

# **Budget statement and Pre-Budget Report**

## **Pension Implications for High Income Individuals in the LGPS in England and Wales**

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This leaflet sets out the implications from 6 April 2010 onwards of tax changes affecting high income employees with income (from all sources) of over £100,000.

It is based on our understanding of the law and current consultation papers as at January 2010. Due to the complexity of the subject matter, we feel that it is best to provide you with as much information as possible, including some worked examples. If you are potentially affected by these measures you will need to consider your position very carefully and, where necessary, seek your own independent financial / tax advice. Various terms are used in this leaflet which, if they are not explained in the main text, are defined at the end of the leaflet.

## Background

In his Budget statement on 22 April 2009 the Chancellor of the Exchequer announced the following changes to tax rates and allowances for taxpayers with income over £100,000:

- (a) from 6 April 2010 the basic tax free personal allowance for income tax (currently £6,475) will be gradually reduced by £1 for every £2 that an individual's "adjusted net income" exceeds £100,000 until the tax free personal allowance is reduced to Nil;
- (b) from 6 April 2010, there will be an additional higher tax rate of 50 per cent on taxable income above £150,000;
- (c) from 6 April 2011 higher rate pensions tax relief for individuals with an annual income of £150,000 or more will be tapered away so that for those earning over £180,000 tax relief will be worth 20 per cent; and
- (d) to prevent those individuals in (c) above from seeking to take advantage of the higher pensions tax relief in the meantime, a new special annual allowance tax charge was introduced from 22 April 2009. This will apply to those with "relevant income" of £150,000 or more who change their normal ongoing regular pension savings and whose total pension savings in the tax year exceed £20,000 (the anti-forestalling measures).

In his Pre-Budget Report statement on 9 December 2009 the Chancellor of the Exchequer announced further changes relating to (c) and (d) above. These are that:

- (e) from 6 April 2011 the restriction of higher rate pensions tax relief will apply to those with gross incomes of £150,000 and over. Gross income will incorporate all pension contributions, **including** those provided by or eventually funded by an employer, and before any deductions for charitable donations are made. However, individuals with pre-tax incomes, **excluding** employer pension contributions, of less than £130,000 will be unaffected (even if adding back employer pension contributions would take the gross income to £150,000 or more); and
- (f) the anti-forestalling measures will be extended from 9 December 2009 so that they will cover all those with "relevant income" of £130,000 and over.

The legislation governing the anti-forestalling measures is subject to a series of anti-avoidance tests designed to prevent attempts to circumvent the application of the anti-forestalling rules.

In his Pre-Budget Report the Chancellor of the Exchequer also said:

- (g) "Public sector workers will make a greater contribution to the increasing value of pensions, with those earning over £100,000 paying more."

All of these provisions are covered in more detail in the rest of this leaflet, including matters for high earners to consider. The information in this leaflet is based on our understanding of the Finance Act 2009, the government's consultation on (f) above – see [http://www.hm-treasury.gov.uk/prebud\\_pbr09\\_consult\\_pensions.htm](http://www.hm-treasury.gov.uk/prebud_pbr09_consult_pensions.htm) - and on guidance on the HMRC website at:

<http://www.hmrc.gov.uk/budget2009/index.htm>  
<http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM15100000.htm>  
<http://www.hmrc.gov.uk/budget2009/tax-relief-pen-cont.htm>  
<http://www.hmrc.gov.uk/budget2009/pensions-technical-1550.pdf>  
<http://www.hmrc.gov.uk/pbr2009/pbrn18.htm>

Of course, whilst the above set out the current plans for 2010 onwards, a change of Government in 2010 could result in changes to these plans.

So, let's have a look at each of the current plans in detail.

## (a) Removal of basic tax free personal allowance from 6 April 2010

This change applies from 6 April 2010 and only affects you if your "adjusted net income" is over £100,000 in 2010/11. If it is, your tax free personal allowance will be reduced by £1 for every £2 that your "adjusted net income" exceeds £100,000 until the personal allowance is reduced to Nil.

If your "adjusted net income" is £100,000 or less, then you will be unaffected by this tax change.

"Adjusted net income"<sup>1</sup> is calculated in a series of steps. The starting point is "net income" which is the total of your income subject to income tax (i.e. your income after the deduction of your basic pension contributions to the LGPS and any additional pension contributions you make to the LGPS or to the Scheme's AVC or SCAVC facilities). This figure is then reduced by the grossed-up amount<sup>2</sup> of any Gift Aid contributions you make and the grossed-up amount of any pension contributions which have received "tax relief at source" (e.g. any contributions you may have made to a personal pension).

Note that tax relief on contributions to the LGPS is given through the "net pay" and not the "tax relief at source" arrangements.

The final step is to add back any relief for payments to trade unions or police organisations deducted in arriving at your net income. The result is your adjusted net income. The following examples are for the tax year 2010/11.

### **Example 1 – Restricted Personal Allowance and Pension Contributions from 6 April 2010.**

Bev has a salary of £114,000. The effect of the restriction in her personal allowance is:

Income	£114,000	full personal allowance	£6,475
LGPS Conts (7.5%)	£ 8,550		
Net income	£105,450		
Limit	£100,000		
Excess	£ 5,450	restrict ½	£2,725
		Reduced personal allowance	£3,750
Net income	£105,450		
Reduced personal allowance	£ 3,750		
Chargeable	£101,700		
	£ 37,400 x 20%	=	£ 7,480.00
	£ 64,300 x 40%	=	£25,720.00
Tax due			£33,200.00

Note that in 2009/10 the tax due would only have been £32,110.00 i.e.

Income	£114,000		
LGPS Conts (7.5%)	£ 8,550		
Personal allowance	£ 6,475		
Net chargeable income	£ 98,975		
	£ 37,400 x 20%	=	£ 7,480.00
	£ 61,575 x 40%	=	£24,630.00
Tax due			£32,110.00

<sup>1</sup> See definition in section 58 of the Income Tax Act 2007

<sup>2</sup> Grossed up by the basic rate of tax for the tax year

## Example 2 – restricted personal allowance and pension contributions from 6 April 2010

Trevor has a salary of £122,160. The effect of the restriction in his personal allowance is:

Income	£122,160	full personal allowance	£6,475
LGPS Conts (7.5%)	£ <u>9,162</u>		
Net income	£112,998		
Limit	£ <u>100,000</u>		
Excess	£ <u>12,998</u>	restrict ½	£ <u>6,499</u>
		Reduced personal allowance	£ Nil
Net income	£112,998		
Reduced personal allowance	£ <u>0</u>		
Chargeable	£112,998		
	£ 37,400 x 20%	= £ 7,480.00	
	£ 75,598 x 40%	= £ <u>30,239.20</u>	
Tax due		£ <u>37,719.20</u>	

Note that in 2009/10 the tax due would only have been £35,129.20 i.e.

Income	£122,160		
LGPS Conts (7.5%)	£ 9,162		
Personal allowance	£ <u>6,475</u>		
Net chargeable income	£106,523		
	£ 37,400 x 20%	= £ 7,480.00	
	£ 69,123 x 40%	= £ <u>27,649.20</u>	
Tax due		£ <u>35,129.20</u>	

### Matters to consider

It appears that pension contributions paid to a scheme using the “net pay” arrangements (such as the LGPS) can be used to reduce taxable income to £100,000 or less. Therefore, as a member of the LGPS, if your taxable income exceeds £100,000 you might wish to consider the possibility of reducing your “adjusted net income” to £100,000 or less, thereby potentially preserving your full tax free personal allowance, by utilising one or more of the following:

- paying additional regular contributions (ARCs) into the LGPS to purchase extra pension, or
- paying additional contributions into the Scheme’s Additional Voluntary Contribution (AVC) facility to provide additional benefits, or
- if you have nominated a co-habiting partner to receive a survivor’s pension upon your death, and you have pre 6 April 1988 membership in the LGPS, you could pay additional contributions to the LGPS to provide that some or all of your pre 6 April 1988 membership will count in calculating the eligible co-habiting partner’s survivor pension, or
- reducing your taxable income (but not your pensionable pay) via a salary sacrifice arrangement (e.g. for child care vouchers)<sup>3</sup>

It is not clear whether HMRC intended this effect for “net pay” arrangements (such as the LGPS), as it produces an anomaly with, for example, personal pensions where a person’s personal pension contribution does not reduce taxable pay (as tax relief is claimed back by the personal pension scheme and, for higher rate tax payers, by the individual via their self assessment tax return – known as the “tax relief at source” arrangement).

It may be that the anomaly between the “net pay” and the “tax relief at source” arrangements was an unintended consequence resulting from the fact that the law governing the tax and pension system is extremely complex.

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<sup>3</sup> Where the employer currently offers a salary sacrifice arrangement (e.g. for child care vouchers) and an employee chooses to increase the amount of salary sacrificed or begin to make use of the salary sacrifice arrangements, there is an argument to say HMRC could not necessarily challenge the use of the salary sacrifice arrangement to reduce “adjusted net income” to £100,000 or less. Anyone considering doing so, or anyone considering making use of a new salary sacrifice arrangement being introduced by their employer with a view to reducing their “adjusted net income” to £100,000 or less, would be best advised to check the position with HMRC.

## Warning

You need to bear in mind that:

- a decision to pay additional contributions to a pension scheme or AVC facility could mean that you would exceed what is called the "annual allowance", resulting in a tax charge (see the section in this leaflet containing example 11 for further details);
- a decision to pay additional contributions to a pension scheme or AVC facility could also result in a special annual allowance tax charge (see item "(d) and (f)" later in this leaflet) but if this is the case, an adjustment is made to the amount subject to the special annual allowance tax charge; and
- if you have enhanced protection (see the item under example 10 later in this leaflet), a decision to pay AVCs will result in the loss of that protection.

So, before deciding whether to pay additional contributions to a pension scheme or AVC facility you will need to carefully consider the potential implications.

## (b) Higher rate tax charge of 50 per cent from 6 April 2010 for taxable income above £150,000

This change applies from 6 April 2010. From 2010/11 there will be 3 main rates of income tax:

- the basic rate of 20% on taxable income up to £37,400,
- the higher rate of 40% on taxable income between £37,401 and £150,000, and
- a new additional rate of 50% on taxable income above £150,000.

The following example is for the tax year 2010/11. No account has been taken of any effect which the proposed changes to tax relief on pension contributions might have from 2011/12 (see item "(c) and (e)" later in this leaflet).

Tax due will be collected through a combination of PAYE deductions during the year and payment through Self Assessment.

### Example 3 – 50% rate and pension contribution

Roger has a salary of £170,000. The effect of the restriction in his personal allowance and the introduction of the 50% tax rate is shown below.

Income	£170,000	full personal allowance	£ 6,475
LGPS Conts (7.5%)	£ <u>12,750</u>		
Net income	£157,250		
Limit	£ <u>100,000</u>		
Excess	£ <u>57,250</u>	restrict ½	£ <u>28,625</u>
		Reduced personal allowance	£ Nil
Net income	£157,250		
Allowance	£ <u>    0</u>		
Chargeable	£157,250		
	£ 37,400 x 20%	= £ 7,480.00	
	£112,600 x 40%	= £45,040.00	
	£ 7,250 x 50%	= £ <u>3,625.00</u>	
	Tax due	£ <u>56,145.00</u>	

### Matters to consider

It appears that pension contributions paid to a scheme using the "net pay" arrangements (such as the LGPS) can be used to reduce taxable income to £150,000 or less. Therefore, as a member of the LGPS, if your taxable income exceeds £150,000 you might, in order to reduce your taxable income to £150,000 or less and thus avoid the 50% tax rate, wish to consider one or more of the following:

- paying additional regular contributions (ARCS) into the LGPS to purchase extra pension, or
- paying additional contributions into the Scheme's Additional Voluntary Contribution (AVC) facility to provide additional benefits, or
- if you have nominated a co-habiting partner to receive a survivor's pension upon your death, and you have pre 6 April 1988 membership in the LGPS, you could pay additional contributions to the LGPS to provide that some or all of your pre 6 April 1988 membership will count in calculating the eligible co-habiting partner's survivor pension, or
- reducing your taxable income (but not your pensionable pay) via a salary sacrifice arrangement (e.g. for child care vouchers)<sup>4</sup>

It is not clear whether HMRC intended this effect, or whether it was an unintended consequence resulting from the fact that the law governing the tax and pension system is extremely complex.

<sup>4</sup> Where the employer currently offers a salary sacrifice arrangement (e.g. for child care vouchers) and an employee chooses to increase the amount of salary sacrificed or begin to make use of the salary sacrifice arrangements, there is an argument to say HMRC could not necessarily challenge the use of the salary sacrifice arrangement to reduce taxable income to £150,000 or less. Anyone considering doing so, or anyone considering making use of a new salary sacrifice arrangement being introduced by their employer with a view to reducing their taxable income to £150,000 or less, would be best advised to check the position with HMRC.

## Warning

You need to bear in mind that:

- a decision to pay additional contributions to a pension scheme or AVC facility could mean that you would exceed what is called the "annual allowance", resulting in a tax charge (see the section in this leaflet containing example 11 for further details);
- a decision to pay additional contributions to a pension scheme or AVC facility could also result in a special annual allowance tax charge (see item "(d) and (f)" later in this leaflet) but if this is the case, an adjustment is made to the amount subject to the special annual allowance tax charge; and
- if you have enhanced protection (see the item under example 10 later in this leaflet), a decision to pay AVCs will result in the loss of that protection.

So, before deciding whether to pay additional contributions to a pension scheme or AVC facility you will need to carefully consider the potential implications.

## **(c) and (e) Pensions tax relief for high earners to be tapered away from 6 April 2011**

In the Pre-Budget Report on 9 December 2009 the government launched a 3-month consultation on the detailed implementation of the proposed restriction of tax relief for high earners from 6 April 2011. Consultation on the government's proposals runs until 3 March 2010. The full consultation document, which contains details of the proposals and worked examples, can be viewed at: [http://www.hm-treasury.gov.uk/d/pbr09\\_consult\\_pensions.pdf](http://www.hm-treasury.gov.uk/d/pbr09_consult_pensions.pdf)

The following is a summarised version of the proposals which will affect you if you have:

- "gross income" of £150,000 or more; **and**
- "relevant income" of at least £130,000.

"Gross income" is the aggregate of your income (before any deductions for employee pension contributions or charitable donations are made) **plus** the value of any pension benefit funded by (or eventually funded by) your employer.

**For the purposes of this section only** (i.e. the tapering of tax relief for high earners), "relevant income"<sup>5</sup> is the aggregate of your income (before any deductions for employee pension contributions or charitable donations are made) but will **exclude** the value of any pension benefit funded by (or eventually funded by) your employer - this is effectively a pre-tax income floor, so that individuals with "relevant income" of less than £130,000 will be unaffected.

Only if you have "relevant income" of £130,000 or more will you need to establish the value of the pension benefit funded by (or eventually funded by) your employer. You will then need to add that value to your "relevant income" to determine whether your "gross income" is £150,000 or over.

There will be rules to address the rearrangement of remuneration packages away from salary to pension benefits in order to limit manipulation around the £130,000 floor. These rules will operate by adding back into income any salary sacrificed in return for greater pension benefits<sup>6</sup>.

If your "relevant income" is at least £130,000 and your "gross income" is over £180,000 you will have tax relief on the value of all employee and (deemed) employer pension contributions restricted to basic rate (20%).

If your "gross income" is between £150,000 and £180,000, tax relief will be tapered. The taper will operate as a series of steps so that, as "gross income" rises from £150,000 to £180,000, the rate of tax relief is gradually reduced from 50% to 20%.

The government is consulting on the size and number of the steps. Under its current proposals, where the taper indicates that the rate of tax relief on pension contributions should be between 40 per cent and 50 per cent, the tapered rate will apply only to contributions that would otherwise have received marginal rate relief of 50 per cent, with contributions otherwise receiving 40 per cent marginal rate relief unaffected; and where the taper indicates that the rate of relief on pension contributions should be between 20 and 40 per cent, the tapered rate will apply to all contributions.

In the year in which an individual starts to draw pension benefits, the individual's income will often be significantly lower than in previous years, particularly where this coincides with retirement, if only because it reflects employment income for part of the year and a pension for the remainder.

The Government therefore proposes that in the year that benefits are drawn the measure of income will be the higher of the "gross income" in the previous tax year or that in the year in which benefits are taken (subject to the £130,000 floor). This will ensure that a suitable income test is used in determining whether individuals are affected by the income threshold and taper.

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<sup>5</sup> Note that "relevant income" is defined very differently for the purposes of the anti-forestalling measures set out in item "(d) and (f)" later in this leaflet.

<sup>6</sup> Salary sacrifice in return for increased pension contributions to the LGPS by the employer or increased benefits from the pension scheme where the cost will be met by the employer is not possible under the LGPS.

The Government recognises that redundancy payments could in some cases mean that an individual is unexpectedly brought within the scope of the restriction of tax relief on pension contributions. Individuals who had made their pension choices with the expectation of one tax treatment would in these cases suddenly be faced with different tax consequences.

In line with the wider tax treatment of termination payments, the Government is minded to exempt the first £30,000 of a redundancy payment (and other termination payments<sup>7</sup>) from “gross income” for the purposes of restricting tax relief on pension contributions.

So, there will be three main steps in the process:

- step one is to look at your income to determine whether you are affected by the restriction on pensions tax relief:
  - you are not affected unless your “relevant income”, before any deductions for employee pension contributions or charitable donations, is £130,000 or over;
  - if your “relevant income” is £130,000 or over, you are only affected by the restriction if your “gross income”, before any deductions for employee pension contributions or charitable donations but including the value of the employer contributions, is £150,000 or over.

If you are affected, it is then necessary to move to steps two and three:

- step two is to determine the appropriate rate of tax relief on pension contributions to which you are entitled. A taper will apply to your gross income between £150,000 and £180,000, which will gradually reduce tax relief on pension contributions until it is restricted to the basic rate (20 per cent); and
- step three is to then apply the appropriate restriction of tax relief to pension contributions made by you and the employer.

For defined benefit pension arrangements (such as the LGPS), it is proposed that the deemed employee and employer contribution is calculated by a method which reflects the value of the pension built up during the year. The government is consulting on how to assess this value; its preferred approach is to use age-related factors (ARFs) varying by both age and normal pension age.

The ARFs method would operate by:

- working out the pension benefits built up to the end of the year<sup>8</sup> (including pension in the LGPS derived from any additional membership or additional pension granted by the employer<sup>9</sup> but excluding any enhancement of membership due to ill health retirement during the year)
- subtracting from this the pension benefits built up to the end of the previous year (including pension derived from any additional membership or additional pension granted by the employer), as adjusted by a relevant revaluation rate (e.g. the Retail Prices Index), and
- multiplying the answer by the appropriate Age Related Factor (ARF).

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<sup>7</sup> It is not clear whether the granting of additional membership or additional pension by the employer under, respectively, regulations 12 or 13 of the LPS (Benefits, Membership and Contributions) Regulations 2007 as part of a termination package count towards “gross income”, how such an award should be valued and whether the first £30,000 of the value of the award (when aggregated with any redundancy payment) is exempt. It is understood that where an employer decides under regulations 5 and 6 of the Local Government (Early Termination of Employment) (Discretionary Compensation) (England and Wales) Regulations 2006 to:

- base a redundancy payment on an employee’s actual weeks pay (where this exceeds the statutory weeks pay limit of £380), and / or
- make a one off lump sum compensation payment of up to 104 weeks pay (inclusive of any redundancy payment) to an employee leaving employment on the grounds of redundancy or business efficiency

the amount of any such payment in excess of £30,000 will count towards the “gross income” figure of £150,000.

<sup>8</sup> It is not yet clear how the effect on pension rights as the result of a Pension Sharing Order following divorce or dissolution of a civil partnership is to be taken into account in the calculation.

<sup>9</sup> It is not clear whether the first £30,000 of the value of additional membership or additional pension granted as part of a termination package should be excluded.

It is proposed that there will be an obligation on employers to identify any employee to whom they provide gross pay and taxable benefits of £130,000 or more and to whose pension they contribute, and to request a benefit statement from the pension scheme on the employee's behalf.

The pension scheme will have three months to provide the statement. The statement will provide the employee with information regarding actual or deemed employer contributions and the employee's own contributions made to that scheme over the previous year.

These benefit statements will need to be available by 6 July, in common with other benefits-in-kind notified to employees on form P11D.

The restriction on relief will operate by collection of a recovery charge through the self-assessment tax return system to bring tax relief back to basic rate, or the appropriate rate as determined by the taper.

The Self Assessment tax return will be amended to include boxes to record the amount of a Scheme member's individual contributions (A) and employer contributions (B). Generally, it will work as follows:

- (i) for individuals in defined contribution schemes, it is generally easy for the individual to obtain both the value of the individual (A) and employer (B) contribution and work out their total contribution (A+B). This information will be readily available from the employer or pension scheme; and
- (ii) individuals in defined benefit schemes will need a valuation of the deemed contribution. This will give the total deemed contribution made to their Defined Benefit pension in the year. The individual will need to subtract from this their employee contributions (A) to derive the deemed employer contribution (B).

So, as far as membership of the LGPS is concerned, (A) would be all the employee's contributions to the LGPS and any contributions they have made to the LGPS Additional Voluntary Contribution (AVC) facility; and (B) would be the amount of the deemed employer contribution to the LGPS, as determined in accordance with (ii) above, plus the amount of any employer contribution to the LGPS Shared Cost Additional Voluntary Contribution (SCAVC) facility.

Where the tax charge resulting from the restriction on pensions tax relief exceeds £15,000 it is proposed that individuals will be able to ask the Scheme to pay the charge on their behalf, with an appropriate actuarial reduction in their pension benefit. The key steps of the 'Scheme pays' process are:

- the individual calculates the recovery charge as part of the Self Assessment process;
- if the recovery charge is greater than £15,000 the individual can elect to use the 'Scheme pays' option. The individual informs the Scheme and records this, and the amount of the tax to be recovered, on the Self Assessment return;
- to ensure consistency of treatment between the 'Scheme pays' option and the individual paying the tax charge out of their after-tax income, the 'Scheme pays' charge will be grossed up to reflect that the individual will have benefited from at least basic rate relief on their pension contributions or deemed contributions;
- for a defined contribution scheme the individual's fund will be reduced by the amount of the 'Scheme pays' charge. For defined benefit schemes (such as the LGPS), the Scheme will communicate the actuarially fair reduction to future pension benefits to the individual. The Scheme will have three months to provide this information; and
- the individual will have to confirm the Scheme should proceed with the payment, and the Scheme will then report and pay the recovery charge on the individual's behalf.

The individual will be able to elect for the Scheme to pay up to the 31 January payment date for Self Assessment. In order to receive the necessary information from the Scheme in time to make a decision as to whether to meet the recovery charge personally or to instruct the Scheme to pay, individuals will have to initiate the 'Scheme pays' process three months before (by the end of October).

If the individual initiates this process after the end of October, they will be liable for interest on any late paid tax if the Scheme has not received confirmation to proceed with the payment by 31 January.

## **(d) and (f) New special annual allowance tax charge – effective from 22 April 2009 – the anti-forestalling provisions**

In anticipation of the above intended new restriction on tax relief for high earners from 6 April 2011, the Government has introduced what are known as anti-forestalling measures for 2009/10 and 2010/11 in order to restrict higher rate tax relief on pension contributions for individuals. This is to ward against individuals who would be affected by the tapering of tax relief from 6 April 2011 from seeking to make significant additional pension savings before then in order to get full tax relief at the current rates. The restrictions apply:

(i) from **22 April 2009** if:

- your “relevant income” in a tax year (or either of the previous two tax years<sup>10</sup>) is or has been £150,000 or higher, and
- on or after 22 April 2009 you increase your pension contributions above your “normal ongoing regular pension savings”, and
- your “total pension savings” in the tax year exceed the “special annual allowance figure” of, usually, £20,000

and, in addition:

(ii) from **9 December 2009** if:

- your “relevant income” in a tax year (or either of the previous two tax years<sup>11</sup>) is or has been £130,000 or over but less than £150,000, and
- on or after 9 December 2009 you increase your pension contributions above your “normal ongoing regular pension savings”, and
- your “total pension savings” in the tax year exceed the “special annual allowance figure” of, usually, £20,000.

In either case, only if all three of the above conditions are met will you be subject to a special annual allowance tax charge.

Please note, however, the special annual allowance tax charge will not apply to defined benefits under the LGPS (a defined benefits scheme) in the year a person becomes entitled to their benefits<sup>12</sup>, provided that the taking of benefits is not part of a scheme or arrangement the main purpose of which, or one of the main purposes of which, is to avoid the special annual allowance charge.

The special annual allowance tax charge will, nonetheless, apply to money purchase benefits in the year a person becomes entitled to their pension benefits (e.g. to money purchase benefits from the AVC facility under the LGPS).

So, to work out whether you meet all three conditions, it is necessary to consider what is meant by “relevant income”, “normal ongoing regular pension savings”, “total pension savings” and “special annual allowance figure”. These terms are defined in the sections below.

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<sup>10</sup> So, for 2009/10, income for 2007/08 and 2008/09 will also be considered; and for 2010/11, income for 2008/09 and 2009/10 will also be considered.

<sup>11</sup> So, for 2009/10, income for 2007/08 and 2008/09 will also be considered; and for 2010/11, income for 2008/09 and 2009/10 will also be considered.

<sup>12</sup> This means the year in which, and from which, a Scheme member's benefits are actually payable to him / her. See <http://www.hmrc.gov.uk/manuals/rpsmanual/RPSM15106010.htm> for further details.

## What is “relevant income”?

Broadly, **for the purposes of the special annual allowance**, “relevant income” is

- your total income that is subject to income tax<sup>13</sup> i.e. after deduction of your LGPS pension contributions (including added years contributions), and any contributions you make to the Scheme’s AVC, SCAVC, ARC or ASBC facilities etc, where tax relief is given under the “net pay” arrangement,
- plus the amount of the contributions mentioned in the preceding bullet point i.e. LGPS pension contributions (including added years contributions), and any contributions you make to the Scheme’s AVC, SCAVC, ARC or ASBC facilities etc, where tax relief is given under the “net pay” arrangement,
- less any amounts upon which you are entitled to tax relief for the tax year concerned and which arise under the list in section 24 of the Income Tax Act 2007. This is mainly concerned with deductions for trade and property losses, but does include some other items,
- less any relievable pension contributions paid by you during the tax year e.g. any contributions you made to the LGPS, including contributions to purchase added years and contributions to the Scheme’s AVC, SCAVC, ARC and ASBC facilities, and the grossed up amount of any contributions you made to, for example, a personal pension under the “tax relief at source” arrangements, but only up to a maximum amount of £20,000 in aggregate,
- plus any income sacrificed<sup>14</sup> under a salary sacrifice agreement put in place
  - on or after 22 April 2009 for those with relevant income of £150,00 or more, or
  - on or after 9 December 2009 for those with relevant income of £130,000 or over but less than £150,000in return for increased contributions to a pension scheme by the employer or increased benefits from the pension scheme where the cost will be met by the employer,
- less any gift aid donations you make.

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<sup>13</sup> This would include earnings from employment; earnings from self-employment/partnerships; most pensions income (i.e. State, occupational and personal pensions in payment); interest on most savings; income from shares (dividend income); rental income; and income received by an individual from a trust.

<sup>14</sup> Salary sacrifice in return for increased pension contributions to the LGPS by the employer or increased benefits from the pension scheme where the cost will be met by the employer is not possible under the LGPS.

#### **Example 4 - "relevant income" calculation for the 2009/10 tax year**

**Step 1:** Mark's taxable employment income for the tax year 2009/10 is £140,600 and he has other taxable income for the year of £20,000. His total income for the year is £160,600 (£140,600 + £20,000).

**Step 2:** Mark's taxable employment income for the year would have been greater but for contributions of £10,545 (£140,600 x 7.5%) that he made in the tax year to the LGPS (a registered pension scheme operating under the "net pay" arrangement). The amount of those contributions is added to the 'Step 1' figure, giving an amount of £171,145 (£160,600 + £10,545).

**Step 3:** Mark did not have any qualifying loss or other reliefs. The amount found after this step, therefore, is still £171,145.

**Step 4:** As well as the contributions of £10,545 to the LGPS under the "net pay" arrangement, Mark also made 'net' contributions of £10,000 to a personal pension scheme in the same year under the "tax relief at source" arrangements. However, the total relievable contribution that he made for the year in respect of the personal pension scheme is the 'grossed up' amount of £12,500. The total relievable contributions are £23,045 (£10,545 + £12,500) but only £20,000 can be deducted from the amount found at Step 3, giving an amount of £151,145 (£171,145 - £20,000).

**Step 5:** No salary sacrifice arrangement was made in the tax year. The amount found after this step, therefore, is still £151,145.

**Step 6:** Mark made a 'gift aid' qualifying donation of £500 in the tax year. This represents £625 (when the donation of £500 is grossed up), which is the amount deducted from the amount found at Step 5. This gives an amount of £150,520 (£151,145 - £625), which is Mark's "relevant income" amount for the 2009/10 tax year.

It should be noted, however, that in calculating "relevant income", it is necessary to exclude the first £30,000 of the aggregate of:

- any statutory redundancy payment, and
- any lump sum payment made by the employer on terminating an employee's contract of employment on redundancy or efficiency grounds and which is made under regulation 5 (power to base redundancy pay on actual pay) or regulation 6 (power to award a lump sum termination payment of up to 104 weeks pay) of the Local Government (Early Termination of Employment) (Discretionary Compensation) (England and Wales) Regulations 2006.

If the employer grants a person additional membership in the LGPS or additional LGPS pension under regulations 12 or 13, respectively, of the LGPS (Benefits, Membership and Contributions) Regulations 2007, the value of that award / the sum paid by the employer to the Pension Fund in respect of that award would also not count as "relevant income". This is on the basis that the sum paid by the employer is not made as part of a salary, or redundancy, sacrifice agreement<sup>15</sup>.

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<sup>15</sup> If the sum is paid as part of such a sacrifice agreement then the sum would be included in "relevant income" if the sacrifice agreement was made on or after 22 April 2009.

## What are “normal, ongoing, regular pension savings”?

As a member of the LGPS (a defined benefit pension scheme) all your basic contributions to the Scheme and, subject to the following proviso, any additional contributions you may be making to provide additional defined benefits under the Scheme will be normal, ongoing, regular pension savings. Normal, ongoing regular pension savings are known as “protected pension inputs” and are not subject to the special annual allowance tax charge.

However, if:

- your “relevant income” in a tax year (or either of the previous two tax years) is or has been £150,000 or higher, and you increase, on or after 22 April 2009, your benefits<sup>16</sup> under the Scheme (e.g. you start paying ASBCs or ARCs), or
- your “relevant income” in a tax year (or either of the previous two tax years) is or has been £130,000 or over but less than £150,000, and you increase, on or after 9 December 2009, your benefits<sup>17</sup> under the Scheme (e.g. you start paying ASBCs or ARCs)

this additional element will represent an increase in your normal, ongoing, regular pension savings and will be a “non-protected pension input”.

Similarly, if you are paying contributions to a money purchase arrangement (e.g. you are making contributions to the AVC or SCAVC facilities in the LGPS), these will be normal, ongoing, regular pension savings and thus be a “protected pension input” provided:

- if your “relevant income” in a tax year (or either of the previous two tax years) is or has been £150,000 or higher, the contributions (including any employer contributions) were being made at least quarterly before 22 April 2009, or
- if your “relevant income” in a tax year (or either of the previous two tax years) is or has been £130,000 or over but less than £150,000, the contributions (including any employer contributions) were being made at least quarterly before 9 December 2009.

However, if:

- your “relevant income” in a tax year (or either of the previous two tax years) is or has been £150,000 or higher, and you commenced the contributions on or after 22 April 2009 (or you increase the contributions otherwise than in accordance with the terms of an agreement made before noon on 22 April 2009<sup>18</sup>), or
- your “relevant income” in a tax year (or either of the previous two tax years) is or has been £130,000 or over but less than £150,000, and you commenced the contributions on or after 9 December 2009 (or you increase the contributions otherwise than in accordance with the terms of an agreement made before noon on 9 December 2009<sup>19</sup>)

the contributions (or the increased contributions) will represent an increase in your normal, ongoing, regular pension savings and will be a “non-protected pension input”.

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<sup>16</sup> If, other than in the year your benefits become payable, your employer increases your benefits under the Scheme by granting you additional membership in the LGPS or additional LGPS pension under regulations 12 or 13, respectively, of the LGPS (Benefits, Membership and Contributions) Regulations 2007, then whether or not the value of that award would be a “protected pension input” will depend on the facts and circumstances under which the discretionary power in those regulations to make such an award is used – see <http://www.hmrc.gov.uk/manuals/rpsmanual/RPSM15103150.htm> for further information

<sup>17</sup> See footnote 15.

<sup>18</sup> If you increase your contributions but the increase was not agreed before noon on 22 April 2009, the increase will not be a “protected pension input” and will be tested against the special annual allowance. Contributions which increase with earnings (e.g. expressed as x% of earnings) should be considered to be paid at the same “rate” and remain protected. But where contributions are increased in accordance with an option in the Scheme rules, even where that option was in place before 22 April 2009, the increased element of the contribution will not be protected if the increase was not agreed before noon on 22 April 2009.

<sup>19</sup> If you increase your contributions but the increase was not agreed before noon on 9 December 2009, the increase will not be a “protected pension input” and will be tested against the special annual allowance. Contributions which increase with earnings (e.g. expressed as x% of earnings) should be considered to be paid at the same “rate” and remain protected. But where contributions are increased in accordance with an option in the Scheme rules, even where that option was in place before 9 December 2009, the increased element of the contribution will not be protected if the increase was not agreed before noon on 9 December 2009.

## What are “total pension savings”?

This is all of your pension savings that receive UK tax relief<sup>20</sup> and includes:

- savings in all registered pension schemes including
  - defined benefit schemes, and
  - defined contribution schemes (also known as money purchase schemes), and
  - contributions paid both by individuals and anyone on their behalf and by employers
- savings in non-UK pension schemes that benefit from UK tax relief

The value of your pension savings (the “pension input amount”) in a tax year (the “pension input period”<sup>21</sup>) is valued as follows:

- for defined contribution arrangements (including AVCs and SCAVCs), this generally means the total of the contributions, including any from the employer, paid in to the pension scheme during the tax year; and
- for defined benefit arrangements, this means any increase in the value of your accrued rights in those arrangements during the tax year (see examples 5 and 8 below for method of calculating the increase in value during the tax year)

Note that the following are not included in “total pension savings”:

- any statutory redundancy payment, and
- any lump sum payment made by the employer on terminating an employee’s contract of employment on redundancy or efficiency grounds and which is made under regulation 5 (power to base redundancy pay on actual pay) or regulation 6 (power to award a lump sum termination payment of up to 104 weeks pay) of the Local Government (Early Termination of Employment) (Discretionary Compensation) (England and Wales) Regulations 2006.

## What is the Special Annual Allowance figure?

The special annual allowance figure is £20,000 or, if contributions are made less regularly than quarterly to a money purchase arrangement and it would produce a figure greater than £20,000, the special annual allowance figure is the average of those infrequent contributions over tax years 2006/07, 2007/08 and 2008/09, subject to a maximum figure of £30,000.

If your “relevant income” in a tax year (or either of the previous two tax years) is or has been £150,000 or higher, any non regular pension savings from 6 April 2009 to 21 April 2009 will reduce the special annual allowance, but those non regular pension savings will not themselves be subject to the special annual allowance tax charge.

If your “relevant income” in a tax year (or either of the previous two tax years) is or has been £130,000 or over but less than £150,000, any non regular pension savings from 6 April 2009 to 8 December 2009 will reduce the special annual allowance, but those non regular pension savings will not themselves be subject to the special annual allowance tax charge.

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<sup>20</sup> Where a Scheme member is purchasing added years of membership and is made redundant or retired on business efficiency grounds before completing the added years contract, the member can make a capital payment to the Pension Fund in respect of the outstanding amount of the regular payments contract in accordance with regulation 87 of the LGPS Regulations 1997 which is a saved regulation by virtue of Schedule 1 of the LGPS (Transitional Provisions) Regulations 2008. However, saved regulation 83(4) only permits the capitalisation after leaving. There is nothing in the Finance Act 2004 to prevent a member paying a contribution to the Scheme after leaving in accordance with regulation 83 but such a payment is not tax relievable. This is because section 188 of the Finance Act 2004 only refers to tax relief being given if the member is an active member. It says “(1) An individual who is an active member of a registered pension scheme is entitled to relief under this section in respect of relievable pension contributions paid during a tax year if the individual is a relevant UK individual for that year.” Thus, as the capital sum would not count as part of “total pension savings” nor as part of “normal, ongoing, regular pension savings” and as the special annual allowance tax charge does not apply to benefits from a defined benefit scheme in the year a person becomes entitled to those benefits, the benefits derived from capitalising an added years contract can be ignored.

<sup>21</sup> The “pension input period” for the special annual allowance will always be the tax year ending on 5 April. This currently differs from the pension input period for the existing annual allowance (which in the LGPS currently ends on 31 March).

## Some worked examples

We appreciate that all of this is, to say the least, rather complicated and hope that the examples on the following pages will help to explain how the provisions will work in practice. Note that, in all examples, the starting figure for an individual's special annual allowance is assumed to be £20,000.

### ***Example 5 – “Relevant income” of £150,000 or more but no liability to special annual allowance tax charge***

Gary is in the LGPS in England or Wales and his “relevant income” from all sources is £150,000 or more. The Scheme pays a pension of 1/60 of his pensionable salary for each year of membership after 31 March 2008 and a pension of 1/80 of his pensionable salary plus a lump sum of 3/80 of his pensionable salary for each year of membership up to 31 March 2008.

At 6 April 2009, after 5 years membership, his pensionable salary upon which his benefits would be calculated was £165,000 and by 5 April 2010 it has risen to £168,000. He makes no extra contributions to the Scheme.

All of his benefits in the LGPS are, therefore, a “protected pension input”. If Gary's only pensions savings are in the LGPS, the value of his benefits is calculated by working out the difference in the capital value of his pension savings between the start of the period and the end of the period.

The calculation is as follows:

Opening Value:

Membership from 6 April 2004 to 31 March 2008	
£165,000 x 1/80 x 3 years 360 days x 10 (factor to give capital value)	= £82,217.46
£165,000 x 3/80 x 3 years 360 days	= £24,665.23
Membership from 1 April 2008 to 5 April 2009	
£165,000 x 1/60 x 1 years 5 days x 10 (factor to give capital value)	= <u>£27,876.71</u>
Total	<u>£134,759.40</u>

Closing Value:

Membership from 6 April 2004 to 31 March 2008	
£168,000 x 1/80 x 3 years 360 days x 10 (factor to give capital value)	= £83,712.33
£168,000 x 3/80 x 3 years 360 days	= £25,113.70
Membership from 1 April 2008 to 5 April 2010	
£168,000 x 1/60 x 2 years 5 days x 10 (factor to give capital value)	= <u>£56,383.56</u>
Total	<u>£165,209.59</u>

His “protected pension input” is therefore £165,209.59 - £134,759.40 = £30,450.19. Although this is more than £20,000 he will not be liable to a special annual allowance tax charge as he does not have any “non-protected pension input”.

If Gary had been paying extra contributions to the LGPS to purchase added years of membership, the increase between the opening and closing value of his benefits due to that added years contract would also be a “protected pension input”. This is because the added years contract would have been entered into prior to 22 April 2009.

[Note: The factor of 10 used to work out the value of rights in a defined benefit scheme is set in legislation i.e. section 234(4) of the Finance Act 2004.]

***Example 6 – “Relevant income” of £150,000 or more and liability for a special annual allowance tax charge***

Let's assume Gary had decided in May 2009 to commence payment of monthly AVCs, amounting to £1,000 per month. His “protected pension input” amount for 2009/10 in respect of his main LGPS benefits would still be £30,450.19 (as shown in example 5) upon which there would be no special annual allowance tax charge.

However, as he will have commenced AVC payments on or after 22 April 2009, amounting to £11,000 in 2009/10, and his normal pension savings in the LGPS exceed £20,000, all of his AVCs are a “non-protected pension input” and will be taxed.

He will therefore be liable to pay a special annual allowance tax charge on the full £11,000 at the difference between the tax relief received on the £11,000 and tax relief at basic rate (20% for 2009/10). This will be collected through his Self-Assessment tax return. AVCs paid in 2010/11 would similarly be subject to a special annual allowance tax charge.

***Example 7 – “Relevant income” of £150,000 or more and liability for a special annual allowance tax charge***

If Gary had decided in July 2006 to commence payment of monthly AVCs, amounting to £500 per month and decided in May 2009 to increase them to £1,100 per month, his “protected pension input” amount for 2009/10 in respect of his main LGPS benefits would still be £30,450.19 (as shown in example 5) upon which there would be no special annual allowance tax charge.

The regular monthly AVCs of £500 he decided to pay from July 2006 are also a “protected pension input” (of £6,000 for 2009/10) because he was paying them prior to 22 April 2009. However, as he will have increased his AVC payments on or after 22 April 2009, the increase (amounting to £6,600 in 2009/10) will be a “non-protected pension input” and will be taxed.

He will therefore be liable to pay a special annual allowance tax charge on the full £6,600 at the difference between the tax relief received on the £6,600 and tax relief at basic rate (20% for 2009/10). This will be collected through his Self-Assessment tax return.

If he carried on paying those extra £600 per month AVCs in 2010/11 (£7,200 for the year), the £7,200 would similarly be subject to a special annual allowance tax charge.

**Example 8 – “Relevant income” of £130,000 or more but less than £150,000 but no liability to special annual allowance tax charge**

Lucy is in the LGPS in England or Wales and her “relevant income” from all sources is £130,000 or more but less than £150,000. The Scheme pays a pension of 1/60 of her pensionable salary for each year of membership after 31 March 2008 and a pension of 1/80 of her pensionable salary plus a lump sum of 3/80 of her pensionable salary for each year of membership up to 31 March 2008.

At 6 April 2009, after 5 years membership, her pensionable salary upon which her benefits would be calculated was £135,000 and by 5 April 2010 it has risen to £138,000. She makes no extra contributions to the Scheme. All of her benefits in the LGPS are, therefore, a “protected pension input”.

If Lucy’s only pensions savings are in the LGPS, the value of her benefits is calculated by working out the difference in the capital value of her pension savings between the start of the period and the end of the period.

The calculation is as follows:

Opening Value:

Membership from 6 April 2004 to 31 March 2008	
£135,000 x 1/80 x 3 years 360 days x 10 (factor to give capital value)	= £67,268.83
£135,000 x 3/80 x 3 years 360 days	= £20,180.65
Membership from 1 April 2008 to 5 April 2009	
£135,000 x 1/60 x 1 years 5 days x 10 (factor to give capital value)	= <u>£22,808.22</u>
Total	<u>£110,257.70</u>

Closing Value:

Membership from 6 April 2004 to 31 March 2008	
£138,000 x 1/80 x 3 years 360 days x 10 (factor to give capital value)	= £68,763.70
£138,000 x 3/80 x 3 years 360 days	= £20,629.11
Membership from 1 April 2008 to 5 April 2010	
£138,000 x 1/60 x 2 years 5 days x 10 (factor to give capital value)	= <u>£46,315.07</u>
Total	<u>£135,707.88</u>

Her “protected pension input” is therefore £135,707.88 - £110,257.70 = £25,450.18. Although this is more than £20,000 she will not be liable to a special annual allowance tax charge as she does not have any “non-protected pension input”.

If Lucy had been paying extra contributions to the LGPS to purchase added years of membership, the increase between the opening and closing value of her benefits due to that added years contract would also be a “protected pension input”. This is because the added years contract would have been entered into prior to 9 December 2009.

[Note: The factor of 10 used to work out the value of rights in a defined benefit scheme is set in legislation i.e. section 234(4) of the Finance Act 2004.]

### ***Example 9 – “Relevant income” of £130,000 or more but less than £150,000 and liability for a special annual allowance tax charge***

Let's assume Lucy had decided in January 2010 to commence payment of monthly AVCs, amounting to £1,000 per month. Her “protected pension input” amount for 2009/10 in respect of her main LGPS benefits would still be £25,450.18 (as shown in example 8) upon which there would be no special annual allowance tax charge.

However, as she will have commenced AVC payments on or after 9 December 2009, amounting to £3,000 in 2009/10, and her normal pension savings in the LGPS exceed £20,000, all of her AVCs are a “non-protected pension input” and will be taxed.

She will therefore be liable to pay a special annual allowance tax charge on the full £3,000 at the difference between the tax relief received on the £3,000 and tax relief at basic rate (20% for 2009/10). This will be collected through her Self-Assessment tax return. AVCs paid in 2010/11 would similarly be subject to a special annual allowance tax charge.

### ***Example 10 – “Relevant income” of £130,000 or more but less than £150,000 and liability for a special annual allowance tax charge***

If Lucy had decided in July 2006 to commence payment of monthly AVCs, amounting to £500 per month and decided in January 2010 to increase them to £1,100 per month, her “protected pension input” amount for 2009/10 in respect of her main LGPS benefits would still be £25,450.18 (as shown in example 8) upon which there would be no special annual allowance tax charge.

The regular monthly AVCs of £500 she decided to pay from July 2006 are also a “protected pension input” (of £6,000 for 2009/10) because she was paying them prior to 9 December 2009. However, as she will have increased her AVC payments on or after 9 December 2009, the increase (amounting to £1,800 in 2009/10) will be a “non-protected pension input” and will be taxed.

She will therefore be liable to pay a special annual allowance tax charge on the full £1,800 at the difference between the tax relief received on the £1,800 tax relief at basic rate (20% for 2009/10). This will be collected through her Self-Assessment tax return. If she carried on paying those extra £600 per month AVCs in 2010/11 (£7,200 for the year), the £7,200 would similarly be subject to a special annual allowance tax charge.

## **Does the Special Annual Allowance apply to members with Enhanced Protection?**

You may have registered with HMRC for what is called “enhanced protection” if the value of your pension benefits at 5 April 2006 was more than the 2006/07 standard lifetime allowance of £1.5million.

It was also possible to register for enhanced protection if you believed the value of your benefits at 5 April 2006 might in the future be more than the standard lifetime allowance or if you believed your pension benefits in any one year would increase by more than the normal annual allowance (£245,000 for 2009/10 and £255,000 for 2010/11 to 2015/16).

If you have enhanced protection you will not pay tax on benefits in excess of the standard lifetime allowance provided your benefits at retirement do not exceed the value of your benefits at 5 April 2006 as increased after then, in general terms, by the greater of 5% per annum, the increase in the Retail Price Index or increases in your pensionable pay.

If you have enhanced protection you will, nonetheless, still be subject to all the provisions set out in this leaflet. Please note, however, that you will lose enhanced protection if you pay contributions into a defined contribution pension arrangement (e.g. you start paying AVCs into the AVC facility in the LGPS).

## How does the special annual allowance interact with the existing annual allowance?

The existing annual allowance is the amount by which the value of your pension benefits may increase in any one year (disregarding any increase in the value of any benefits in the year that they become payable) without you having to pay an annual allowance tax charge. The year from 1 April to 31 March is used to measure the increase in the value of pension benefits.

The "annual allowance" is set by the Treasury and for 2009/2010 is £245,000 and for 2010/11 is £255,000. The assessment covers any pension benefits you may have in all tax-registered pension arrangements – not just the LGPS.

If you exceed the annual allowance in any year (other than the year that all your benefits become payable) you are responsible for reporting this to HMRC on your self-assessment tax return and for paying the annual allowance tax charge. The annual allowance tax charge is 40% of any increase in benefits above the annual allowance.

### **Example 11 – Annual Allowance Tax Charge**

During 2009/10, Adam was promoted. He already had a significant amount of service in the pension scheme and upon the promotion received a substantial increase in salary.

At 31 March 2010, he has the following benefits built up in the LGPS:

- LGPS membership – 36 years
- Final pay - £160,000

Retirement pension for service to 31 March 2008 =  $34/80 \times £160,000$  = £68,000.00 p.a.  
Retirement pension for service from 1 April 2008 =  $2/60 \times £160,000$  = £ 5,333.33 p.a.  
£73,333.33 p.a.

Lump sum retirement grant for service to 31 March 2008 =  $3 \times 34/80 \times £160,000$  = £204,000.00

And during 2009/10, Adam also paid £12,000 into the AVC facility in the LGPS

One year prior (31 March 2009), the value of his benefits was as follows:

- LGPS membership – 35 years
- Final pay - £120,000

Retirement pension for service to 31 March 2008 =  $34/80 \times £120,000$  = £51,000.00 p.a.  
Retirement pension for service from 1 April 2008 =  $1/60 \times £120,000$  = £ 2,000.00 p.a.  
£53,000.00 p.a.

Lump sum retirement grant for service to 31 March 2008 =  $3 \times 34/80 \times £120,000$  = £153,000.00

The increase in Adam's pension savings for comparison with the annual allowance is:

[(10 x Pension at 31 March 2010) + Lump sum at 31 March 2010 + AVCs paid in 2009/10] minus  
[(10 x Pension at 31 March 2009) + Lump sum at 31 March 2009]

= [(10 x £73,333.33) + £204,000 + £12,000] – [(10 x £53,000) + £153,000]

= £949,333.30 – £683,000.00 = £266,333.30

As £266,333.30 is more than the annual allowance threshold at the 31 March 2010 (£245,000 in the tax year 2009/10), there is a tax charge of 40% on the excess amount i.e. [£266,333.30 - £245,000.00] x 40% = £8,533.32 tax.

The special annual allowance will run alongside the existing annual allowance. In practice this means that all increases in your pension savings – ‘pension input amounts’ - will continue to be tested against the existing annual allowance (£245,000 for 2009/10 and £255,000 for 2010/11) in the usual way. However, any pension input amounts that represent new saving that is taken out by, or in respect of, you:

- in the period starting with 22 April 2009 and ending on 5 April 2011, if you have “relevant income” of £150,000 or more, and
- in the period starting with 9 December 2009 and ending on 5 April 2011, if you have “relevant income” of £130,000 or more but less than £150,000

will be tested against the special annual allowance as well but if this would mean you would become subject to a tax charge under the annual allowance and special annual allowance an adjustment is made to the amount subject to the special annual allowance tax charge.

### **(g) Potential increase in pension contributions for high earners**

On 25 June 2009, Communities and Local Government (the government department responsible for the regulations governing the LGPS) issued an informal consultation letter asking for views on a proposal to change the employee contribution rates and bandings from April 2010, with a new higher rate of 8.5% being introduced for those earning between £75,001 and £100,000 and 10% for those earning £100,001 or more. In his Pre-Budget Report on 9 December 2009, the Chancellor of the Exchequer said “*Public sector workers will make a greater contribution to the increasing value of pensions, with those earning over £100,000 paying more.*”

At the present time, no formal decisions have yet been announced as to exactly what changes to the employee contribution rates and bandings in the LGPS will be or when these will be implemented from.

## Definitions

### ARC facility

You can pay extra contributions into the LGPS to buy up to £5,000 of extra annual pension in blocks of £250. This extra pension is payable on top of your normal LGPS benefits. You can buy extra pension for yourself and, if you wish, extra pension for your husband, wife, civil partner, nominated co-habiting partner and for eligible children on your death. For more information please see <http://www.lgps.org.uk/lge/core/page.do?pageId=102217>

### ASBC facility

A survivor's pension for a nominated co-habiting partner is normally based on membership from 6 April 1988, but if you have membership in the LGPS before 6 April 1988 you can pay additional contributions so that some or all of that earlier membership counts in calculating a surviving nominated co-habiting partner's pension under the LGPS. An option to pay ASBCs has to be made by 31 March 2011. For more information please see: <http://www.lgps.org.uk/lge/core/page.do?pageId=102217>

### AVC facility

All local government pension funds have an in-house AVC scheme where you can invest money, deducted directly from your pay, through an AVC provider (often an insurance company or building society). If you choose to pay AVCs under the LGPS, the AVCs are invested separately in funds managed by the AVC provider. You have your own personal account that, over time, builds up with your contributions and the returns on your investment, and will be available to you when you retire. For more information please see <http://www.lgps.org.uk/lge/core/page.do?pageId=102217>

### Defined benefit (DB) scheme

This is a pension scheme where an individual accrues rights to future pension benefits that are determined, typically, by reference to their earnings and length of service within the pension scheme. The LGPS is a defined benefit scheme (except for the AVC and SCAVC facilities within the LGPS, which are defined contribution arrangements).

### Defined contribution (DC) scheme

This is a scheme where entitlement to benefits is wholly dependent on the contributions made to the scheme and the investment returns. The AVC and SCAVC facilities within the LGPS are defined contribution arrangements.

### Net pay arrangement

This is the method employers normally use to deduct pension contributions to an occupational pension scheme from an employee's pay, before operating Pay As You Earn so that the employee automatically receives tax relief on pension contributions at their marginal rate. Tax relief on contributions you make to the LGPS or to the ARC, ASBC, AVC and SCAVC facilities under the LGPS is given under the net pay arrangement.

### SCAVC facility

This is an AVC facility in the LGPS to which the employer contributes as well as the employee. It is at the employer's discretion whether to provide a SCAVC facility.

### Tax relief at source arrangement

This is a method for giving basic rate relief on pension contributions. An individual makes a pension contribution to, for example, a personal pension scheme, of the full value they wish to make, less an amount equal to the basic rate of income tax. The pension scheme then claims basic rate tax relief from HMRC. The LGPS does not use the tax relief at source arrangement.

## **Further details**

For further details on the matters covered in this leaflet, please call Kevin Greenough at the Fund on 0151 242 1354.

Please note, however, that we are not able, and are not registered, to provide Scheme member's with individual financial or tax advice.

## **Disclaimer**

The information contained in this leaflet is based on our understanding of the law and current consultation papers as at January 2010. It should not be treated as a complete and authoritative statement of the law. You may wish, or will need, to take your own legal and financial / tax advice on the interpretation and effect of the law on you. We accept no responsibility whatsoever for any direct or consequential loss, financial or otherwise, damage or inconvenience, or any other obligation or liability incurred by anyone relying on information contained in this leaflet.