

FIREFIGHTERS' PENSION COMMITTEE

RESTRICTION OF PENSIONS TAX RELIEF: APPLYING THE ANNUAL ALLOWANCE TO PENSION GROWTH

Note by DCLG

In July of this year, HM Treasury (HMT) and HM Revenue and Customs (HMRC) issued a discussion document setting out an alternative approach to the previous Government's proposals for restricting pensions tax relief. The document invited comment and a response was issued by the Committee in August.

2. For the Firefighter schemes, particular concern was expressed over the effect of one-off increases, or "spikes" in pensionable pay, for example, arising from promotions in to Flexible Duty roles or promotions from Area Manager to Brigade Manager roles. Due to the generally flat role structure, movement between roles can result in a comparatively high increase in pay. Another concern was the effect of double accrual, which accelerates in-year pension growth. Both of these factors increase the risk of the new Annual Allowance (AA) being exceeded by scheme members, particularly when the effect is combined. For higher earners, there is a risk that the effect of double accrual alone could lead to year on year AA charges.

3. In October HMT issued a summary of the response and detailed the next steps. A link to the document is below:

http://www.hm-treasury.gov.uk/d/restricting_pensions_summary141010.pdf

4. HMT have taken steps to alleviate some of the concerns raised generally by respondents. The basic principles of valuation and charging remain but the new AA will be set at £50,000 which is higher than the top of the range previously proposed of £30 - £45,000. The valuation factor will be 16 which is at the lower end of the original range. These decisions are expected to remove more pension savers from the scope of the changes.

5. HMT have also developed measures to mitigate against the effects of "spikes" in pensionable pay and pension accrual. The main measure is the carry forward of any unused AA from up to three previous years. This means that where there is growth above the AA in any year, an individual can add unused allowance from the previous three years, commencing with the earliest year, to the current AA before testing the growth. Carry forward will be allowed in 2011/12 using retrospective valuations under the new arrangements for 2008/09, 2009/10 and 2010/11.

6. A further measure is allowing for the effect of inflation to be reflected in the opening value of the pension at the start of the year. The opening value is notionally increased by the relevant rate of CPI and takes place regardless of

whether there has been any increase in pensionable pay. This has the effect of reducing the calculated amount of growth.

7. The mitigation measures should have a significant impact on the numbers of scheme members likely to be affected but this will depend on individual circumstances.

8. Some examples of how the mitigation measures are applied and the effect on pension are given in the Annex. Please note, these are our calculations based on best information from HMT/HMRC.

9. The latest guidance is now on the HMRC website, link below:

<http://www.hmrc.gov.uk/pensionschemes/annual-allowance/index.htm>

10. With regard to double accrual, there is a point at which the AA could be exceeded purely based on the growth through double accrual and without any increase in pensionable pay during the year. This point can be calculated as follows:

$$\frac{\pounds 50,000 \text{ (AA)}}{16 \text{ (Factor)}} \times \frac{60}{2} = \pounds 93,750$$

However, because of the mitigation measures, and the application of CPI to the opening value, this does not necessarily mean that all those in receipt of pay above £93,750 will exceed the AA purely through double accrual (See example A in the Annex).

11. No special allowances or concessions have been made by HMT for schemes with fast accrual. The Committee's response to the discussion document suggested that "smoothing" of accrual could be applied for those who have reached double accrual (in other words, spreading the effect of double accrual over the whole of pensionable service). We have asked HMT to look again at the issue and we will keep the Committee informed of any change in their approach.

12. HMT are currently considering the means by which AA charges may be paid including whether liabilities can be rolled forward and paid from pension entitlement rather than current income; whether the pension scheme could pay the charge on behalf of the individual to be recovered later, over time. Consideration is also being given to exemptions for cases of "major" ill-health.

13. Draft clauses in relation to the restriction of pensions tax relief planned for inclusion in the Finance Bill 2011 are due to be published for consultation towards the end of 2010.

The Committee is invited to note.

Department for Communities and Local Government
November 2010

Annual Allowance Examples

Example A: Member on high pay. No growth in pensionable pay in 2010/11 or 2011/12 but in double accrual.

The effect of applying CPI of 3.1% to the opening pension value calculation means that, despite the effect of double accrual, the increase in value is within the Annual Allowance by £26,337.39.

PIP	Opening P/Pay	Closing P/Pay	Pay ¹ Increase	CPI ²	Opening Service (60ths)	Closing Service (60ths)	Opening Pension value	Closing Pension Value	Increase in value	Excess/ carry fwd (-)
2008/09	£90,426.53	£92,641.98	1.0245	1.018	28	30	£42,958.63	£46,320.99	£3,362.36	£3,797.76
2009/10	£92,641.98	£93,800.00	1.0125	1.045	30	32	£48,405.43	£50,026.67	£1,621.23	-£24,060.25
2010/11	£93,800.00	£93,800.00	1	1.011	32	34	£50,576.96	£53,153.33	£2,576.37	-£8,778.03
2011/12	£93,800.00	£93,800.00	1	1.031	34	36	£54,801.09	£56,280.00	£1,478.91	-£26,337.39

Example B: Member on high pay. No growth in pensionable pay in 2010/11 or 2011/12 but in double accrual.

In this example, the increase in value is still within the Annual Allowance by £12,160. Note, however, that had the new limits applied in 2008/09 and 2010/11, a tax charge would have arisen. With regard to 2010/11, the excess of £15,920 would have been reduced by the carry over of £8,518.52 leaving a charge of 40% against a revised excess of £7,401.48 (£2,960.59)

PIP	Opening P/Pay	Closing P/Pay	Pay Increase	CPI	Opening Service (60ths)	Closing Service (60ths)	Opening Pension value	Closing Pension Value	Increase in value	Excess/ carry fwd (-)
2008/09	£144,605.32	£148,148.15	1.0245	1.018	28	30	£68,697.17	£74,074.08	£5,376.91	£36,030.52
2009/10	£148,148.15	£150,000.00	1.0125	1.045	30	32	£77,407.41	£80,000.00	£2,592.59	-£8,518.52
2010/11	£150,000.00	£150,000.00	1	1.011	32	34	£80,880.00	£85,000.00	£4,120.00	£15,920.00
2011/12	£150,000.00	£150,000.00	1	1.031	34	36	£87,635.00	£90,000.00	£2,365.00	-£12,160.00

¹ Pay settlements 2008/09 2.45%; 2009/10 1.25%; 0% for subsequent years unless shown. Note that no adjustment made for part years for simplicity purposes.

² Applicable rates of CPI are 2008/09 1.8%; 2009/10 4.5%; 2010/11 1.1%; 2011/12 3.1% (source: HMT/ONS).

Example C: Extension of example B

The application of CPI continues to reduce the increase in value. Note however that this example assumes a CPI of 2.5% and no growth in pensionable pay.

2012/13	£150,000.00	£150,000.00	1	1.025	36	38	£92,250.00	£95,000.00	£2,750.00	-£6,000.00
2013/14	£150,000.00	£150,000.00	1	1.025	38	40	£97,375.00	£100,000.00	£2,625.00	-£8,000.00

Example D: Further extension of example B

This example illustrates the effect of a pay increase of 5% in 2013/14. The value of the pension increases by £7,625 resulting in an excess of £72,000 above the Average Allowance. There is a total of £20,160 of unused allowance from 2011/12 and 2012/13 reducing the excess to £51,840 and giving a charge (at the individual's marginal tax rate of 50%) of £25,920.

2012/13	£150,000.00	£150,000.00	1	1.025	36	38	£92,250.00	£95,000.00	£2,750.00	-£6,000.00
2013/14	£150,000.00	£157,500.00	1.05	1.025	38	40	£97,375.00	£105,000.00	£7,625.00	£72,000.00

Example E: Member promoted from Station Manager A(FDS) to Group Manager B(FDS) in double accrual.

In this example, the increase in pension value is in excess of the Annual Allowance by £44,704.72 which would, without mitigation measures, have resulted in a tax charge of 40% (£17,881.16) wiping out the increase in pensionable pay. However, there is unused AA from the previous 3 years. All of 2008/09 will be used plus £19,882.57 from 2009/10 so no tax charge will arise and there will be a balance of unused allowance to carry forward to future years.

PIP	Opening P/Pay	Closing P/Pay	Pay Increase	CPI	Opening Service (60ths)	Closing Service (60ths)	Opening Pension value	Closing Pension Value	Increase in value	Excess/ carry fwd (-)
2008/09	£43,330.41	£44,392.00	1.0245	1.018	20	22	£14,703.45	£16,277.07	£1,573.62	-£24,822.15
2009/10	£44,392.10	£44,947.00	1.0125	1.045	22	24	£17,009.57	£17,978.80	£969.23	-£34,492.36
2010/11	£44,947.00	£44,947.00	1	1.011	24	26	£18,176.57	£19,477.03	£1,300.47	-£29,192.54
2011/12	£44,947.00	£55,714.00	1	1.031	26	28	£20,080.82	£25,999.87	£5,919.05	£44,704.72