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

HM Revenue and Customs impose two controls on the amount of pension savings you can make without having to pay extra tax. These controls are known as the Annual Allowance and Lifetime Allowance. This is in addition to any income tax you pay on your pension once it is in payment.

This factsheet looks at the Annual Allowance, which is the amount by which the value of your pension benefits may increase in a year without you having to pay a tax charge. For information on the Lifetime Allowance please read the Lifetime Allowance factsheet.

## What is the Annual Allowance?

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

If the value of your pension savings in a year (including pension savings outside of the LGPS) are more than the annual allowance, the excess will be taxed as income.

The Government reduced the AA from £255,000 to £50,000 from 6 April 2011, and then reduced it again to £40,000 from 6 April 2014. Further changes to the annual allowance were made for higher earners from 6 April 2016. These changes are covered in more detail later in this factsheet.

**Table 1 - Annual allowance rates since 2011**

| Pension Input Period | Annual Allowance |
|---|---|
| 1 April 2011 to 31 March 2012 | £50,000 |
| 1 April 2012 to 31 March 2013 | £50,000 |
| 1 April 2013 to 31 March 2014 | £50,000 |
| 1 April 2014 to 31 March 2015 | £40,000 |
| 1 April 2015 to 5 April 2016 | £80,000 (transitional rules apply) |
| 6 April 2016 to 5 April 2017 onwards | £40,000 (unless tapering applies) |

## Will I be affected by the Annual Allowance?

Most people will not be affected by the AA tax charge because the value of their pension savings will not increase in a year by more than £40,000, or, if it does, they are likely to have unused allowance from previous years that can be carried forward.

You are most likely to be affected if one or more of the statements below applies to you:

- you have membership of the LGPS that was built up in the final salary section (built up before 1 April 2014 in England and Wales, or before 1 April 2015 in Scotland) and you receive a significant pay increase
- you transferred in membership from another public service pension scheme[1] in the past which retains a final salary link and you receive a significant pay increase
- you pay a high level of additional contributions
- you are a higher earner
- you transfer pension rights into the LGPS from a previous public service pension scheme[1] under the preferential club transfer rules and your salary (full time equivalent) on joining the LGPS is higher than the salary you earned when you left the previous scheme
- you combine a previous LGPS pension benefit that was built up in the final salary section of the LGPS with your current pension account and your salary (full time equivalent) has increased significantly since leaving the scheme
- you have accessed flexible benefits on or after 6 April 2015.

If your LGPS pension savings exceed the standard AA in any year ending 5 April, Hammersmith and Fulham Pension Fund will contact you by 6 October to let you know.

## The 50/50 section of the LGPS

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

Before taking any action to reduce your tax liabilities you should always seek independent financial advice from an FCA registered adviser. For help in choosing an independent financial adviser visit the money advice service website.

## How is the Annual Allowance calculated?

The increase in the value of your pension savings in the LGPS in a year is calculated by working out the value of your benefits immediately before the start of the 'pension input period', increasing the value by inflation and then comparing it with the value of your benefits at the end of the 'pension input period'.

The 'pension input period' (PIP) is the period over which your pension growth is measured. From 6 April 2016, PIPs for all pension schemes are aligned with the tax year – 6 April to 5 April. Before the 2016/17 year, the PIP for the LGPS was 1 April to 31 March, except for the 2015/16 year when special transitional rules applied.

[1] A public service pension scheme includes a pension scheme covering civil servants, the judiciary, the armed forces, any scheme in England, Wales or Scotland covering local government workers, teachers, health service workers, fire and rescue workers or members of the police forces; or membership of a new public body pension scheme.

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

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

If the value of pension benefits at the end of the PIP less the value of your pension benefits immediately before the start of PIP (adjusted for inflation), is more than the AA then you may have to pay a tax charge.

It is important to note that the assessment for the AA covers any pension benefits you have where you have been an active member during the year, not just benefits in the LGPS. For example, if the increase in the value of your LGPS benefits was £30,000 in 2019/20 when the AA was £40,000, but you also had an increase in the value of other pension benefits of £15,000 in the same year, that would mean you had a total increase in pension benefits of £45,000. If you did not have any carry forward (see below for more information), you would be liable for a tax charge on the amount you exceeded the AA by, even though you did not breach the AA in either scheme.

## Carry forward

You would only be subject to an AA tax charge if the value of your total pension savings for a year increases by more than the AA for that year. However, a three year carry forward rule allows you to carry forward unused AA from the previous three years. This means that, even if the value of your pension savings increases by more than the AA in a year, you may not have to pay an AA tax charge.

For example, if the value of your pension savings in 2019/20 increased by £50,000 (ie by £10,000 more than the AA) but in the three previous years had increased by £25,000, £28,000 and £30,000, then the amount by which the increase in your pension savings fell short of the AA for those three years would more than offset the £10,000 excess pension saving in the current year. There would be no AA tax charge to pay in this case.

To carry forward unused AA from an earlier year, you must have been a member of a tax registered pension scheme in that year.

## Changes to the Annual Allowance

The Finance (No 2) Act 2015 introduced two important changes to the AA with effect from 6 April 2016:

1. Introduced an Annual Allowance taper for high earners from 6 April 2016
2. Adjusted the ‘pension input period’ during 2015/16 so that it aligned with the tax year from 6 April 2016.

### 1. Tapered Annual Allowance for higher earners

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

**Table 2 – tapered annual allowance limits**

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

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

Please note, you are not allowed to deduct from taxable income any amount of employment income given up for pension provision as a result of any salary sacrifice made on or after 9 July 2015.

### How does the taper work?

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

**Table 3 - The tapered AA in 2020/21**

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

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

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

| Adjusted Income | Annual Allowance |
|---|---|
| £150,000 or below | £40,000 |
| £160,000 | £35,000 |
| £170,000 | £30,000 |
| £180,000 | £25,000 |
| £190,000 | £20,000 |
| £200,000 | £15,000 |
| £210,000 or above | £10,000 |

**Example 1 – Sanjay**

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

Sanjay's Threshold income is more than £110,000 and his Adjusted Income is more than £150,000. His AA is tapered for the 2019/20 year.

| | |
|---|---|
| Tapered AA | £21,186* |
| In excess of AA | £21,263 (£42,449 - £21,186) |
| **AA tax charge** at marginal rate | £8,505.20 (marginal rate of 40% assumed) |

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

**Example 2 – Cerys**

| | |
|---|---|
| Gross salary **2020/21** | £220,000 |
| Less employee pension contributions (12.5%) | £27,500 |
| **Threshold income 2020/21** | £192,500 |
| Pension savings in the year | £71,837 |

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

| | |
|---|---|
| Standard AA | £40,000 |
| Pension savings in excess of AA | £31,837 |
| **AA tax charge** at marginal rate | £14,327 (marginal rate of 45% assumed) |

**Example 3 – Huang**

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

Huang's Threshold income is more than £200,000 and her Adjusted income is more than £240,000. Her AA will be tapered for the 2020/21 year.

| | |
|---|---|
| Tapered AA | £18,840* |
| In excess of AA | £49,731 |
| **AA tax charge** at marginal rate | £22,379 (marginal rate of 45% assumed) |

* Taper = £282,321 - £240,000 = £42,321 ÷ 2 = £21,160 (rounded down)
Standard AA £40,000 - £21,160 = £18,840

Please note, the examples above make no allowance for any carry forward and assume an inflation adjustment of zero. The pension savings in the year are based on the assumption that the members have no final salary benefits in the LGPS and that they are not paying any additional contributions.

### 2. Aligning the 'Pension Input Period' with the tax year

The 'pension input period' (PIP) is the period over which your pension growth is measured. Until 2014/15 the PIP in the LGPS ran from 1 April to 31 March. From 6 April 2016, PIPs for all pension schemes are aligned with the tax year – 6 April to 5 April. Special transitional arrangements applied for 2015/16 meaning that there were two PIPs in 2015/16, as set out below:

**Pre-alignment tax year:** 1 April 2015 to 8 July 2015 - the revised AA during this period is £80,000

**Post-alignment tax year:** 9 July 2015 to 5 April 2016 - the AA for this period is the amount of the £80,000 not used up from the pre-alignment tax year (subject to a maximum of £40,000) together with any carry forward available from the three previous years.

If you have flexibly accessed any benefits in a money purchase pension arrangement on or after 6 April 2015 (see below) you should contact Hammersmith and Fulham Pension Fund for information about how the pre and post alignment tax years worked as it is different to the above.

## Annual Allowance 'Flexible Benefit' access

If you have any benefits in a money purchase (defined contribution) pension arrangement which you have flexibly accessed on or after 6 April 2015 then the Money Purchase Annual Allowance (MPAA) rules may apply. However, the MPAA will only apply if your total contributions to a money purchase arrangement in a Pension Input Period exceed the MPAA.

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

**Table 5: The Money Purchase Annual Allowance (MPAA)**

| Tax Year | MPAA | Alternative Annual Allowance<br>If MPAA is exceeded |
|---|---|---|
| 2016/17 | £10,000 | £30,000 |
| 2017/18 onwards | £4,000 | £36,000 |

Special transitional rules applied for the tax year 2015/16 – contact Hammersmith and Fulham Pension Fund for more information, if applicable.

If you access flexible benefits, you will be provided with a flexible access statement; you should provide your Hammersmith and Fulham Pension Fund with a copy of this statement.

Flexible access means taking a cash amount over the tax-free lump sum from a flexi-access drawdown account, taking an uncrystallised funds pension lump sum (UFPLS), purchasing a flexible annuity, taking a scheme pension from a defined contribution scheme with fewer than 12 pensioner members or taking a stand-alone lump sum if you have primary but not enhanced protection[2].

## How would I pay an Annual Allowance tax charge?

If you exceed the AA in any year you are responsible for reporting this to HMRC on your self-assessment tax return.

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

[2] A stand-alone lump sum is a lump sum relating to pre 6 April 2006 where the whole amount can be taken as a lump sum without a connected pension

If you have an AA tax charge that is more than £2,000 and your pension savings in the LGPS alone have increased in the year by more than the standard AA, you may be able to opt for the LGPS to pay some or all of the tax charge on your behalf. The tax charge would then be recovered from your pension benefits.

If you want the LGPS to pay some or all of an AA tax charge on your behalf, you must notify Hammersmith and Fulham Pension Fund no later than 31 July in the year following the end of the year to which the AA charge relates. However, if you are retiring (and take all of your benefits from the LGPS) and you want the LGPS to pay some or all of the tax charge on your behalf from your benefits, you must tell your pension fund before you become entitled to those benefits.

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

## Am I affected?

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

## More information

If you have any questions about your LGPS membership or benefits, please contact Hammersmith and Fulham Pension Fund:

**By phone:** 0300 200 1031
**By email:** myhelpdeskpensions@surreycc.gov.uk
**In writing:** Pension Services
Surrey County Council
Room 218 County Hall, Penrhyn Road
Kingston upon Thames, KT1 2DN

## Disclaimer

This factsheet provides an overview of the AA rules at April 2020. It should not be treated as a complete and authoritative statement of the law. The rules governing AA can be complex and are subject to change; if you are unsure how to proceed you are advised to obtain independent financial advice. For help in choosing an independent financial advisor visit the money advice website.