Business Services Organisation
HSC Pension Service

Pension tax changes: Your questions answered

The Government has confirmed changes to the way pensions are taxed.
From the 2011/12 tax year the annual allowance has reduced from £255,000 to £50,000.

- The way that pension's growth is calculated will change.
- From 6 April 2012 the lifetime allowance will reduce from £1.8 million to £1.5 million and there is a new transitional protection called Fixed Protection (available up to 5 April 2012)

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Annual Allowance

What is the annual allowance?

The annual allowance restricts the amount of tax relief that you are entitled to receive on your pensions savings. The annual allowance limit covers all your pension savings, except your State pension, so any other pension savings, e.g. AVCs or a personal pension will need to be added to the value of your HSC pension.

How is the annual allowance calculated?

In defined benefit schemes such as the HSC Pension Scheme the annual allowance is not based on the contributions that you pay into the Scheme, but is based on the growth in the value of your benefits. The growth in your benefits is measured over a "Pension Input Period" which is normally 1 April to the following 31 March in the HSC Pension Scheme.

Am I at risk of exceeding the annual allowance?

The vast majority of members will not be affected. Early indications are that the changes will primarily affect high earners (those earning over £150,000 a year).

You may also be affected if you earn less than £150,000 but:

- you receive a significant pay rise or are promoted to a higher paid role; or
- have a long period of pensionable service, or;
- Earn pension at a higher rate than the normal Scheme accrual.

Members on lower salaries can be affected if they receive a large one off increase in pensionable pay.

The following may increase your chance of breaching the annual allowance limit:

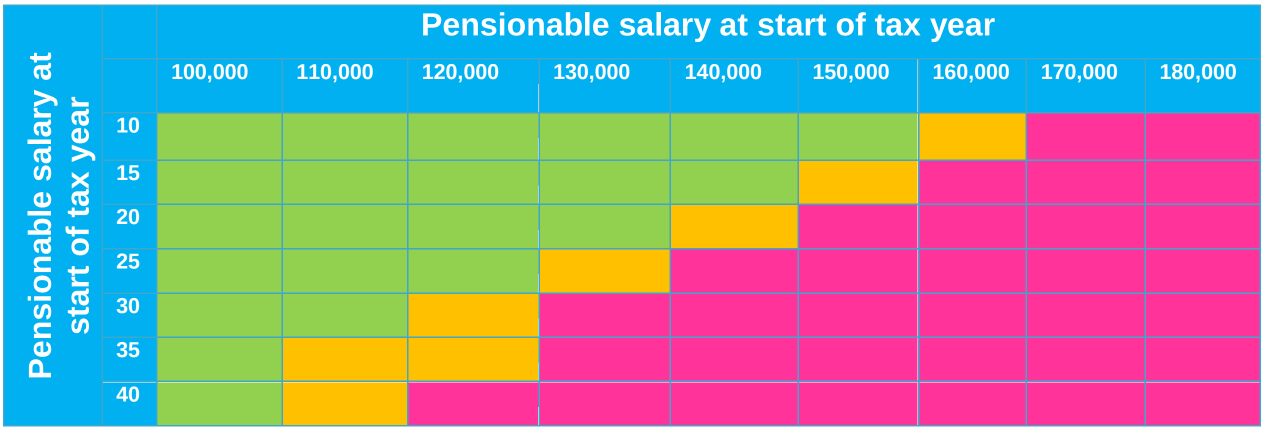
- Paying significant amounts of additional pension
- Linking of previous service in the HSC Pension Scheme
- Paying significant amounts of pension contributions outside the HSC Pension Scheme
- Taking Tier 2 Ill Health retirement

However, in these circumstances, up to three previous years of unused ‘carry forward’ allowance may be used to reduce or offset the subsequent excess above the annual allowance.

The table below gives an example of how this could impact HSC Pension Scheme members from 6 April 2011.

The table shows which employees may be affected if pay increases by 5% and inflation is 3%

Different levels of pay increases and inflation can result in different people being affected.



Pension growth likely to be above reduced annual allowance

Pension growth may be above reduced annual allowance

Pension growth unlikely to be above reduced annual allowance

Are there any exemptions?

There are some cases when the annual allowance restrictions will not apply, for example, death, terminal ill health or some tier 2 ill-health retirements.

The annual allowance in force up to 5 April 2011 does not apply in the year in which benefits came into payment or to those members with Enhanced Protection. However, these exemptions ceased from 6 April 2011.

What is “carry forward”?

If you exceed the annual allowance in any one year you can ”look back” up to three previous tax years to see if you have any unused allowance from these years. If you do, you may be able to “carry forward” any unused allowance and add this to your allowance in the current year. This means that if your pension’s growth exceeds the £50,000 in any one year, say due to a promotion, you may not have any extra tax to pay, depending upon your personal circumstances.

The maximum amount that can be carried forward is £50,000 for each of the 3 previous tax years, and is calculated on the current annual allowance rules.

What happens if I exceed the annual allowance?

If you exceed the annual allowance will be taxed at your highest marginal rate on the amount over the annual allowance. So, if your “pension input amount” is £65,000, then £15,000 may be subject to tax. However, you may be able to use “carry forward” to reduce or eliminate your annual allowance charge.

What is the HSC Pension Input Period?

The Pension Input Period is the period over which the annual allowance is worked out. In the HSC Pension Scheme it is normally 1 April to the following 31 March. This is shown in the examples in this document.

What is the Pension Input Amount?

The Pension Input Amount is the “capitalised” value of your pension and separate lump sum growth.

The “capitalised” value of your pension and separate lump sum is found by using the following calculation: (Pension x 16) + separate lump sum*.

To work it out you take the value of your pension and lump sum at the start of the Pension Input Period (plus an allowance for inflation) and subtract it from the value of your pension and lump sum at the end of the Pension Input Period. It is the result of this calculation (the “growth”) that is measured against the annual allowance.

*Mandatory lump sums are treated differently (2008 Section)

How will I know if I have exceeded the annual allowance?

It is a member’s responsibility to ensure that any annual allowance tax charges are worked out, declared and paid in time. HM Revenue and Customs (HMRC) rules require that members who are over the Annual Allowance and who have tax to pay must do so via self assessment or via the Scheme Pays process if they meet the criteria. For 2011/12 the self-assessment deadline for declaring and paying any tax due is 31 January 2013.

The HM Revenue and Customs self assessment process enables members to estimate any tax payable on their tax return. Members will then have 12 months in which to correct any estimated information provided. Members wishing to find out more should visit the HMRC website at: www.hmrc.gov.uk

Members of the HSC Pension Scheme will normally be able to use the calculators and ready reckoners available on the HSC Pensions website or through their employers to estimate their annual allowance used in the HSC Pension Scheme.

Practitioners who build up Career Average Re-valued Earnings (CARE) benefits cannot use these tools and may therefore wish to consider discussing how to estimate their annual allowance use with their accountant or tax adviser.

HSC Pensions will provide Annual Allowance Pension Savings Statements to members over the annual allowance in the HSC Pension Scheme by 6 October 2013, in respect of the years 2011/12 and 2012/13 in line with legal requirements.

How is the annual allowance calculated for 1995 Section membership?

Here is an example of how the annual allowance is calculated from April 2011:
On 1 April 2011 the member's pensionable pay is £60,000 and they have been a member of the Scheme for 14 years.
On 31 March 2012 the member's pensionable pay has risen by 5% to £63,000 and by then they have built up 15 years of Scheme membership.
The annual allowance is calculated by deducting the opening value of the member's benefits (after allowing for inflation) from the closing value of the member's benefits.

Working out the opening value

On 1 April 2011 the value of the member's benefits (the opening value) is calculated as:
1. Amount of annual pension 14/80 x £60,000 = £10,500
2. Multiply annual rate of pension by a factor of 16: £10,500 x 16 = £168,000
3. Add amount of separate lump sum £168,000 + (3 x £10,500) = £199,500
4. Increase by CPI* (in this case 3.1%) £199,500 x 1.031 = £205,684.50

The opening value is £205,485.00

Working out the closing value

On 31 March 2012 the value of the member's benefits (the closing value) is calculated as:
1. Amount of annual pension 15/80 x £63,000 = £11,812.50
2. Multiply annual rate of pension by a factor of 16: £11,812.50 x 16 = £189,000
3. Add amount of separate lump sum £189,000+ (3 x £11,812.50) = £224,437.50

The closing value is £224,437.50.

Working out the Pension Input Amount

The Pension Input Amount is £18,753 (£224,437.50-£205,684.50). As this is less than the annual allowance of £50,000, the member will not have an annual allowance charge (assuming no pension contributions are being paid by the member elsewhere).

*The opening value is increased by the Consumer Prices Index (CPI) before it is deducted from the closing value (for this example at a rate of 3.1%). You can read more about CPI at: www.statistics.gov.uk

How is the annual allowance calculated for 2008 Section membership?

Here is an example of how the annual allowance will be calculated from April 2011.
On 1 April 2011 the member's pensionable pay is £80,000 and they have 31 years pensionable service.

On 31 March 2012 the member's pensionable pay has risen by 5% to £84,000 and they have built up 32 years pensionable service.

The Pension Input Amount is the increase in the value of the member's pension saving over the Scheme year. This is the difference between the opening value (after allowing for inflation) and the closing value of the benefits.

Working out the opening value

The member's opening value is calculated as:
1. Find amount of annual pension 31/60 x £80,000 = £41,333.33
2. Multiply annual rate of pension by flat factor of 16: £41,333.33 x 16 = £661,333.28
3. Increase by CPI* (in this case 3.1%) £661,333.28 x 1.031 = £681,834.61.

The member's opening value is £681,834.61.

Working out the closing value

The member's closing value is calculated as:
1. Find amount of annual pension 32/60 x £84,000 = £44,800
2. Multiply annual rate of pension by flat factor of 16 £44,800 x 16 = £716,800

The closing value is £716,800.

If you have any mandatory lump sum, then you will need to include this in the calculation and your pension should be adjusted to take account of this, when calculating the annual allowance used up.

Working out the Pension Input Amount

The Pensions Input Amount is £34,965.39 (£716,800.00-£681,834.61) As this is less than the annual allowance of £50,000 the member will not have an annual allowance charge, (assuming no pension contributions are being paid by the member elsewhere).

*The opening value is increased by the Consumer Prices Index (CPI) before it is deducted from the closing value (for this example at a rate of 3.1%). You can read more about CPI at: www.statistics.gov.uk

How is the annual allowance calculated for 1995 Section practitioner membership?

On 1 April 2011 the member's career dynamised earnings are £4,500,000.

Working out the opening value

On 1 April 2011 the value of the member's benefits (the opening value) is calculated as:
1. Amount of annual pension
1.4% x £4,500,000 = £63,000

2. Multiply annual rate of pension by a factor of 16
£63,000 x 16 = £1,008,000

3. Add amount of separate lump sum
£1,008,000 + (3 x £63,000) = £1,197,000

4. Increase by CPI (in this case 3.1%*)

£1,197,000 x 1.031 = £1,234,107
The opening value is £1,234,107

*The opening value is increased by the Consumer Prices Index (CPI) before it is deducted from the closing value (for this example at a rate of 3%). You can read more about CPI at: www.statistics.gov.uk

Working out the closing value

On 31 March 2012 career dynamised earnings have increased to £4,801,500**. The member has a further pensionable income of £200,000 in 2011/12. The members total career dynamised earnings are therefore £4,801,500 + £200,000 = £5,001,500.

****It is assumed that the career dynamised earnings have increased by 6.7% from 1 April 2011 to 31 March 2012.**

5. Amount of annual pension

1.4% x £5,001,500 = £70,021

6. Multiply annual rate of pension by a factor of 16

£70,021 x 16 = £1,120,336

7. Add amount of separate lump sum

£1,120,336 + (3 x 70,021) = £1,330,399
The closing value is £1,330,399

Working out the pension input amount

The pension input amount is £96,292 (£1,330,399 - £1,234,107). As this is more than the annual allowance of £50,000, the member may have an annual allowance charge. However, "Carry Forward" may reduce or eliminate any tax charge. Pension contributions to other registered pension schemes should be added if these are being paid by the member elsewhere. Please note that the above example ignores added years contracts and the existence of officer appointments, which can increase the value of benefits.

What about contributions to other pension arrangements?

Your total pension savings are subject to the annual allowance test so any contributions you are paying to other registered pension schemes will also need to be included when calculating how much your pension has grown by in any one year.

I am being made redundant, how do I know if I will be affected?

You will not be affected by being made redundant if your pensions‟ growth is usually below the annual allowance unless you receive an enhancement to your pensionable service. Any growth in excess of the annual allowance may be partially or fully offset by "carry forward" allowance

Other redundancy payments which do not affect your pension or lump sum are not included in the annual allowance test.

I am retiring on ill health grounds, how do I know if I will be affected?

Members who retire on ill health grounds are not automatically excluded from annual allowance charges. If you are retiring on ill health grounds, you are more likely to be affected if you are eligible for ill health benefits which provide an uplift to your pension and lump sum.

This normally happens when you are awarded "Tier 2" ill health retirement benefits. Any growth in excess of the annual allowance may be partially or fully offset by the "carry forward" allowance.

HMRC have stated that their "Severe Ill Health" Test must be met in order for an individual to be exempt from the annual allowance in the year that they retire on ill health grounds.

The HMRC Severe Ill Health test is different, and in addition to the test members of the HSC Pension Scheme need to undergo in order to assess whether they qualify for ill health retirement benefits under the HSC Pension Scheme.

As part of your ill health application you may be asked whether you consent to the additional HMRC test being undertaken. This test can help to establish whether or not you are exempt from any annual allowance charge in the tax year that you retire. However, if the test is undertaken you may still be subject to an annual allowance charge, depending on the outcome of the test.

More information about the test can be found at:
www.hmrc.gov.uk/pensionschemes//annual-allowance/guide.htm

I am thinking of buying Additional Pension, how do I know if I will be affected?

When Additional Pension is purchased, this increases a member's pension beyond any normal increases. This is more likely to affect higher earners, especially if they also have longer service.

If you are buying additional pension by lump sum of in excess of £2,500 pension then you are much more likely to be affected by the annual allowance. More information on additional pension and the annual allowance can be found at:
http://www.nhsbsa.nhs.uk/Pensions/3126.aspx

How do I pay any annual allowance tax charge?

Individuals should pay any annual allowance tax charge through the HMRC 'Self Assessment' process. More details on 'Self Assessment' can be found at:
www.hmrc.gov.uk/sa/index.htm

Members of the HSC Pension Scheme who meet certain criteria may elect to pay their tax charge via a corresponding reduction to their benefits, rather than by directly paying the tax charge via their self assessment tax return.

This option, called "Scheme Pays" may only be elected if the following conditions are met:

- The member exceeds the annual allowance in the HSC Pension Scheme in the relevant tax year from 2011/12 onwards
- The member has an overall tax charge of more than £2,000 in the same relevant tax year
- The member has not taken all their benefits in the HSC Pension Scheme

In these circumstances HSC Pensions may pay the tax charge on behalf of the individual member. There may be some limited circumstances in which HSC Pensions cannot pay the tax charge on the member's behalf. In these instances you will be notified of this when you apply.

The member's pension benefits would be reduced permanently to allow for the value of the tax charge.

Lifetime allowance

What is the lifetime allowance?

The lifetime allowance is the overall total amount of pension's savings that you can have at retirement without incurring a tax charge. It is currently £1.8 million for the 2010/11 tax year but will reduce to £1.5 million from 6 April 2012.

How is the lifetime allowance calculated?

In defined benefit schemes like the HSC Pension Scheme the lifetime allowance is based on the "capital value" of your benefits. More information on the capital value can be found on the HSC Pensions website.

Am I at risk of exceeding the lifetime allowance?

The lower lifetime allowance may affect you if you are in the 1995 Section and you have a pension of £65,217 a year, plus your standard lump sum.

If you are in the 2008 Section and have a pension (before taking any lump sum) of £75,000, you may be affected.

If you have any pension savings in addition to the above, including money purchase additional voluntary contributions (AVCs), the pension amounts stated above will be lower.

Further information on the lifetime allowance can be found on the HSC Pensions website.

What is fixed protection?

HMRC has introduced Fixed Protection which is available up to 5 April 2012. A member who has been accepted for fixed protection will have their lifetime allowance „fixed" at £1.8 million, rather than the reduced standard LTA of £1.5 million.

How can I find out more?

Further information is available at:
www.hmrc.gov.uk/pensionschemes/annual-allowance/guide.htm
www.hmrc.gov.uk/pensionschemes/lifetime-allowance/index.htm