

## Pensions and Taxation – Update October, 2010

I would like to bring your attention to some **important** announcements made recently by the Coalition Government regarding pensions and taxation.

As part of the so-called simplification of pension scheme tax rules in 2006, HM Revenue and Customs (HMRC) introduced the concepts of **Lifetime Allowance** and **Annual Allowance**.

The Lifetime Allowance operates so that if the capital value of a person's accumulated pension rights is greater than the lifetime limit (currently £1.8m), they are obliged to pay tax on the excess above the limit. The Annual Allowance works in a similar fashion, except that it compares the annual growth in a person's pension rights against an annual limit (currently £255k) and where the limit is exceeded, tax is due on the excess. In each case, the tax is the responsibility of the individual.

Since 2006, the limits have operated at such a high level that very few members of public sector pension schemes have been affected.

The Coalition Government have announced that they intend to:

- Reduce the **Lifetime Allowance** from £1.8m to £1.5m (from April, 2012); and
- Reduce the **Annual Allowance** from £255k to £50k (from April, 2011)

The reduction in the Lifetime Allowance to £1.5m will only affect a small number of higher paid individuals. Such persons may wish to take advice from specialist tax consultants on the implications and how best to protect their positions.

The reduction in the Annual Allowance could affect a larger number of individuals if:

- they have a significant increase in pensionable pay; or
- pay large amounts of AVCs; or
- have a large amount of pensionable service; or more probably
- a combination of the above

The annual allowance test is to be determined by calculating the value of pension rights at 31st March and subtracting the value of the rights at the previous 31<sup>st</sup> March. The value of the pension rights at each 31<sup>st</sup> March is to be calculated by multiplying the annual pension amount by a factor of 16, then adding on any lump sum entitlement and the value of any AVCs contributed during the year. In making the comparison between current and previous year, it will be permitted to revalue the pension at the previous 31<sup>st</sup> March by the intervening rise in the Consumer Price Index – thus reducing the extent of any growth.

The Government have stated that it is not their intention that individuals with a one-off spike in salary should be unduly penalised and for that reason will allow unused allowances from three previous years to offset any subsequent excess.

The following points are also relevant:

- There is no proposal to increase the £50k threshold until at least 2014/15
- The first year of assessment against the £50k will be 2011/12. First bills will be due in January, 2013.
- For individuals with a very significant increase in their pension rights in a specific year, the Government will consult on options to allow them to pay their tax charge out of their pension rather than current income.
- The Government will look to exempt ill-health benefits from the Annual Allowance test.

- The Government will not exempt redundancy/efficiency retirements from the Annual Allowance test. However, it remains unclear exactly what this means and whether the value of Strain Payments and Compensatory Added Years will have to be counted in the assessment of annual pensions growth.
- Where individuals have exceeded the threshold, pension schemes must provide members with details of their pensions growth within six months of the end of the tax year.
- Details of the proposals are available at [http://www.hm-treasury.gov.uk/d/restricting\\_pensions\\_summary141010.pdf](http://www.hm-treasury.gov.uk/d/restricting_pensions_summary141010.pdf)

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