Annual Allowance

Policy for Tapered Annual Allowance

Background

HMRC legislation restricts the amount of pension a scheme member can accrue in a tax year. When it was first introduced in 2006 the level started at was £215,000 and by 2011 had increased to £255,000

However this rate was then cut considerable to £50,000 and a further reduction made down to £40,000 from the 2014/15 tax year.

As a result of these reductions more and more LGPS members were caught by this restriction.

In order to eradicate spikes where a member gained a sudden increase in pay such as a promotion, there is a protection of being able to offset any excess against any unused allowance from the three previous years,.

The Annual Allowance has to be assessed against all pension input amounts and the member has to make sure that all their pension arrangements (including outside arrangements) where increased benefits have been accrued during the year are included.

Where a member still exceeds the level there is a tax charge to be paid base on the member's marginal rate of tax. This must be reported on the member's tax return before the 31 January following the relevant year end.

If the amount of tax due is below £2,000 the member has to make the tax payment to HMRC themselves.

If it exceeds £2,000 the member can either pay the tax required in full or can request APF for Scheme Pays to apply for all or part of the amount due. If requested the Scheme has to accept this arrangement as it is mandatory. For any amount covered by the scheme pays arrangement the member's pension is adjusted when the benefits become payable.

A further complication has been added from the 2016/17 tax year whereby any member who's Threshold Income exceeds £110,000 and Adjusted Income exceeds £150,000 would have their Annual Allowance reduced by £1 for every £2 exceeded.

Any tax charge resulting from the reduction of the Annual Allowance is not covered by the mandatory scheme pays arrangement but can be included under voluntary scheme pays where the Fund can decide whether to agree or not.

It is considered best practice to have a policy to set out how requests on voluntary scheme pays will be administered by the Fund going forward. It will also provide clarity for Pension Administration and scheme members.

The Pension Committee are asked to approve a policy on whether to allow such requests and if so when such applications should be allowed.

The Tapered Annual Allowance

Commenced Tax Year 2016/2017

Threshold income of £110,000

•Under? -annual allowance automatically remains at £40,000
•Over? -calculate if tapered annual allowance applies

Adjusted Income of over £150,000

•£40,000 annual allowance reduced by
£1 for every £2 that adjusted income exceeds £150,000

•Maximum reduction to Annual allowance £30,000 leaving Minimum Annual Allowance of £10,000

Summary Definitions

Threshold Income		**If exceeds £110,000**		**➔**	**Adjusted Income £150,000**
Taxable income from all sources, less tax reliefs including pension contributions: Includes					**Threshold income plus:**
salary	**bonuses**	**pension income in payment**	**P11d earnings**		**total of any Defined Contributions in year – e.g. AVCs and FSAVCs**
interest on savings		**dividend payments**	**rental income**		**total pensions accrual in a Defined Benefit scheme –e.g. LGPS / FPS [Figure given on Pension Savings Statement**
salary sacrificed in pension arrangement set up or increased after 9/7/2015					

The Tapered Annual Allowance

Commenced 2016/2017

	Adjusted Income	Exceeds £150,000 by	Tapered Annual Allowance Calculation	Annual Allowance reduced by	Tapered Annual Allowance
A	£180,000	£30,000	£40,000 - £30,000 / 2 =	£15,000	£25,000
B	£210,000	£60,000	£40,000 - £60,000 / 2 =	£30,000	£10,000
C	£240,000	£90,000	£40,000 - £90,000 / 2 =	£45,000 but Maximum £30,000	~~-£ 5,000~~ Minimum £10,000

Example 1

Implications of Scheme Pays

Pension Input Amount	**£50,000**	**(excess standard AA £40,000 = £10,000)**	
Unused allowance (previous three years)	£25,000		
Revised amount	£25,000		
Tapered reduction £ 30,000			
Revised Annual Allowance	£10,000		
Excess Input amount	£15,000	if marginal rate = 45%	Tax due is £6,750
Excess Standard	£10,000	if marginal rate = 45%	Tax due is £4,500
Excess Remainder	£ 5,000	if marginal rate = 45%	Tax due is £2,250

The member can ask the Fund to pay the tax under Scheme Pays on Standard excess of £4,500 and this is mandatory
The member can ask for the Fund to pay the tax of £2,250 as scheme pays under voluntary scheme pays

The full effect of tapering and scheme pays may occur in subsequent years where there is no unused allowance and where the Standard Annual Allowance is not exceeded but there is full Tapering as in example 2

Example 2

To illustrate the full extent a possible following year could be

Pension Input Amount	**£40,000**	**(excess standard AA £40,000 = £0)**	
Unused allowance (used in previous year)	£ 0		
Revised amount	£40,000		
Tapered reduction £ 30,000			
Revised Annual Allowance	£10,000		
Excess Input amount	£30,000	if marginal rate = 45%	Tax due is £13,500
Excess Standard	£ 0	if marginal rate = 45%	Tax due is £0
Excess Remainder	£ 30,000	if marginal rate = 45%	Tax due is £13,500

The member cannot ask the Fund to pay the tax under mandatory scheme pays as there is no Standard Excess

The member can ask for the Fund to pay the tax of £13,500 as scheme pays under voluntary scheme pays

How Scheme Pays is recovered

Age 55	AA Tax Charge		GAD Scheme Pays Factor		Pension Offset (p.a.)	Based on receiving benefits at State Pension Age
Male	£13,500	/	11.36	=	£1188,38	Amount would be subject to CPI and also an adjustment if payment was not from State Pension Age
Female	£13,500	/	12.35	=	£1093.12	

So APF would pay tax and would not begin to receive anything back for 12 years and it would then take 13 -14 years on pension before it is fully recovered. There could be several years where this could happen [e.g. six similar scheme pays would mean the Fund paying out £81,000

Possible Reasons for and against Voluntary Scheme Pays

	Fund [employers]		Member	
	Pros	**Cons**	**Pros**	**Cons**
Calculations	Administration: Simplified as no split of tax charge required		Easier to Understand	
Recruiting	Employers may consider this could be bargaining tool in recruiting high level management			
Recovery		The Fund is already compelled to allow scheme pays for excess above Statutory Annual Allowance. Scheme Member can apply at any age and several times It will be many years before fully recovered and if member dies before pension starts no or very little recovery may occur Although it is a tax on a member, initially it is the Fund that takes the hit	Member is allowed a deferment in paying tax with full recovery not required until many years and in some instances may never fully repay	
Other		Tax where voluntary scheme pays applies has to be made by 31 January following the relevant tax year which is over a year before that under Mandatory Scheme Pays	Pension Offsets can be beneficial when assessing Lifetime Allowance	

Annual Allowance: Summary Notes

Avon Pension Fund must notify scheme member by 5th October following the relevant tax year if Standard Annual Allowance is exceeded

Scheme member must assess their Annual Allowance position once APF have notified them of any excess Pension input amount

They must consider all their pension arrangements and take into account any unused allowance for the previous 3 years

If they still exceed they must confirm to HMRC on Self-Assessment Tax Return

The tax payable must be calculated on their marginal tax rate, and a decision made as to whether they want to pay the tax directly or if it exceeds £2,000 whether they wish to apply for scheme pays.

Regardless of whether the standard Annual Allowance has been exceeded they must check whether Annual Allowance tapering applies in their case, firstly by checking whether their Threshold Income exceeds £110,000 and if it does then, whether their Adjusted Income is above £150,000.

If it exceeds then the annual allowance should be revised accordingly which will create or increase any excess Pension Input as a result of tapering must be assessed for tax

Whether Voluntary Scheme Pays is possible will be dependent on APF policy.

The current maximum tax payable in respect of tapering is 13,500 (£30,000 x 45% (current maximum tax rate))

For the Tax Year 2016/2017, the Scheme Member must submit a Self-Assessment Tax Return to HMRC by 31 January 2018 stating that there is an AA tax charge and if any will be met by Scheme Pays

For the Tax Year 2016/2017, the Tax payable under Mandatory Scheme Pays must be paid by the Fund by 14 February 2019

For the Tax Year 2016/2017, the Tax payable under Voluntary Scheme Pays must be paid by the Fund by 31 January 2018

Voluntary Scheme pays only applies for Scheme Members whose Adjusted Income exceeds £150,000 which although appears limited it is dependent on any other outside income that the scheme member is receiving unknown to APF.

A scheme member may be required to pay tax on any excess pension input on several occasions before receiving their pension benefits and there could be several separate scheme pay debits on a member’s record on crystallising their benefits.