Merseyside Pension Fund
Fact Sheet 13: Changes to tax relief and your Pension from April 2011

The Government has announced plans to change the tax limits applying to pensions some of these changes will take effect from April 2011. There are limits set by HM Revenue & Customs which impact on pensions. These are the Lifetime Allowance (LTA) and the Annual Allowance (AA).

Lifetime Allowance:

The lifetime allowance (LTA) is the limit on the total value of pension benefits you can draw at retirement without incurring a penal tax charge. The LTA is currently £1.8M but the Government is proposing to reduce this to £1.5M from April 2012. Within the Local Government Pension Scheme (LGPS) this reduction is only likely to impact on very high earners who have a large number of years' membership. The Government is looking at providing some measure of protection for those people who have made decisions based upon the current LTA limit.

LTA usage is measured by multiplying the pension by a factor of 20 and adding to it any lump sum taken together with the value of any Additional Voluntary Contribution (AVC) fund.

We will publish further information when it becomes available.

Annual Allowance:

As its name implies the Annual Allowance is a limit that applies to the increase in pension benefits from one year to the next. The current AA had a limit of £255,000 and again within the LGPS was only likely to impact upon high earners who had a significant pay increase. The new proposals reduce the AA to £50,000 with effect from April 2011 and change the method for valuing pension benefits against the new limit.

From April 2011 the increase in pension benefits is calculated by comparing your pension benefits adjusted by inflation at the start of what is referred to as the Pension Input Period (PIP) with their value at the end of the PIP. Within the LGPS the PIP is defined as running from 1st April to 31st March.

You will be able to carry forward any unused AA from the previous 3 years.

Calculating your AA usage

AA usage is calculated by applying a factor of 16 to the pension and adding to it the value of any accrued lump sum together with the value of contributions paid into any Defined Contribution arrangement such as an AVC.

Exceptions to the AA charge

The AA charge will not apply to benefits payable at death or for people receiving their pension benefits who have a serious illness with a likely life expectancy of less than 12 months.

HM Revenue and Customs are considering extending the exemption to normal ill health retirements. We will advise you when they have made a decision.

Example

Alan has 32 years membership of the scheme at 1st April 2011 and his pensionable pay was £40,000. His accrued pension benefits, allowing for the different calculation of pre and post 2008 benefits, at the start of the input period were £16,500 pension and £43,500 Lump Sum.

The AA value of his benefits at the start of the PIP are: -

Pension multiplied by 16	£16,500 x 16	=	£264,000.00
Plus Lump Sum		+	£ 43,500.00
Opening Value			£307,500.00

At the end of the PIP this value needs		
To be adjusted by inflation, let us assume 3.1%	+	£ 9,532.50
Revised Opening Value	=	£317,032.50

At 31st March 2012 Alan has accrued another year's membership of the scheme and his pensionable pay has risen to £50,000. His accrued pension benefits are now £21,458.33 pension and £54,375.00 lump sum.

The AA value of his benefits at the end of the PIP are: -

Pension multiplied by 16 £21,458.33 x 16	=	£343,333.28
Plus Lump Sum	+	£ 54,375.00
Closing Value	=	£397,708.28

If Alan had been making AVC contributions during the year he would have to add the value of those contributions to the Closing Value.

His AA usage for the year is

Closing Value	=	£397,708.28
Less Revised Opening Value	-	£317,032.50
AA usage	=	**£ 80,675.78**

This exceeds the AA of £50,000 by £30,675.78 and it would appear that he may have to pay tax on this at his marginal rate. If he had a 40% marginal tax rate this would be £451.45 or £225.72 if his marginal rate was 20%. Fortunately for Alan he had not had anything like this kind of pay rise in the previous 3 years and so was able to apply any unused AA from those years, as they exceeded the £30,675.78 he did not suffer a tax charge.

Be Aware

These changes to the AA do not only impact upon high earners but can effect anyone who has a significant increase in pensionable pay and has significant membership or who combines a sizeable period of previous pension scheme membership with their current membership at a higher pensionable pay.

More information

For more information or if you have a question about any aspect of your LGPS membership or benefits, please contact the Fund at:

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