Environment Agency
Pension Fund

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The tax controls on pension savings

About this guide

The Environment Agency Pension Fund (EAPF) is part of the Local Government Pension Scheme (LGPS) and is governed by the LGPS regulations. This guide is for all employees who have joined the Local Government Pension Scheme (LGPS) and who want to know more about the tax issues that affect their pensions savings.

The 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 and reduced again in April 2014 to its current level of £40,000. The AA also applies in the year you take your benefits, although there's an exemption in the case of severe ill health retirement or on death.

The period over which pension savings are measured (known as the Pension Input Period, or PIP) is the same as the tax year and runs from 6 April to 5 April. 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 that tax year.

Even if the value of your pension savings increase by more than the AA in a year, you may not have to pay an AA tax charge. This is because you can use any unused AA from the last three years (known as Carry Forward) to offset any excess savings in the current year.

For example, if the value of your pension savings for a tax year increase by £60,000 (£20,000 more than the standard AA for 2020/21), but in the three previous years had increased by £25,000 (2019/20), £28,000 (2018/19) and £32,000 (2017/18), then the total 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'd 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.

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 to offset any excess.

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 tax year (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 tax year (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 tax year + CPI (the opening value); and

b) The value of your benefits at the end of the tax year (the closing value) including any contributions you've paid into the EAPFs in-house 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.

What happens if I transfer a previous pension into the EAPF?

If you elect to transfer pension rights into the LGPS from a public service pension 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 EAPF service, then any increase in value to your earlier benefits will count towards your pension savings.

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

What happens if I've a Pension Sharing Order following divorce or dissolution of a civil partnership?

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 is implemented.

What happens if I retire due to permanent ill health?

If you retire on the grounds of permanent ill health and an independent registered medical practitioner certifies that it's unlikely 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's 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 service pension 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 that tax year were more than the AA. We'll also tell you how much the value of your LGPS benefits have increased by and the amount of any AVCs you've paid during that tax year.

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

If you exceed the AA in any year and you're unable to offset the whole of the excess against your carry forward of unused allowance, 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 have an AA tax charge, 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 you meet all of the conditions set out below:

- 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 2019/20 tax year, you must elect for scheme pays by 31 July 2021)

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 have an AA tax charge to pay, but you **don't have the right** to use Mandatory Scheme Pays, you may still 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	=	6,000.00
	6 / 60 x £60,000	=	6,000.00
	(£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		18,000.00
			249,325.92
Appropriate percentage			+ 0%
To give an opening value of			**249,325.92**

We don't include any AVCs paid into the opening value

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	=	6,200.00
	6 / 60 x £62,000	=	6,200.00
	(£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		18,600.00
Add AVCs paid in this year			1,000.00
To give a closing value of			**277,838.56**

Working out the increase in value during 2016/17

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

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

This member has an annual allowance of £40,000 so 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 don't allow payment of money purchase AVCs before payment of main scheme benefits, it's possible to transfer the AVCs out of the scheme where they can be accessed flexibly.

If you choose to access your AVCs flexibly or any other pension savings in a money purchase arrangement you'll trigger the Money Purchase Annual Allowance (MPAA). 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 you exceed this limit by paying AVCs or contributions into another money purchase arrangement, 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 standard AA limit of £40,000.

Transitional Rules for 2015/16

Before 1 April 2015 pension savings in the LGPS were measured from 1 April to 31 March. From 1 April 2015 arrangements were made to move all pension saving assessments so that they aligned to the tax year. Please contact Capita if you need more information about the way pension savings were valued in 2015/16.

Tapered annual allowance

Further reduction in the AA for high earners from April 2016

From 6 April 2016 changes to the AA rules introduced a 'tapered annual allowance' (TAA) that could affect people with a taxable income above the 'threshold income' (please see definition below).

Under the new rules, the standard AA reduces by £1 for every £2 of 'adjusted income' (please see the definition of 'adjusted income', below). If you've got adjusted income over £150,000 for any tax years between 2016/17 and 2019/20 or if you've got adjusted income over £240,000 for tax years 2020/21 onwards, your AA will be tapered and subject to the following minimum amounts.

Tax year(s) applicable	Threshold Income	Adjusted Income – tapering starts	Minimum Tapered Annual Allowance	Maximum Reduction in AA
2016/17 – 2019/20	£110,000	£150,000	£10,000	£30,000
2020/21 onwards	£200,000	£240,000	£4,000	£36,000

Definition of 'Threshold income'

'Threshold income', is broadly equal to your taxable income after the deduction of your total pension contributions (including any AVCs you've paid into the EAPFs in-house AVC) in a tax year.

If your threshold income is £110,000 or less (2019/20 limit), you won't be subject to the TAA restriction, regardless of the level of your adjusted income. For the year 2020/21 onwards the threshold income limit rises to £200,000. Please note that anti-avoidance rules also apply.

Definition of 'Adjusted Income'

In broad terms your 'adjusted income' is generally your threshold income plus the value of your pension savings.

If you exceed the standard AA we'll send you a pension savings statement which will tell you the value of the pension savings you made during the tax year that will count towards your adjusted income.

Lifetime Allowance

What is the lifetime allowance?

The lifetime allowance (LTA) is the total capital value of all of the pension benefits you can have without 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. However, 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 currently increases each year in line with the rise in the Consumer Prices Index. The current LTA for 2020/21 is £1,073,100. Most people won't be affected by the LTA charge, as they won't have pension savings of more than £1,073,100.

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 in payment 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.

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 remaining 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 built up to that date were Primary and Enhanced Protection. To be eligible for any of these protections you must have 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 have 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 have lost FP2014 if you built 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, you can't apply for FP2016 if you built up any benefits after 5 April 2016 as you would not meet the requirements for keeping this protection.

Applying for Fixed and Individual Protection 2016

HMRC 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 have more than one scheme, add the amounts from each scheme together.

For more information or to apply online, please visit **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

If you have any questions regarding your pension entitlement you can contact our pension administrator, Capita, by:

- Using the '**Contact the EAPF**' button on the website at **www.eapf.org.uk**
- Emailing **info@eapf.org.uk**
- Following on twitter **@EAPensionFund**
- Calling **0800 121 6593** **+44 114 452 5008 (overseas)**
- Sending your query to **Capita** **11b Lingfield Point** **Darlington, DL1 1AX**