



Derbyshire
Pension
Fund

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Annual allowance: Factsheet for LGPS members

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Contents

Introduction	3
What is the annual allowance?	3
Will I be affected by the annual allowance?	3
The 50/50 section of the LGPS	4
How the annual allowance is calculated	4
Carry forward	5
Changes to the annual allowance	5
1. Tapered Annual allowance for higher earners	6
2. Aligning the 'Pension Input Period' with the tax year	8
Annual allowance 'flexible benefit' access	9
How to pay an annual allowance tax charge	10
More information for affected members	10
Disclaimer	10

Introduction

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 available at www.derbyshirepensionfund.org.uk/LTA.

What is the annual allowance?

The annual allowance 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 annual allowance 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 annual allowance 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 scheme¹ 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 scheme¹ 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 annual allowance in any year ending 5 April, Derbyshire 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 annual allowance 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 50/50 by visiting www.derbyshirepensionfund.org.uk/50-50.

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: <https://www.moneyadvice.service.org.uk/en/articles/choosing-a-financial-adviser>.

How the annual allowance is 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 annual allowance then you may have to pay a tax charge.

It is important to note that the assessment for the annual allowance 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 annual allowance 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 annual allowance by, even though you did not breach the annual allowance in either scheme.

Carry forward

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

For example, if the value of your pension savings in 2019/20 increased by £50,000 (i.e. by £10,000 more than the annual allowance) 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 annual allowance for those three years would more than offset the £10,000 excess pension saving in the current year. There would be no annual allowance tax charge to pay in this case.

To carry forward unused annual allowance 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 annual allowance 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 annual allowance is tapered for high earning individuals. The annual allowance 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 annual allowance is tapered down by £1. Your annual allowance cannot be reduced below the minimum that applies. The limits that apply changed for the 2020/21 year. Table 2 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 annual allowance	If your annual allowance is tapered, the minimum annual allowance that can apply	£10,000	£4,000

Threshold income includes all sources of income that are taxable e.g. 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 annual allowance by £1 for £2 of adjusted income received over £240,000, until a minimum annual allowance of £4,000 is reached. This means that from 6 April 2020 the annual allowance for high earners is as follows:

Table 3 - The tapered annual allowance 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 annual allowance 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 annual allowance is tapered for the 2019/20 year.

Tapered annual allowance	£21,186*
In excess of annual allowance	£21,263 (£42,449 - £21,186)
Annual allowance tax charge @ marginal rate	£8,505.20 (marginal rate of 40% assumed)

* Taper = £187,629 - £150,000 = £37,629 ÷ 2 = £18,814 (rounded down)

Standard annual allowance £40,000 - £18,814 = tapered annual allowance £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 annual allowance will not be tapered in 2020/21.

Cerys's pension savings will be measured against the standard annual allowance of £40,000.

Standard annual allowance	£40,000
Pension savings in excess of annual allowance	£31,837
Annual allowance tax charge at marginal rate assumed)	£14,327 (marginal rate of 45%)

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 annual allowance will be tapered for the 2020/21 year.

Tapered annual allowance	£18,840*
In excess of annual allowance	£49,731
Annual allowance 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 annual allowance £40,000 - £21,160 = £18,840

Please note, examples 1, 2 and 3 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 annual allowance during this period is £80,000

Post-alignment tax year: 9 July 2015 to 5 April 2016 - the annual allowance 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 Derbyshire 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 rules may apply. However, the money purchase annual allowance will only apply if your total contributions to a money purchase arrangement in a Pension Input Period exceed the money purchase annual allowance.

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 money purchase annual allowance. If your contributions exceed the money purchase annual allowance your defined benefit pension (LGPS) savings will be tested against the alternative annual allowance and you will pay a tax charge in respect of your money purchase saving in excess of the money purchase annual allowance.

Table 5: The money purchase annual allowance

Tax Year	Money purchase annual allowance	Alternative Annual allowance If money purchase annual allowance 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 Derbyshire Pension Fund for more information: www.derybshirepensionfund.org.uk/contactus.

If you access flexible benefits, you will be provided with a flexible access statement; you should provide Derbyshire 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 protection².

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

How to pay an annual allowance tax charge

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

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

If you have an annual allowance 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 annual allowance, 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 annual allowance tax charge on your behalf, you must notify Derbyshire Pension Fund no later than 31 July in the year following the end of the year to which the annual allowance 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.

At Derbyshire Pension Fund's discretion, we may also agree to pay some or all of an annual allowance charge on your behalf in other circumstances, e.g. where your pension savings are not in excess of the standard annual allowance but are in excess of the tapered or money purchase annual allowance, or where part of the charge relates to pension savings outside of the LGPS.

More information for affected members

If you think you are affected by the annual allowance, you can find more information about pension tax and the annual allowance on the government's website:

<http://www.gov.uk/tax-on-your-private-pension/annual-allowance>.

If you are unsure if you will be affected by the annual allowance, you can use the annual allowance quick check tool on the LGPS member website: <https://www.lgpsmember.org/more/annual-allowance-quick-check-tool.php>.

Disclaimer

This factsheet provides an overview of the annual allowance rules at April 2020. It should not be treated as a complete and authoritative statement of the law. The rules governing annual allowance 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 at <https://www.moneyadviceservice.org.uk/en/articles/choosing-a-financial-adviser>.