From Pensions Section, Falkirk Council

This note is to alert you to a possible change in tax rules that is being **considered** by the UK Government.

The proposed change only affects pension scheme members and even then would only apply in certain circumstances. Just to be clear, the tax charge discussed in this e-mail is **not** income tax but a special tax on excess pensions growth.

UK tax legislation contains an element known as the ***Annual Allowance****.* This is the amount by which your pension pot may grow each year before you become liable for a tax charge. The current allowance is £255,000 and is set at such a high level that only a very small number of highly paid people would ever be liable for a tax charge.

The Government is considering reducing the Annual Allowance to between £30,000 and £45,000. This is a level at which **higher earners** in most schemes and **medium earners** in fast accrual schemes such as the Police and Fire Pension Schemes could be affected. The proposals are being considered as an alternative to some of the tax raising provisions introduced by the previous Government.

The closing date for responses to the consultation is 27th August, 2010. Details of the Government discussion paper can be viewed at:

http://www.hm-treasury.gov.uk/d/consult_pensionsrelief_discussion.pdf

The following text explains the issue in more detail:

Annual pensions growth is **currently** calculated as follows:
1. Take the value of your pension at the start of the year (e.g. April,2010), multiply it by 10 and add on any lump sum value.
2. Take the value of your pension after a year (e.g. April, 2011), multiply it by 10 and add on any lump sum value.
3. Subtract [1] from [2]
4. Add on the cash value of any AVC's made during the year.

As well as proposing to reduce to the Annual Allowance to between £30 and £45k, the Government is also considering whether an uplift factor of between 15 and 20 would be more appropriate than the current factor of 10.

There are a number of factors that can lead to there being an increase in pensions growth, namely:
- An increase in pensionable pay.
- Additional scheme membership accumulated during the year
- Any AVC's paid during the year.
- Any membership enhancements awarded on cessation (e.g. ill health enhancement, but not compensatory added years).

Here is a sample calculation of the Annual Allowance for someone with 20 years membership on a salary of £75,000. (For ease of illustration, it is assumed that all membership is based on 60ths). It is assumed that the "uplift factor" is 15:

Start of Year (April 2010)	20/60ths x £75,000 =	£25,000 x 15 =	£375,000
End of Year (March 2011)	21/60ths x £76,000 =	£26,600 x 15 =	£399,000
Annual Allowance Increase			£24,000

The increase of £24,000 is below the minimum threshold being considered by Government. However, if the factor were to be set at 20 the increase in the Annual Allowance would be £32,000, which could trigger a potential tax charge. The proposed tax charge would be tax at the employee's marginal tax rate on the excess increase above the minimum value. In this example, the charge could be 40% of £2,000 (£32,000 less £30,000), i.e. £800.

Another scenario which could give rise to the tax charge is that of ill health retirement. This type of retirement usually involves the award of additional membership which boosts a member's benefits and could even propel a lower earner into tax charge territory.

To sum up, if the proposals come to fruition it is possible that higher earners could face an (annual) tax charge on their pensions growth. In addition, some lower paid employees – irrespective of salary – may also be affected depending on their circumstances.

Pensions Section
13th August, 2010.