Environment Agency
Pension Fund

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The tax controls on pension savings

The Local Government Pension Scheme (LGPS) is registered with HM Revenue and Customs (HMRC), which means that you receive tax relief on your contributions as they're deducted from your pay. However, there are two HMRC limits on the amount of pension savings you can have before you may have to pay a tax charge. This is over and above any tax due under the PAYE system on your pension once it's in payment.

The two limits on pension savings are known as the annual allowance and the lifetime allowance; in this factsheet, we'll take a brief look at these allowances. Most people will be able to save as much as they wish with full tax relief, as their pension savings will be less than these allowances.

Annual Allowance

What is the annual allowance?

The annual allowance (AA) is the amount your pension savings (also known as pension input amount or PIA) can increase in any one year before you may have to pay a tax charge.

From April 2011, the AA reduced from £255,000 to £50,000, reduced again in April 2014 to £40,000 and remains at £40,000 for 2018/19. The AA also applies in the year you take your benefits, although there is an exemption in the case of severe ill health retirement or on death.

Generally speaking, any pension benefits you have in tax registered pension arrangements where you've paid contributions during the tax year (or your employer has paid contributions on your behalf) are included in calculating your pension savings in a year. Prior to April 2016, the period over which pension savings are measured (known as the Pension Input Period, or PIP) for the LGPS ran from 1 April to 31 March, and from 2015/16 it ran from 1 April 2015 to 5 April 2016. From April 2016, the PIP has been aligned with the tax year and runs from 6 April to 5 April.

You'll only have an AA tax charge if the value of your pension savings in a tax year increase by more than the AA, after offsetting any unused AA from the last three tax years (known as Carry Forward) against the AA excess. This means that, even if the value of your pension savings increase by more than the AA in a year, you may not have to pay the AA tax charge.

For example, if the value of your pension savings for a tax year increase by £60,000 (£20,000 more than the maximum AA for 2016/17), but in the three previous years had increased by £25,000 (2015/16), £28,000 (2014/15) and £42,000 (2013/14), then the total cumulative amount by which each of these previous years fell short of the AA in those years* (i.e. £15,000 + £12,000 + £8,000 = £35,000) would more than offset the £20,000 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've been a member of a tax registered pension scheme in that year.

*AA was £50,000 for 2013/14, and £40,000 for 2014/15 and 2015/16

Most people won't be affected by the AA tax charge because the value of their pension savings won't increase in a tax year by more than the AA. If it does, they're likely to have unused allowance from previous tax years that can be carried forward.

How can I work out if I may be affected by the AA?

Working out whether you're affected by the AA is quite complex, but this should help you work out your general position.

In general terms, the increase in the value of your pension savings in a year is calculated by working out the value of your benefits immediately before the start of the PIP (6 April) and revaluing them by inflation (currently using higher of Consumer Prices Index (CPI) or 0%). The figure is then compared with the value of your benefits at the end of the PIP (i.e. the following 5 April).

In a defined benefit scheme, like the LGPS, the value of your benefits is calculated by multiplying the amount of your pension by 16 and adding any separate lump sum you're automatically entitled to from the pension scheme.

If the difference between:

a) The value of your benefits immediately before the start of the PIP + CPI (the opening value); and

b) The value of your benefits at the end of the PIP (the closing value), plus any contributions you've paid into the scheme's Additional Voluntary Contribution (AVC) arrangement in the year

is more than the AA, you may have to pay a tax charge. The method of valuing benefits in other schemes may be different to the method used in the LGPS.

If you elect to transfer pension rights into the LGPS from a public sector scheme that takes part in the public sector transfer 'club', then any increase in benefits as a result of the transfer being calculated under 'club' terms counts towards your pension savings in the LGPS in the year the transfer payment is received. In addition, if you combine any previous LGPS benefits with your current Environment Agency Pension Fund (EAPF) service, then any increase in value to your previous benefits will count towards your pension savings.

Please note a transfer in from a private sector scheme (such as an insurance company, or a previous occupational pension scheme that isn't a public sector scheme) doesn't count towards your pension savings in the LGPS in the year the transfer payment is received.

If your pension benefits in the LGPS are reduced following a Pension Sharing Order (known as a 'pension debit') due to divorce or dissolution of a civil partnership, then, for the purposes of calculating the value of your pension savings in the LGPS, the reduction in your benefits is ignored in the year that the Pension Sharing Order is applied to your benefits. Vice versa, if, following a Pension Sharing Order, your benefits are increased (as a separate entitlement known as a 'pension credit'), the increase in your benefits is ignored in the year that the Pension Sharing Order creates the pension credit.

If you retire on the grounds of permanent ill health and an independent registered medical practitioner certifies that it's unlikely that you'll be able to work (in any capacity) before your State Pension Age, there's no AA tax charge on the ill health retirement benefits, even if your benefits are enhanced.

You're most likely to be affected by the AA tax charge if you:

- Have a lot of scheme membership that is linked to final salary and you've had a significant pay increase
- Pay high levels of AVCs or APCs, or have been awarded a lot of additional pension in the LGPS by your employer
- Transferred a pension into the EAPF from another public sector scheme that takes part in the public sector transfer 'club' and your new salary is much higher than in your previous employment
- Combined previous LGPS final salary service with your current EAPF service and your new salary is much higher than in your previous employment.

We'll inform you automatically before 6 October, following the end of the relevant tax year, if your LGPS pension savings in a PIP are more than the AA. We'll also tell you how much the value of your LGPS benefits have increased during a PIP, plus the amount of any AVCs you've paid during that PIP.

What happens if my pension savings increase by more than the AA?

If you exceed the AA in any year, you're responsible for reporting this to HMRC on your self-assessment tax return. You'll also have to pay a tax charge (at your marginal rate) on the amount that the increase in your pension savings for the tax year, less any unused allowance from the previous three years, is more than the AA.

If you've an AA tax charge and your pension savings in the LGPS alone have increased in the tax year by more than the AA, you may ask the EAPF to pay some or all of the tax charge on your behalf; this option is called Scheme Pays. The tax charge would then be recovered as a deduction from your pension benefits.

Please note that you'll **have the right** to use Scheme Pays (known as Mandatory Scheme Pays) if all of the conditions, set out below, are met:

- the AA tax charge is £2,000 or more;
- the AA tax charge is for pension savings above £40,000 in the LGPS alone; and
- you elect for Scheme Pays no later than 31 July of the following tax year in which the AA charge relates (e.g. for a charge in the 2017/18 tax year, you must elect for scheme pays by 31 July 2019)

However, if you're retiring and become entitled to all of your benefits from the LGPS and you want the EAPF to pay some or all of the tax charge on your behalf (with the relevant deduction being applied to your benefits), you must tell Capita (our administrators for the EAPF) before you become entitled to those benefits. Capita will be able to tell you more about this and the time limits that apply.

If you've an AA tax charge to pay, but you **don't have the right** to use Mandatory Scheme Pays, you may still be able to elect for Scheme Pays, though only if the EAPF agrees to your request (if agreed, this is known as Voluntary Scheme Pays). If this applies to you, you may apply in writing to Capita, giving the reasons for wanting to use Voluntary Scheme Pays.

For more information on both Mandatory and Voluntary Scheme Pays, please see our 'Annual Allowance Scheme Pays – Questions & Answers' factsheet at **www.eapf.org.uk/publications.** You can also use our online 'Scheme Pays click tool' at **www.eapf.org.uk/schemepays** to see how to apply.

Example showing the increase in pension savings for an active member of the LGPS throughout 2016/17

Working out the opening value of the member's benefits for 2016/17 - at 5 April 2016

Pensionable pay for the year to 31 March 2015	= £59,000
Pensionable pay for the year to 31 March 2016	= £60,000
Pensionable pay for 1 to 5 April 2016 (5 days)	= £847
Pensionable pay for final salary benefits	= £60,000

Scheme membership = 16 years & 5 days (8 years in the old 80ths scheme, 6 years in the 60ths scheme and 2 years & 5 days in the CARE scheme)

The career average pension is revalued by CPI; the CPI to apply for 1 April 2015 and 1 April 2016 is 1.2% & -0.1% respectively

The actuarial increase (determined by the Government) is 0%

			£
Annual pension	8 / 80 x £60,000	=	6,000
	6 / 60 x £60,000	=	6,000
	(£59,000 / 49) + 1.2% - 0.1%	=	1,217.31
	(£60,000 / 49) - 0.1%	=	1,223.27
	£847 / 49	=	17.29
Total annual pension			**14,457.87**
Multiply by 16			231,325.92
Add lump sum	8 x 3 / 80 x £60,000		18,000
			249,325.92
Appropriate percentage			+ 0%
To give an opening value of			**249,325.92**

Do not add into the opening value any AVCs paid

You'll see below how we work out the closing value of the member's benefits.

Working out the closing value of the member's benefits for 2016/17 - at 5 April 2017

Pensionable pay for the year to 31 March 2015 = £59,000
Pensionable pay for the year to 31 March 2016 = £60,000
Pensionable pay for the year to 31 March 2017 = £61,000
Pensionable pay for 1 to 5 April 2017 (5 days) = £861
Pensionable pay for final salary benefits = £62,000

Scheme membership = 17 years & 5 days (8 years in the old 80ths scheme, 6 years in the 60ths scheme and 3 years & 5 days in the CARE scheme).

The career average pension is revalued by CPI; the CPI to apply for 1 April 2015, 1 April 2016 and 1 April 2017 is 1.2%, -0.1% & 1% respectively

AVCs paid between 6 April 2016 to 5 April 2017 = £1,000

			£
Annual pension	8 / 80 x £62,000	=	6,200
	6 / 60 x £62,000	=	6,200
	(£59,000 / 49) +1.2% -0.1% + 1%	=	1,229.49
	(£60,000 / 49) -0.1% + 1%	=	1,235.50
	(£61,000 / 49) +1%	=	1,257.35
	£861 / 49	=	17.57
Total annual pension			**16,139.91**
Multiply by 16			258,238.56
Add lump sum	8 x 3 / 80 x £62,000		18,600
Add AVCs paid in this year			1,000
To give a closing value of			**277,838.56**

Working out the increase in value during 2015/16

The increase in the member's benefits over the year to 5 April 2017 is:

£277,838.56 - £249,325.92 = **£28,512.64**

Assuming the member's annual allowance is £40,000 (please see overleaf regarding the 'tapered annual allowance'), there is no AA charge for this period, as the increase in the member's benefits is less than £40,000.

In addition, the member has £11,487.36 unused AA from 2016/17 (£40,000 - £28,512.64) to carry forward to 2017/18.

Money Purchase Annual Allowance

Although LGPS rules do not allow payment of money purchase AVCs before payment of main scheme benefits, it's possible to transfer the AVCs out of the Scheme in order to flexibly access the benefits.

Individuals who flexibly access their AVCs or any other pension savings in a money purchase arrangement will trigger the Money Purchase Annual Allowance (MPAA) rules. The MPAA, which came into effect from April 2015, had a limit of £10,000, this reduced to £4,000, with effect from 6 April 2017; if the limit is exceeded for a tax year, then a tax charge will apply (unlike the AA, the MPAA excess can't be reduced by using any unused MPAA from previous years). Please note that the MPAA is included **within** your AA limit.

Transitional Rules for the 2015/16 Tax Year

The 2015/16 tax year was split into two mini tax years known as the 'pre-alignment tax year' and the 'post-alignment tax year', which ended on 8 July 2015 and 5 April 2016 respectively.

The AA for pension savings made during the PIP that ended on 8 July 2015 (pre-alignment tax year) was £80,000, plus any available carry forward.

The AA for pension savings made during the PIP that ended on 5 April 2016 (post-alignment tax year) is the amount of the £80,000 that was not used, subject to a maximum of £40,000, plus any remaining available carry forward from the 2012/13, 2013/14 and 2014/15 PIPs.

Members who weren't a member of a registered pension scheme during the pre-alignment tax year had an Annual Allowance of £40,000 for the post-alignment tax year.

Tapered annual allowance

Further reduction in the AA for high earners from April 2016

Changes to the AA regulations have introduced a 'tapered annual allowance' (TAA) from 6 April 2016 for those earning over £150,000 in a tax year, though, in practice, this may affect any member with a pensionable income of above £110,000 (known as the 'threshold income' – please see definition below).

Under the new regulations, the AA reduces by £1 for every £2 of 'adjusted income' that exceeds the £150,000 level, subject to a minimum AA of £10,000 (please see the definition of 'adjusted income', below).

Definition of 'Threshold income'

To give some assurance for scheme administrators and individuals who may be affected, and to ensure that lower paid individuals aren't affected by the addition of pension savings, the TAA restriction is subject to an income floor of £110,000. This is known as 'threshold income', which is broadly your taxable income after the deduction of your pension contributions (including AVCs deducted under the net pay arrangement).

Where an individual has threshold income of £110,000 or less, they can't be subject to the TAA restriction, regardless of the level of their adjusted income. Please note that anti-avoidance rules also apply.

Definition of 'Adjusted Income'

The income definition for the TAA is not the same as taxable or gross income, but does include the value of pension savings. This is known as 'adjusted income' and will ensure the restriction applies fairly and can't be avoided.

The calculation of adjusted income is fairly complex and starts by adding up all of an individuals' income that is subject to tax, such as income from employment, property and dividends, etc. Other specified items, including any member contributions and the value of 'employer contributions', are added in to understand if the adjusted income is greater than £150,000, and so subject to the TAA.

Calculating the value of employer contributions

For defined benefits arrangements such as the LGPS, this will involve working out the Pension Input Amount (the growth in your pension during the relevant tax year) for the arrangement in the tax year, using the normal AA rules. You'll then need to deduct from this figure, the total of any member contributions paid into that arrangement in the tax year.

Lifetime Allowance

What is the lifetime allowance?

The lifetime allowance (LTA) is the total value of all of the pension benefits you can have without you having to pay a tax charge when you draw them. If the value of your pension benefits when you draw them is more than the LTA, you'll have to pay tax on the excess benefits.

The LTA covers any pension benefits you may have in all tax registered pension arrangements – not just the LGPS. This doesn't include any state retirement pension, state pension credit or any survivor's or dependant's pension you may be entitled to.

The LTA for 2015/16 was £1.25 million, but was reduced to £1 million from 2016/17. The current LTA for 2018/19 is £1.03 million. Most people won't be affected by the LTA charge, as they won't have pension savings of more than £1.03 million.

How can I work out if I could be affected by the reduced LTA?

To work out the capital value of pension benefits (for LTA purposes) that start to be drawn after 5 April 2006, you multiply your pension by 20 and add any lump sum you draw from the pension scheme. As an example, and to give you a general idea, an LGPS pension of £45,000 per year and a lump sum of £100,000 would be equivalent to a capital value of £1 million.

For pensions already in payment before 6 April 2006, the capital value of these pensions is calculated by multiplying the annual rate of the pension* at the time that you first start to draw other pension benefits after 5 April 2006 by 25. Any lump sum already paid is ignored in the valuation.

*including any pensions increase up to that date

When any LGPS benefit, or any other pension benefit in another arrangement you have, is put into payment you use up some of your LTA, so even if your pensions are small you should keep a record of the amount of LTA used up.

What happens if the value of my pension benefits is more than the LTA?

If your LGPS benefits are more than your LTA you'll have to pay tax on the excess. If excess benefits are paid as a pension the charge will be 25%, with income tax deducted on the ongoing pension payments. If the excess benefits are taken as a lump sum they'll be taxed once only at 55%.

Are there any protections from the LTA tax charge?

When the LTA was introduced from 6 April 2006, the two main protections for benefits accrued up to that date were Primary and Enhanced Protection. To be eligible for any of these protections you must've met the conditions required and registered with HMRC by 5 April 2009. If you already have Primary or Enhanced protection, you shouldn't be affected by the reduction in the LTA.

Reduction to LTA in 2012/13

When the LTA was first reduced from £1.8 million to £1.5 million in 2012/13, HMRC introduced an additional form of protection called Fixed Protection 2012 ('FP2012'). With FP2012, your LTA is fixed at £1.8 million rather than the standard LTA. However, if in the future the standard LTA rises to be more than £1.8 million, your LTA will then be the higher standard LTA. You must've applied to HMRC before 6 April 2012 to have obtained FP2012.

You'll lose FP2012 if you start a new pension arrangement (other than to accept a transfer of existing pension rights), if your pension benefits increase by more than the cost of living increases, or if you pay contributions into a money purchase pension arrangement other than to a life assurance policy providing only death benefits that started before 6 April 2006. You'll also be subject to restrictions on where and how you can transfer benefits. It's a condition of FP2012 that the amount of benefit you can build up will be limited, so if you've FP2012, and wish to keep it, you would've needed to have stopped contributing membership by 5 April 2016. If you lose FP2012, you must inform HMRC within 90 days.

Reduction to LTA in 2014/15

The LTA was further reduced to £1.25 million from 6 April 2014, resulting in further protections being introduced known as Fixed Protection 2014 ('FP2014') and Individual Protection 2014 ('IP2014'). FP2014 is similar to FP2012, and enabled you to fix your LTA up to a maximum of £1.5 million, meaning you can have pension savings up to £1.5 million without paying a LTA charge. You couldn't have FP2014 if you already have Primary, Enhanced or FP2012 and you must've applied to HMRC before 6 April 2014.

As well as holding FP2014, you may also hold IP2014. IP2014 has effect from 6 April 2014 for those who already had pension savings of over £1.25 million on 5 April 2014 and gives you a protected LTA up to a maximum of £1.5 million. You must've applied to HMRC before 6 April 2017 to have obtained IP2014.

Please note that you'll lose FP2014 if you build up any benefits after 5 April 2016.

Reduction to LTA in 2016/17

As the LTA was further reduced to £1 million from 6 April 2016, further protections were introduced known as Fixed Protection 2016 ('FP2016') and Individual Protection 2016 ('IP2016'). The 2016 protections protect your personal LTA up to £1.25 million in the same way as the 2014 protections did. You can only apply for these protections online and there will be no closing date for applications.

Please note that, if you wish to apply for FP2016, you'll lose this protection if you build up any benefits after 5 April 2016.

Applying for Fixed and Individual Protection 2016

HMRC have introduced an online self-service for pension scheme members to apply for IP2016 or FP2016. Once you've successfully applied for protection, the online service will provide you with a reference number, which you'll need to keep and give to Capita.

Before applying you'll need:

- An account for HMRC online services - you can set one up when you start your application
- To know what your pension(s) were worth on 5 April 2016 and a breakdown of the amount

If you don't know this information, you can ask your pension scheme administrator. If you've more than one scheme, add the amounts from each scheme together.

For more information or to apply online, please visit **https://www.gov.uk/guidance/pension-schemes-protect-your-lifetime-allowance**

It's important to remember that most people will be able to save as much as they wish with full tax relief as their pension savings will be less than the annual and lifetime allowances.

More information

We hope you find this information helpful. Further information on the tax rules is available on HM Revenue and Customs website at:

http://www.hmrc.gov.uk/pensionschemes/understanding-aa.htm
http://www.hmrc.gov.uk/pensionschemes/pension-savings-la.htm

General information on the Local Government Pension Scheme can be found at **www.eapf.org.uk** and **www.lgps.org.uk**

Contact details

Capita look after the day to day administration the Scheme and will be your main point of contact for any questions you have about your benefits. You can contact them by:

- Using the '**contact us**' button on the website at **www.eapf.org.uk**
- Emailing **info@eapf.org.uk**
- Calling **0800 1216593**
- Sending your query to: **Capita, 11b Lingfield Point, Darlington DL1 1AX**

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