance is £40,000
2016/17 Annual Allowance	£40,000	
Value of pension benefits built up	£19,500	As this is less than John's Annual Allowance, there is no AA charge

	CERYS	
Basic salary 2016/17	£115,000 p.a.	
Threshold Income 2016/17	£135,000	
Value of pension benefits built up	£44,000	
Adjusted Income i.e. total taxable earnings plus pension contributions	£179,000	As this is greater than £150,000, Cerys' Annual Allowance is calculated as:
2016/17 Annual Allowance	£25,500	£40,000 – 0.5 x (£179,000 – £150,000)
In excess of AA	£18,500	
AA tax charge at member's marginal rate (assumed 40%)	£7,400	This is 40% x £18,500

	SANJAY	
Basic salary 2016/17	£150,000 p.a.	
Threshold Income 2016/17	£175,000	
Value of pension benefits built up	£57,000	
Adjusted Income i.e. total taxable earnings plus pension contributions	£232,000	As this is greater than £210,000, Sanjay's Annual Allowance is the minimum £10,000:
2016/17 Annual Allowance	£10,000	
In excess of AA	£47,000	
AA tax charge at member's marginal rate (assumed 45%)	£21,150	This is 45% x £47,000

Note that these examples makes no allowance for any ***'carry forward'*** that could be used (see previous page).

How would I pay any Annual Allowance charges?

If you exceed the AA in any tax year, your Scheme is obliged to notify you of this so you can take appropriate action. It is your responsibility to declare any Annual Allowance tax charges to HMRC via personal Tax Returns. You would then have to pay any tax bill that is notified to you. However, you do have the option of using ***"Scheme Pays"*** – this is where, the Scheme would pay the tax charge on your behalf and, instead, you would receive a lower pension when you come to retire – further details can be provided on request.

LIFETIME ALLOWANCE

What is it?

The Lifetime Allowance (LTA) is the maximum overall value of pension benefits you can receive over your working life before a tax penalty applies. The LTA is currently £1.25 million but it will decrease to £1.0 million from 6 April 2016. From April 2018 this £1 million will be increased each year in line with inflation, measured by the Consumer Price Index (CPI).

How is it calculated?

Each time you start receiving new pension benefits, you use up part of your LTA. To assess the value of the benefits that have been put into payment, pension brought into payment is valued as £20 for every £1 per annum – this is regardless of which pension scheme you take your pension from or how old you are when you take your benefits – and any additional lump sum that you receive is simply valued on a £1 for £1 basis.

What does this mean?

Two simple examples, for members retiring on 1 May 2016 are set out below.

	SARAH
LGPS pension	£20,000 p.a.
LGPS Lump Sum	£45,000
AVC savings	£200,000
Value of LGPS pension/lumpsum i.e. 20 x £20,000 p.a. + £45,000	£445,000
Total value of pension benefits i.e. £200,000 + £445,000	£645,000

As this is lower than the LTA of £1 million, no LTA charge is payable. If Sarah has other pension benefits elsewhere, she has £355,000 of the LTA remaining.

	MARK
LGPS pension	£30,000 p.a.
LGPS Lump Sum	£67,000
AVC savings	£500,000
Value of LGPS pension/lumpsum i.e. 20 x £30,000 p.a. + £67,000	£667,000
Total value of pension benefits i.e. £500,000 + £667,000	£1,167,000
Value of benefits above the LTA	£167,000
LTA charge	£91,850

As this is greater than the LTA of £1.0 million, an LTA charge is payable

This is 55% of the value of benefits above the LTA (if paid as a lump sum)

What if I already have pension savings worth more than £1m?

HMRC confirmed that there will be two forms of protection when the Lifetime Allowance reduces to £1m from 6 April 2016, these are summarised below.

Fixed Protection 2016 (FP16): The member retains a Lifetime Allowance of £1.25m, but cannot build up any further pension benefits in the future.

Individual Protection 2016 (IP16): The member has a Lifetime Allowance, between £1m and £1.25m, based on the value of their pension savings at 5 April 2016.

If you already have Protection in place as a result of the LTA having been reduced previously, those Protections remain in place.

If you believe that the value of your benefits already exceeds, or is expected to exceed the LTA you may be able to take action to maximise outcomes. If you are unsure about the best course of action, we recommend that you obtain specialist financial advice (see below).

IS THERE ANYTHING ELSE I NEED TO KNOW RIGHT NOW?

Pension input Periods (PIPS) – What are they?

This is the period over which the amount of pension savings are measured for the purposes of comparing them against the Annual Allowance as described above.

From 6 April 2016, PIPs for all pension schemes will be aligned to the tax year (i.e. starting in the 2016/17 tax year). The PIP for the LGPS is currently the 1 April – 31 March. This means that the LGPS has 2 PIPs in 2015/16:

- 1 April to 8 July 2015
- 9 July to 5 April 2016

and LGPS members are able to save more than £40,000 of pension benefits in 2015/16 as a result.

ARE YOU AFFECTED? WHAT NEXT?

The specific circumstances of each case can be quite different and can be very complex depending on various factors. Whilst this note has been designed to give a flavour of the potential impacts, it is imperative that you seek specialist financial advice before making any major decisions.

If you think that you are affected by the changes, or you want to simply understand more about what the changes are and what they mean for individuals, please contact your LGPS fund administrator.

Specialist support and advice is available, from general awareness presentations to groups of individuals, to specific one-one advice. If this is something you would like to hear more about please contact your LGPS fund administrator.

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