FDA GUIDE TO PENSIONS TAX RELIEF
ANNUAL ALLOWANCE & LIFETIME ALLOWANCE
FEBRUARY 2016 UPDATE

This briefing provides an update to our guide to pension tax relief issued last year. In that guide we explain what the Annual Allowance ("AA") and Lifetime Allowance ("LTA") are and how they are calculated. We also provide some examples to help you check if you are affected.

The original FDA guide also mentioned that in his July 2015 Summer Budget, the Chancellor, George Osborne announced further changes to the Annual Allowance which will apply for the 2016-17 tax year together with transitional arrangements for the 2015-16 tax year.

In this update, we provide an example of how the transitional Annual Allowance of £80,000 will apply for the 2015-16 tax year, and remind you that the Lifetime Allowance will reduce from £1.25 million to £1 million with effect from 6 April 2016 and what protections are being put in place if this affects you.

Annual Allowance: Transitional arrangements for the 2015-16 tax year

The period over which the amount of pension saving in a pension scheme is measured is called the Pension Input Period ("PIP"). Following the 2015 Summer Budget, all pension schemes are required to align their PIP with the tax year.

In the civil service scheme, the PIP previously ran from 1 January to 31 December. Therefore, during the 2015-16 tax year, the PIP that started on 1 January 2015 is extended to 5 April 2016, with a split at midnight on 8 July 2015.

A transitional Annual Allowance of £80,000 will apply for the 2015-16 tax year, but subject to a maximum £40,000 allowance for pension savings from 9 July 2015 to 5 April 2106. There are therefore two tests that need to be carried out, one pre-July 2015 and one post-July 2015. This is shown in the diagram below:

For the 2015-16 tax year, Government have set the increase to use to "inflation proof" the value of your pension at the start of the PIP (1 January 2015) to the end of the PIP (5 April 2016) at 2.5%. The example that follows demonstrates how the transitional arrangement will affect the Annual Allowance calculation for the 2015-16 tax year.

Example: Transitional arrangements for 2015-16 tax year

On 1st January 2015, Henry has been employed in the Civil Service for 18 years and is a Deputy Director (SCS1) with a pensionable salary of £72,000. As a protected PCSPS member, he continues to build up pension in ***classic***, and has not yet transferred to ***alpha***. During 2015, he is promoted to Director (SCS2) with a pensionable salary of £86,000.

Step 1: Calculate the value at the start of the PIP (1st January 2015) and "inflation proof":

Pension = (£72,000 x (18 years)/80) = £16,200 pa

Lump sum = (3 x £72,000 x (18 years)/80) = £48,600

"Inflation proof" pension = £16,200 x 1.025 = **£16,605 pa**

"Inflation proof" lump sum = £48,600 x 1.025 = **£49,815**

Step 2: Calculate the value at the end of the PIP (5th April 2016):

Pension = £86,000 x (19 years and 3 months)/80 = **£20,694 pa**

Lump sum = 3 x £86,000 x (19 years and 3 months)/80 = **£62,081**

Step 3: Calculate the total increase in value over the PIP:

Pension = (£20,694 - £16,605) x 16 = £65,424

Lump sum = (£62,081 - £49,815) = £12,266

Total = £65,424 + £12,267 = **£77,690**

Step 4: Split the increase pre-July 2015 (189 days) and post-July 2015 (272 days):

Pre-July 2015 increase: £77,690 x 189/(189 + 272) = **£31,851**

Post-July 2015 increase: £77,690 x 272/(189 + 272) = **£45,839**

Note: If Henry had paid any Additional Voluntary Contributions ("AVCs") between 1 January 2015 and 5 April 2016, these would also need to be split between pre- and post-July 2015.

Step 5: Test against the Annual Allowance:

As the pre-July 2015 increase was less than £80,000, the first test is OK.

Although Henry had £48,149 unused pre-July 2015, he can only carry forward a maximum of £40,000 to test against his post-July 2015 increase. Because his Post-July 2015 increase exceeds £40,000, then unless he has unused allowance from the previous 3 tax years, Henry will be subject to a tax charge of £5,839 x 40% = £2,336.

Lifetime Allowance: Individual Protection 2016 and Fixed Protection 2016

Although we do not have full details as yet, we know that two protection regimes will be introduced as a result of the LTA reducing from £1.25m to £1m with effect from 6 April 2016. These will be Individual Protection 2016 and Fixed Protection 2016.

They are expected to work in a very similar way to Individual Protection 2014 ("IP2014") and Fixed Protection 2014. Further details on these protections were provided in the 2015 guide, including a reminder that the deadline to apply for IP2014 is **5 April 2017**.

To apply for Individual Protection 2016, it is expected that individuals will need to have pension savings worth at least £1m as at 5 April 2016. No such requirement is expected to apply for Fixed Protection 2016, but given that no further pension savings can be made with Fixed Protection (otherwise the protection is lost), individuals will want to have pension savings that are either above or expected to be above £1m in the future in order for it to be worthwhile applying.

Individuals will likely be able to apply for both forms of protection, with Fixed Protection taking precedent; Individual Protection would then come into effect if Fixed Protection were to be lost (for example, as a result of making further pension savings). With Individual Protection, there is no restriction on making further pension savings, but those additional pension savings would be subject to an LTA charge.

Although it is yet to be confirmed by HMRC, our interpretation is that Fixed Protection 2016 would provide individuals with a protected LTA of £1.25m and Individual Protection 2016 would provide individuals with a protected LTA of the

value of their pension savings as at 5 April 2016, subject to a maximum of £1.25m. Further details about these regimes are expected from HMRC later this year.

What is coming up?

On Wednesday 16 March 2016, the Chancellor will deliver his Budget speech. There have been rumours recently that he plans to implement a flat rate of pension tax relief somewhere between 25% and 33%.

This would mean that higher rate tax payers would see a reduction in the tax relief they receive on pension contributions in the future, and some higher rate tax payers have considered paying additional voluntary contributions ("AVCs") to take advantage of the current tax relief system – but if you are considering this, you should beware of the potential implications on the Annual Allowance test of doing so, and in particular how the transitional arrangements work in the 2015-16 tax year as shown above.

We will update members on any proposed or actual changes following the Budget.

If members would like further advice in this area they should contact an Independent Financial Adviser who is legally able to advise on these matters.

Through FDA Portfolio members can access the services of Lighthouse Financial Advisers via the FDA website at www.fda.org.uk.

Lighthouse offer FDA members a free initial consultation but should this lead to more detailed advice FDA members will benefit from a special reduced rate.

Disclaimer

This guide is intended to provide information about procedures, criteria and practices in relation to civil service pension schemes and by analogy schemes. There are several schemes with different rules that may be subject to change. As a result, you should not rely on the content of this guide when making decisions relating to Your pension. The FDA strongly recommends that you should seek financial advice before making any significant decision in relation to your pension. The FDA is not legally authorised to provide such financial advice and nothing in this guide is intended to amount to financial advice.

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