Annual Allowance Quick Guide

SCOTTISH PUBLIC PENSIONS AGENCY

CARE about your future

Are you facing a tax bill?

From 6 April 2016, there will be significant changes to the allowances for tax efficient pension savings, which could result in you paying an additional tax on your scheme benefits when you retire.

In the past, these allowances have mainly affected senior officials and those on a progressive career path with frequent promotions. However, we now expect more members to be restricted by these allowances, particularly those with longer periods of service or members who are now earning benefits at double the standard rate (some police officers, firefighters and mental health officers).

In this factsheet, we explain what these changes are, how you might be affected and what you need to do. It's important that you read and understand the impact this may have on you and your retirement, particularly if at least one of these applies to you:

- **you have recently been promoted.**
- **you have been awarded a pay rise.**
- **yyou have a long period of service.**
- **you are earning benefits at double the standard rate.**
- **you earn more than £100,000 a year.**

Why is this so important?

Scheme membership offers you a tax-efficient way to save for your retirement. You receive tax relief on your contributions and you can take a tax-free lump sum when you retire. HMRC sets limits on how much you can benefit from these efficiencies and does this by giving you two allowances:

1. **Your lifetime allowance**
2. **Your annual allowance**

If you exceed these allowances, your benefits may be subject to a tax charge.

Changes to these allowances mean that even if you're not close to the current limits now, you may need to consider your overall position in light of these reductions.

In this guide we focus on changes to the annual allowance. Our Lifetime Allowance Quick Guide covers changes to the lifetime allowance in more detail.

The changes are complex and our guides can only give you an overview. The key thing to remember is that you are urged to seek financial advice as soon as possible if you think you may be affected by the changes we describe.

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What do we mean?

Below are some high level explanations of some of the terms we use in this leaflet.

Adjusted income – your gross taxable income plus your pension input growth, less your pension contributions.

Annual allowance – the value of pension savings you can make each year without incurring a tax liability.

Lifetime allowance – the amount of pension saving you can build during your working life without incurring a tax charge.

Pension input growth – this includes:

- any increase in the notional value of your scheme benefits;
- any added years AVCs you pay; and
- any other pension savings you make.

Threshold income – this is the same as your pensionable pay.

Unprotected member – someone who has joined the 2015 scheme and is no longer earning benefits in the pre 2015 arrangement.

What are the changes and how might they affect you?

There are two key changes that came into effect from 6 April 2016:

1. The lifetime allowance reduced from £1.25 million to £1 million. We expect the lifetime allowance to stay at this level until 2018 and then begin to rise in line with increases to the Consumer Prices Index (CPI). We explain what this might mean for you in our ‘Lifetime Allowance Quick Guide’
2. For the first time, the annual allowance will depend on your income and will reduce from £40,000 a year if your ‘adjusted income’ is more than £150,000 a year. Your annual allowance will not reduce if you have a threshold income of £110,000 or less (it will remain at £40,000).

Pension input growth

You will need to give your financial adviser or accountant a Pension Savings Statement we will provide a statement on request but will send one to you automatically if:

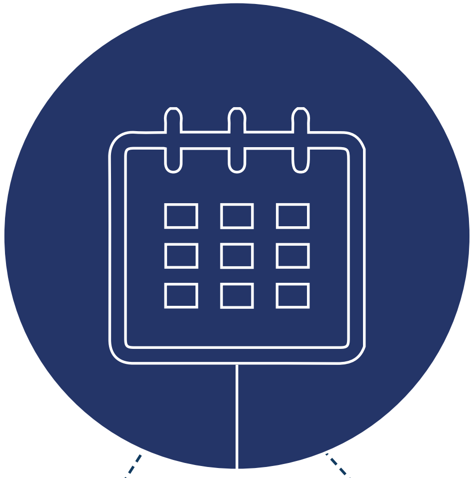
- your pensionable pay is £110,000 a year or more in the tax year 2016/2017 (to help you determine your adjusted income); or
- you breach the £40,000 annual allowance.

Remember, this will only cover your membership in a Scottish public service pension scheme (including any benefits you have transferred in from another arrangement).

You need to ask for the same information from the administrators of any other scheme you have benefits in, including any cross border schemes that you have not transferred across.

Annual allowance

Until now this allowance has been the same for all scheme members but from 6 April 2016, this allowance may reduce for high earners.



How does this work in practice?

If your threshold income is over £110,000 and your adjusted income is over £150,000 your annual allowance will reduce by £1 for every £2 of adjusted income over £150,000.

The maximum reduction is £30,000, which would leave you with a reduced annual allowance of £10,000 a year. We've summarised the impact of this in the table below.

Threshold income	Adjusted income	Annual allowance
Below £110,000	**N/A**	**£40,000**
Above £110,000	**Below £150,000**	**£40,000**
Above £110,000	**Between £150,000 and £210,000**	**Reduces by £1 for every £2 by which your threshold income exceeds £150,000**
Above £110,000	**Above £210,000**	**£10,000**

Are there any other changes?

Yes. Changes to your annual allowance are measured across a period of time, known as the Pension Input Period (PiP). PiPs currently differ between schemes (for public service pension schemes it has covered 1 April to 31 March). To ease the introduction of the tapered annual allowance, the Chancellor has announced that from 6 April 2016 the PiP for all UK pension schemes will run in line with tax years.

"You should contact your financial adviser as soon as possible If you think you may be affected by these changes."

Am I affected by the annual allowance changes and if so, what is the cost?

Whether or not you are affected will depend on number of things, including your level of pay, the size of any pay rises, increases in the cost of living and how much service you have. There are two key points to remember:

1. **You must take into account all your income, including income which is not pensionable.**
2. **If you're an unprotected member and you receive a pay rise, you may see a significant PiP in both the pre and post 2015 schemes. This places you in a higher risk of breaching the annual allowance.**

Everyone's circumstances will be different of course, if your threshold earnings are £110,000 or more you are already likely to be close to seeing your annual allowance begin to taper.

If your threshold earnings are a little less than £160,000, with 30 years' scheme membership and you are awarded a 1% pay rise you are likely to be see your annual allowance fall to £10,000. *

The table below provides some other broad examples of how various income levels might affect the annual allowance

Threshold income	Adjusted income	Reduced annual allowance
£100,000	**N/A**	**N/A**
£110,000	**£147,000**	**N/A**
£113,000	**£150,600**	**£39,700**
£150,000	**£200,000**	**£15,000**
£170,000	**£227,000**	**£10,000**

* based on membership of 30 years, with CPI and salary inflation both at 2%

What should you do now to protect your retirement savings?

If you think you may be affected by these changes, it's important that you speak to your financial adviser as soon as possible.

HMRC has put arrangements in place to help you which are too complex to fully cover here although we have summarised some of them for you.

A summary of the arrangements in place

The Chancellor's decision that all pension schemes will have the same PiP means that for one year only PiPs will run for more than 12 months as the 2015/16 tax year will be split into two mini tax years:

1. **Pre-alignment – between 1 April 2015 and 8 July 2015 (the day of the Budget).** Your annual allowance during this period is £80,000, plus any unused annual allowance you have from the previous three tax years.
2. **Post-alignment – between 9 July 2015 and 5 April 2016.** Your annual allowance for this period is £0, and is effectively the amount of the pre-alignment £80,000 less any allowances you used up during the pre-alignment tax year.

This is subject to a maximum allowance to carry-forward of £40,000, plus any unused annual allowance you have from the previous three full tax years.

If you don't make any savings at all during the pre-alignment tax year your annual allowance for the post-alignment period will be £40,000.

Remember, the PiP includes growth in your benefits in **both** the pre and post April 2015 schemes.

What should you do now?

We will test the value of your pension growth against the annual allowance at the end of the tax year and tell you if you have exceeded the annual allowance limits for 2015/16. If you have exceeded it, you may be able to offset, or negate, this against your unused allowances from previous years and so avoid an additional tax charge.

Here's an example of how this might work.

Meet Val

By 2014/15 Val had been in the scheme for 26 years was earning £175,000 a year. By the end of 2015/16 his pay had increased to £180,000 a year. He's close to retirement, and so hasn't moved to the 2015 scheme.

The combined Pension Input Period for 2015/16 runs from 1 April 2015 to 5 April 2016 (371 days).

The pension team has told Val that his pension growth during the combined period is £52,333. This is higher than the standard annual allowance of £40,000 a year

Post-alignment tax year 9 July 2015 to 5 April 2016 (272 days)	Pre-alignment tax year 1 April 2015 to 8 July 2015 (99 days)
Pension growth £52,333.00 x 272 ÷ (366 + 5) = £38,368.13	Pension growth £52,333.00 - £38,368.13 = £13,964.87

As Val's pension growth for the pre alignment period is £13,964.87 he can carry forward £40,000 of unused annual allowance to his post alignment period.

In the post alignment period Val's pension growth is less than £40,000, so he will not breach the annual allowance. While all this may seem complex, your financial adviser should have a good understanding on how it works.

Your 10 second summary

The allowances for making tax-efficient pension savings is reducing.

We expect more members to be restricted by these allowances than may have been in the past.

You may need to take action before the end of the financial year to avoid a tax charge.

You are urged to speak to your financial adviser or accountant as soon as possible if you think these changes affect you.

Do you have benefits in a private sector pension scheme?

If you have previously worked in the private sector and been a member of a Defined Contribution (DC) scheme, you can now take these benefits in cash if you wish but there may be an even greater impact on your annual allowance arrangements if you do.

If you do have DC benefits and intend to use them to draw down cash, then you should seek further advice before making a decision. This is because your annual allowance could reduce by £10,000 once you begin drawing down cash.

Want to know more?

More details are available in the taxation area of our main website **www.sppa.gov.uk** or you can go to the UK government's website at **www.gov.uk**.

The information in this guide is based on our understanding of the tax and legal position and does not allow for any changes that may be announced after the date of publication. For more information on how your own particular circumstances may be affected, please contact us. This document is for reference purposes only and does not constitute financial advice. It is your responsibility to ensure that you pay any tax due on your pension savings.

We recommend that you take independent financial advice from a registered adviser, who can assess and quantify the extent of any tax liability that is due. You can find a list of independent financial advisers at www.unbiased.co.uk