

SUBJECT:

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**CHANGES TO THE TREATMENT OF TAX RELIEF
FOR PENSIONS**

DATE OF ISSUE:

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AUDIENCE:

- Principals, Vice-Principals and Teachers in grant-aided schools;
- Boards of Governors of all Grant-Aided schools;
- Education and Library Boards;
- Council for Catholic Maintained Schools;
- Institutes of Further Education; and
- Other Interested Bodies.

SUMMARY OF CONTENTS:

This Circular provides information about changes to the treatment of tax relief for pensions.

ENQUIRIES:

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STATUS OF CONTENTS:

Advice
Information for Teachers

RELATED DOCUMENTS:

**SUPERSEDED
DOCUMENTS:**

EXPIRY DATE:

Not applicable

DE WEBSITE:

This Circular is available on
<http://www.deni.gov.uk>

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PENSION NOTICE

IMPORTANT PENSIONS NOTICE TO ALL TEACHERS

CHANGES TO THE TREATMENT OF TAX RELIEF FOR PENSIONS

The UK Government is introducing changes to the way pensions are taxed which are aimed at restricting the tax relief granted to the most highly paid.

Pensions tax relief is regulated by -

- An Annual Allowance (AA), which is the maximum amount by which the value of an individual's total pension rights can increase in any one year before they are liable to pay additional income tax. The Annual Allowance is currently £255,000 in 2010-11, and
- A Lifetime Allowance (LTA) which is the total value of all pension benefits (except the State pension) that can be taken by an individual without paying extra tax. Pension benefits are tested against the LTA at the time that the member takes their pension benefits. The Lifetime Allowance is currently £1.8m in 2010-11.

Changes to the Annual Allowance (AA)

- From the tax year 2011-12 the Annual Allowance (AA) will be reduced from its current level of £255,000 to £50,000.
- Defined benefit pensions for the Annual Allowance test will be valued at a factor of 16:1 plus any automatic lump sum. (They are currently valued at 10:1 in 2010-11). This means that an increase of £1,000 in pension accrued in year will count as £16,000 plus the actual amount of increase in any automatic lump sum.
- The Annual Allowance will now apply in the year of retirement.
- An individual who has a one-off spike in their pension accrual will be able to carry forward unused Allowance from the previous 3 years to off-set the effect of the increase against the £50,000 limit.
- There will be an exemption from the Annual Allowance test for some ill-health early retirement pensions and deferred pensions.

The vast majority of members will not be affected by the new AA. However, those earning over £150,000 or those who receive a significant pay rise as a result of being promoted to a senior role may be affected by the reduction in the AA. The AA is based on the growth in the value of your benefits.

Members whose pension entitlement increases by more than £3,125 (which is the AA of £50,000 ÷ by the factor of 16) after inflation in the year tested against AA, will exceed the £50,000 limit. However, the introduction of the ability to “carry forward” unused allowances from the 3 previous years may mitigate the effect of the change. Any member ultimately exceeding the AA limit will be liable for a tax penalty which will either be paid directly by the member or by adjustment to pension benefits.

Final confirmation is still awaited on a number of issues such as the responsibility for payment of the tax penalty, but it is likely that the AA test will not be applied in the year of death or in the case of lump sums paid as a result of a terminal illness. The Government is still considering whether enhancements awarded due to serious ill health will be tested against the AA and whether the conditions which permit Total Incapacity Benefit will meet the HMRC test of severe ill health. Members who have left the scheme and have deferred taking their preserved benefits will also not be affected by the AA test (unless they are accrued in the current Pension Input Period).

The current exemption which applies to accruals (the build up in pension) in the year up to retirement will be removed and it is still unclear whether additional compensation paid by the employer will affect the AA.

Changes to the Pensions Lifetime Allowance (LTA)

From 6 April 2012, the Lifetime Allowance LTA will reduce from £1.8m to £1.5m. This may affect members who have either (a) an annual pension of over £65,217 plus the standard lump sum or (b) an annual pension of £75,000 before taking a lump sum.

Members who think they may be affected by the changes are advised to seek independent financial advice.

Further information on Pensions Tax relief can be obtained from the HM Treasury website: http://www.hm-treasury.gov.uk/consult_pensionsrelief.htm

HMRC have created a webpage which may be useful entitled “How does the reduced annual allowance affect me?” and is available at:
<http://www.hmrc.gov.uk/pensionschemes/annual-allowance/reduced.htm>

PENSION TAX CHANGES – FEBRUARY 2011 QUESTIONS & ANSWERS FOR TEACHERS

The Government has announced some major changes to the pensions and tax regime.

- 1 From tax year 2011-12, the Annual Allowance (AA) for tax-privileged saving will be reduced from its current level of £255,000 to £50,000 (and the basis of calculation will change)**
- 2 From 6 April 2012, the Lifetime Allowance (LTA) will be reduced from its current level of £1.8m to £1.5m**
- 3 Individuals will be able to carry forward three years of unused AA.**

The following Q&A seek to explain these changes and the impact that they may have. Please note however that the Government is still consulting on a number of elements of the changes and that definitive answers are not yet available to all questions.

ANNUAL ALLOWANCE

Q I am not a high earner. Surely none of this means anything for me?

A The changes are most likely to affect those on higher salaries but could also affect members who get significant pay rises.

You will be affected if your “deemed contributions” exceed your AA in any tax year from 2011-12 onwards. If you don’t use up all of your AA in a year you can carry forward up to three years of unused AA.

Q What are “deemed contributions”?

A Deemed contributions are the total of:

- contributions you pay to a money purchase scheme such as the AVC Scheme, the **partnership** pension account, a stakeholder pension or to a personal pension; plus
- the value of benefits you have built up in any defined benefit scheme such as the Northern Ireland Teachers’ Pension Scheme (NITPS). This is calculated as:
 - 16 times the pension built up in the year, plus
 - the increase in any automatic lump sum over the year.

For the purpose of this calculation benefits earned in a defined benefit scheme in a year (known as the input period) are assumed to be total benefits

less benefits at the end of the previous input period, revalued in some way (for example in line with inflation).

Q How does the Annual Allowance work?

A The Annual Allowance is the amount of deemed contributions you can make to tax-relieved pensions before incurring a tax charge. This includes deemed contributions to defined benefit schemes such as NITPS and actual contributions by you and your employer to a defined contribution scheme (such as a **partnership** pension account or AVCs with Prudential). For defined benefit schemes, deemed contributions will be calculated by reference to benefits built up during the pension input period:

$$\text{Deemed contributions} = 16 \times [P1 - P0 \times (1 + r)] + L1 - L0 \times (1 + r)$$

where:

P1 = amount of pension at the end of the pension input period

P0 = amount of pension at the start of the pension input period

r = revaluation factor (assumed to reflect inflation)

L1 = amount of any lump sum at the end of the pension input period

L0 = amount of any lump sum at the start of the pension input period

Q What happens if my deemed contributions exceed the Annual Allowance?

A Any excess (ie after offsetting the Annual Allowance and any eligible unused Allowance from previous years) will be added to your taxable income for the tax year in question and subject to income tax in the normal way.

Q What is the pension input period?

A For the NITPS the pension input period runs from 1 April to 31 March. The pension input period relevant for tax year 2011-12 (the first year for the new tax regime) is the year 1 April 2011 to 31 March 2012.

Q It seems very unfair to hit me with a tax charge just because I got a promotion

A If you don't use up all your Annual Allowance for any tax year you can carry the unused allowances forward for up to three tax years. This will help protect people who wouldn't normally breach the Annual Allowance. Notional amounts, based on an assumed AA of £50,000, will apply for tax years 2008-09, 2009-10 and 2010-11 for use in 2011-12.

Q I have a deferred pension in another pension scheme. What happens to that?

A Deferred pensions are exempt from the new AA regime.

Q Are there any exemptions to the AA?

A Unlike under the previous (current) arrangements the Annual Allowance test will also apply in the year of retirement. The AA will not apply in the year of death or in the case of pensions or lump sums paid where individuals are diagnosed with serious (terminal) ill-health. The Government has indicated that it will consider exempting other ill-health retirement benefits from the AA test.

LIFETIME ALLOWANCE

Q Remind me how the Lifetime Allowance works.

A Everyone has a Lifetime Allowance (LTA). Whenever you draw a pension (on retirement) you use up some LTA. Once you have used up all of your LTA, LTA tax is payable. Pensions are generally valued using a factor of 20, but a factor of 25 applies to any pension which came into payment before 6 April 2006 (see example below). The LTA is currently £1.8m

Q I am planning to retire in March 2014. While my pension is worth less than £1.5m now, I estimate it will be worth around £1.6m in 2014, so I had expected to be clear of LTA tax. Does this mean I have to bring my retirement forward to March 2012 to avoid being clobbered for tax?

A Treasury proposes to consult on transitional protection to protect people who have already built up pension pots between £1.5m and £1.8m. Details are not yet available but, as your benefits are currently less than £1.5m, you may not benefit from these measures. Decisions on retirement should be taken carefully; while tax is definitely one consideration, it is not the only one.