

Police Federation
Of England and Wales



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FROM THE GENERAL SECRETARY'S OFFICE

IR/sg

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JBB CHAIRMEN AND SECRETARIES

Dear Colleagues

PENSIONS TAX RELIEF : THE ANNUAL ALLOWANCE

In July 2010 HMT/HMRC issued a discussion document on the restriction of pensions' tax relief. The Staff Side of the Police Negotiating Board (PNB) provided its views on the Government's plans on 26 August 2010:

http://www.polfed.org/Staff_Side_HMRC_Restriction_Pensions_Tax_Relief_270810.PDF

On 14 October 2010 the Government announced its proposals for the new regime of restricting pensions' tax relief, which will apply to members of all registered pension schemes. The main proposals and their possible impact are set out below.

Please note that what follows is the Government's intention for the new regime. The provisions will not be finalised until the Finance Act 2011 receives Royal Assent. In the meantime, if members are considering making any financial decisions based upon the Government's proposals we strongly recommend that they seek independent financial advice on the current situation and on their individual circumstances.

Please be aware that this briefing paper does not constitute financial advice.

Under the current regime:

Represent · Influence · Negotiate

- The Annual Allowance for 2010/11 is £255,000;
- The method for calculating the amount of pension saving for a Defined Benefit (DB) scheme (such as the Police Pension Scheme (PPS) 1987 or the New Police Pension Scheme (NPPS) 2006) is to multiply the increase in the value of the pension by a flat factor of 10;
- There is an exemption from the Annual Allowance in the year benefits are taken (including the year of death);
- The Lifetime Allowance for 2010/11 is £1.8m.

However, from 6 April 2011 it is proposed that:

- The Annual Allowance for 2011/12 will reduce to £50,000 and be fixed at this level until at least 2015/2016;
- The method for calculating the amount of pension saving for a DB scheme will increase to a flat factor of 16, although this includes an allowance for inflation on accrued pension to date;
- There will be no blanket exemption from the Annual Allowance in the year benefits are taken;
- There will be a three-year carry forward rule so that individuals can carry forward unused Annual Allowance from the last three years (if they have made pension savings in those years) to the current tax year. This can be used to manage "spikes" in benefit accrual.

In addition, the Lifetime Allowance will be reduced to £1.5m from 6 April 2012.

IMPACT ON POLICE OFFICERS

We do not anticipate that great numbers of the Federated Ranks will be immediately affected by the tax implications of the reduced Annual Allowance (AA). However, circumstances which can create larger pensions savings include a large pay rise (e.g. on promotion, particularly when combined with long pensionable service), higher pay and higher accrual rates (e.g. double accrual for members of the PPS 1987).

Members in these situations should check their position as they may be liable for a tax charge. However, pensions' administrators will automatically inform members who breach the AA.

It is anticipated that colleagues in the superintending and chief officer ranks are more likely to be affected by the proposed changes.

Please see Annex A for some illustrative examples.

QUESTIONS AND ANSWERS

What is the Annual Allowance (AA)?

The Annual Allowance (AA) is the maximum amount of pension savings an individual can have each year that receives tax relief. There is no limit on the amount that can be saved in a pension scheme, but there is a limit on the amount which receives tax relief each year. The effect of the AA tax charge is to remove tax relief on any pension savings over the available AA.

The AA only applies to active benefits. All deferred/frozen benefits already accrued are not included in the AA test.

What is a Pension Input Period (PIP)?

The year in which the benefits earned are compared against the AA will be based on the scheme's current "pension input period" (PIP), rather than the tax year. The PIP for PPS 1987 members is 1 April – 31 March. NPPS 2006 members should contact their pensions administrator for details of their PIP.

As the AA will be reduced from £255,000 to £50,000 more people will be affected by it. Consequently there is a need to measure benefit accrual over the correct period.

It is useful to note that the accrued pension used at the start of the PIP is increased by inflation. This means that accrued benefits are "inflation proofed". Assuming inflation is positive, this will reduce the increase in accrual and potentially the tax payable. The example given under "How do I work out the value of my pension savings?" on p4 shows how the accrued pension at the start of the PIP is inflation proofed.

Will my force's pensions' administrator let me know if I have breached the AA?

Members will automatically be informed by their pensions' administrator if they breach the AA so that they can report this on their Self Assessment tax return.

The scheme administrator will provide information on the pension input amount for the relevant Pension Input Period (PIP) (or the pension input amount for the PIPs ending in any of the three previous tax years), plus the AA for the tax year in which the relevant PIP ends. This will be provided in a "pensions savings statement." It is proposed that the pensions savings statement should be provided no later than either:

- 6 October following the end of the relevant tax year; or
- Where the administrator has not been provided with the requisite information from the member's employer, within three months following receipt of that information.

However, for 2011-12 only, schemes will be allowed an extra 12 months to produce the statements e.g. by 6 October 2013. If members don't receive their pensions savings statement in time to file their 2011-12 tax return, they can use an estimated figure in their return in line with the existing process within Self Assessment.

Members can also make a request in writing for a pensions savings statement. It is proposed that members should receive the statement by the later of:

- three months after receiving the request; or
- 6 October following the end of the relevant tax year.

Again, if the pension scheme administrator has not been provided with the requisite information from the members' employer, the statement shall be provided within three months following receipt of that information.

What happens if my pension savings are above the AA?

Even if pension savings are more than £50,000 in one year members will not incur a charge if they haven't used all their AA from the last three years. The unused AA can be carried forward automatically – members don't need to make a claim to HMRC.

In terms of rolling forward three years' worth of unused AA, the AA for 2008-9, 2009-10 and 2010-11 is deemed to be £50,000. In addition, the new flat rate factor of x16 for defined benefit schemes, such as the police pension schemes, is also to be used.

If, after taking into account any unused AA from the past three years, a member still exceeds the AA they will be taxed on the amount above the AA. This will be at the member's marginal rate of income tax, e.g. if they earn enough to pay 40% tax, then this rate of tax will also apply to the value of the pension accrual in excess of the AA.

The Government has said that individuals whose AA charges exceed £2,000 will be able to elect to meet the full value of the charge from their pension benefits.

How do I work out the value of my pension savings?

Firstly, calculate the value of the annual pension on the first date of the Pension Input Period (PIP). This is 1 April for PPS 1987 members. NPPS 2006 members should contact their pensions administrator for details of their PIP. Say, for example, that this comes to £15,000.

Next, multiply the annual amount of the pension by 16. This is the factor used to value contributions of defined benefit schemes, such as the police pension schemes e.g. £15,000 x16 = £240,000. Members of the NPPS 2006 will now also need to add the value of the separate lump sum to which they would be entitled upon retirement.

This whole amount is then increased by the 12 month increase in the CPI to the September before the start of the tax year for which the AA is being calculated. This ensures that accrued benefits are "inflation proofed" e.g. (assuming a CPI of 3%)
 $£240,000 \times 1.03 = \mathbf{£247,200}$

Then calculate the closing value at the end of the PIP (31 March for PPS 1987 members). This is done by taking the value of the pension on 31 March and multiplying it by the defined benefit factor of 16 e.g. £17,000 x16 = **£272,000**. At this point NPPS 2006 members would also need to add the amount of the promised lump sum.

The increase in the value of the pension is therefore the value at the close of the PIP minus the value at the start of the PIP e.g. £272,000 - £247,200 = **£24,800**.

This figure is less than the Annual Allowance of £50,000. Therefore there is no tax charge.

Please see Annex A for illustrative examples.

Please note that the AA applies to all registered pension arrangements a member participates in, not just their police pension.

What happens in cases of ill health?

There is no AA charge in cases of leaving service with a pension due to terminal ill health. There is also an exemption in the case of severe ill health, where a member is unlikely to be able to undertake gainful employment in any capacity at any time in the future. We await further details.

What is the Lifetime Allowance (LTA)?

There is a limit on the value of retirement benefits that can be drawn from approved pension schemes before tax penalties apply. The limit is called the Lifetime Allowance (LTA) and applies to all registered pension arrangements a member participates in, not just their police pension. The LTA is only considered when an individual actually takes their pension benefits at retirement.

For 2010/11 the LTA is £1.8m. However, from 6 April 2012 the LTA will be reduced to £1.5m.

This means that only members whose pension benefits are worth £90,000 or more at retirement will be affected by the LTA. From April 2012 this will reduce to £75,000.

In order to work out the value of retirement benefit an individual multiplies the value of their annual police pension on retirement (for instance, £25,000) by a defined benefit factor of 20 e.g. £25,000 x 20 = £500,000, which is under the current LTA of £1.8m.

The value of any pension savings above the allowance will be subject to a LTA charge. The charge is 55% if the benefits above the LTA are paid as a lump sum and 25% if they are paid from annual pension income. There will be no change to this charge in 2012.

Transitional arrangements will be introduced for those members whose benefits can expect to exceed the revised LTA (£1.5m) but not the current LTA (£1.8m). We expect these arrangements to be finalised shortly.

In order to receive this, the member would need to apply for fixed protection before 6 April 2012 so that at their date of retirement they retain the £1.8m LTA. Benefits in excess of this would be subject to the LTA charge as is the case currently.

Fixed protection is subject to a number of conditions. These include:

1. No new contributions can be paid to a money purchase/defined contribution scheme (including AVCs).
2. The amount of benefits in a DB scheme can only increase by the scheme's ordinary revaluation rate in deferment as specified in the scheme rules on 9 December 2010.
3. No new pension arrangements under a registered pension scheme can be set up (unless this is just to receive a transfer in from a previous scheme).

Enhanced Protection (EP) as it currently stands will continue and so any member who has a personal LTA agreed under EP provisions will not see a reduction in their LTA as a result of these changes. However one key change is that members with EP will now be subject to the AA test. Therefore, for a member who has retained the final pensionable salary link the increase in their benefit provision resulting from an increase in pensionable salary would be tested against the new £50,000 annual allowance.

Additional Voluntary Contributions (AVCs)

Additional Voluntary Contributions (AVCs) are considered differently under the AA and the LTA. The AA doesn't include investment returns and therefore includes the value of the actual AVC when it is made. The LTA however does include investment returns and therefore includes the value of the AVCs at the point of benefit crystallisation.

FURTHER ENQUIRIES

In the first instance Joint Branch Board Chairs and Secretaries should call Mariam Moollan in the Research Department on 01372 352007. ***Please do not direct individual members or fed reps to the Research Department.***

In addition, HMRC has produced draft guidance documents which may be of interest:

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

We will provide further information when the AA provisions are finalised.

This document does not constitute financial advice. We would strongly recommend members seek independent financial advice on their own individual circumstances. The examples provided at Annex A are for illustrative purposes only.

**Ian Rennie
General Secretary
7 March 2010**

ABBREVIATIONS

AA	Annual Allowance
CPI	Consumer Price Index
EP	Enhanced Protection
HMRC	Her Majesty's Revenue & Customs
HMT	Her Majesty's Treasury
LTA	Lifetime Allowance
MPS	Metropolitan Police Service
NPPS 2006	The New Police Pension Scheme, governed by the Police Pension Regulations 2006
PIP	Pension Input Period
PNB	Police Negotiating Board
PPS 1987	The older Police Pension Scheme, governed by the Police Pensions Regulations 1987

ANNEX A

CALCULATING THE INCREASE IN THE VALUE OF PENSION SAVINGS

These illustrations assume a CPI increase of 3% for revaluing benefits.

The Pensions Input Period (PIP) for PPS 1987 members is 1 April – 31 March. NPPS members should check with their pensions administrator for details of their PIP. Example 7, below, assumes a PIP for the NPPS member of 1 April – 31 March.

Example 1

In April 2010 the pensionable pay of a top of scale constable in a provincial force and in receipt of CRTP is £36,792. The officer has 25 years' service in the PPS 1987 which equates to 30/60ths.

30/60ths x £36,792 = annual pension of £18,396

This amount is multiplied by the defined benefit factor of x16:
£18,396 x 16 = £294,336

And then increased by CPI of 3%
£294,336 x 1.03 (CPI) = £303,166

By March 2011 the value of the officer's pension has grown due to a pay increase and longer pensionable service. His/her pensionable pay is now £37,731 and s/he has 26 years' service, which is equivalent to 32/60ths.

32/60ths x £37,731 = an annual pension of £20,123

This amount is multiplied by the defined benefit factor of x16:
£20,123 x 16 = £321,971

The increase in the value of the pension is therefore:
£321,971 – £303,166 = **£18,805**, which is below the AA of £50,000

Example 2

In April 2010 the pensionable pay of a top of scale constable in a provincial force and in receipt of CRTP is £36,792. The officer has 25 years' pensionable service in the PPS 1987, which is equivalent to 30/60ths.

30/60 x £36,792 = an annual pension of £18,396

This amount is multiplied by the defined benefit factor of x16:
£18,396 x 16 = £294,336

And then increased by CPI of 3%
 $£294,336 \times 1.03 \text{ (CPI)} = £303,166$

By March 2011 the value of the officer's pension has grown due to a promotion to sergeant, a move to the MPS (which includes entitlement to London Weighting), the annual pay rise and longer pensionable service. The officer's pensionable pay is now £40,044 and s/he has 26 years' service, which is equivalent to 32/60ths.

$32/60 \times £40,044 = \text{an annual pension of } £21,357$

This is multiplied by the defined benefit factor of x16:
 $£21,357 \times 16 = £341,709$

The increase in the value of the pension is therefore:
 $£341,709 - £303,166 = \mathbf{£38,543}$, which is below the AA of £50,000

Example 3

In April 2010 the pensionable pay of a top of scale sergeant in a provincial force and in receipt of CRTP is £41,202. The officer has 25 years' pensionable service in the PPS 1987, which is equivalent to 30/60ths.

$30/60 \times £41,202 = \text{an annual pension of } £20,601$

This amount is multiplied by the defined benefit factor of x16:
 $£20,601 \times 16 = £329,616$

And then increased by CPI of 3%
 $£329,616 \times 1.03 \text{ (CPI)} = £339,504$

By March 2011 the value of the officer's pension has grown due to a promotion to Inspector, the annual pay rise and longer pensionable service. The officer's pensionable pay is now £46,788 and s/he has 26 years' service, which is equivalent to 32/60ths.

$32/60 \times £46,788 = \text{an annual pension of } £24,954$

This is multiplied by the defined benefit factor of x16:
 $£24,954 \times 16 = £399,258$

The increase in the value of the pension is therefore:
 $£399,258 - £339,504 = \mathbf{£59,754}$, which is above the AA of £50,000

If the officer has unused AA from the last three years he/she can carry it forward to the current tax year. If, after taking into account any unused AA from the past three years, the officer still exceeds the AA s/he will be taxed on the amount above the AA.

Example 4

In April 2010 the pensionable pay of a top of scale sergeant in a provincial force and in receipt of CRTP is £41,202. The officer has 25 years' pensionable service in the PPS 1987, which is equivalent to 30/60ths.

$$30/60 \times £41,202 = \text{an annual pension of } £20,601$$

This amount is multiplied by the defined benefit factor of x16:
 $£20,601 \times 16 = £329,616$

And then increased by CPI of 3%
 $£329,616 \times 1.03 \text{ (CPI)} = £339,504$

By March 2011 the value of the officer's pension has grown due to a promotion to Inspector, a move to the MPS (which includes entitlement to pensionable London weighting), the annual pay rise and longer pensionable service. The officer's pensionable pay is now £51,117 and s/he has 26 years' service, which is equivalent to 32/60ths.

$$32/60 \times £51,117 = \text{an annual pension of } £27,262$$

This is multiplied by the defined benefit factor of x16:
 $£27,262 \times 16 = £436,198$

The increase in the value of the pension is therefore:
 $£436,198 - £339,504 = \text{£96,694}$, which is above the AA of £50,000

If the officer has unused AA from the last three years he/she can carry it forward to the current tax year. If, after taking into account any unused AA from the past three years, the officer still exceeds the AA s/he will be taxed on the amount above the AA.

Example 5

In April 2010 the pensionable pay of a top of scale MPS chief inspector in receipt of CRTP is £57,990. The officer has 27 years' pensionable service in the PPS 1987, which is equivalent to 34/60ths.

$$34/60 \times £57,990 = \text{an annual pension of } £32,861$$

This amount is multiplied by the defined benefit factor of x16:
 $£32,861 \times 16 = £525,776$

And then increased by CPI of 3%
 $£525,776 \times 1.03 \text{ (CPI)} = £541,549$

By March 2011 the value of the officer's pension has grown due to a pay increase and longer pensionable service. The chief inspector's pensionable pay is now £59,469 and s/he has 28 years' service, which is equivalent to 36/60ths.

$$36/60 \times \text{£}59,469 = \text{an annual pension of } \text{£}35,681$$

This is multiplied by the defined benefit factor of x16:
 $\text{£}35,681 \times 16 = \text{£}570,902$

The increase in the value of the pension is therefore
 $\text{£}570,902 - \text{£}541,549 = \text{£}29,353$, which is below the AA of $\text{£}50,000$

Example 6

In April 2010 the pensionable pay of a top of scale provincial chief inspector in receipt of CRTP is $\text{£}53,760$. The officer has 25 years' pensionable service in the PPS 1987, which is equivalent to 30/60ths.

$$30/60 \times \text{£}53,760 = \text{an annual pension of } \text{£}26,880$$

This amount is multiplied by the defined benefit factor of x16:
 $\text{£}26,880 \times 16 = \text{£}430,080$

And then increased by CPI of 3%
 $\text{£}430,080 \times 1.03 \text{ (CPI)} = \text{£}442,982$

By March 2011 the value of the officer's pension has grown due to a promotion to Superintendent and longer pensionable service. The officer's pensionable pay is now $\text{£}62,298$ and s/he has 26 years' service, which is equivalent to 32/60ths.

$$32/60 \times \text{£}62,298 = \text{an annual pension of } \text{£}33,226$$

This is multiplied by the defined benefit factor of x16:
 $\text{£}33,226 \times 16 = \text{£}531,610$

The increase in the value of the pension is therefore:
 $\text{£}531,610 - \text{£}442,982 = \text{£}88,628$, which is above the AA of $\text{£}50,000$

If the officer has unused AA from the last three years he/she can carry it forward to the current tax year. If, after taking into account any unused AA from the past three years, the officer still exceeds the AA s/he will be taxed on the amount above the AA.

Example 7

In April 2010 the pensionable pay of a provincial constable with 4 years' service is $\text{£}29,319$. The officer has 4 years' pensionable service in the NPPS 2006, which is equivalent to 4/70ths.

$$4/70 \times \text{£}29,319 = \text{an annual pension of } \text{£}1,675$$

This amount is multiplied by the defined benefit factor of x16:

$$£1,675 \times 16 = £26,806$$

The lump sum due would also need to be added to this amount:

$$\begin{aligned} £1,675 \times 4 &= \text{lump sum of } £6,700 \\ £26,806 + £6,700 &= £33,506 \end{aligned}$$

And then increased by CPI of 3%

$$£33,506 \times 1.03 \text{ (CPI)} = £34,511$$

By March 2011 the value of the officer's pension has grown due to a pay increase, advancing one pay point and longer pensionable service. The officer's pensionable pay is now £31,032 and s/he has 5 years' service, which is equivalent to 5/70ths.

$$5/70 \times £31,032 = \text{an annual pension of } £2,217$$

This is multiplied by the defined benefit factor of x16:

$$£2,217 \times 16 = £35,465$$

Add the lump sum element of the pension:

$$\begin{aligned} £2,217 \times 4 &= £8,868 \\ £35,465 + £8,868 &= £44,333 \end{aligned}$$

The increase in the value of the pension is therefore:

$$£44,333 - £34,511 = \mathbf{£9,822}$$
 which is below the AA of £50,000

Example 8

In April 2010 the pensionable pay of a chief superintendent in the MPS is £78,900. The officer has 27 years' pensionable service in the PPS 1987, which is equivalent to 34/60ths.

$$34/60 \times £78,900 = \text{an annual pension of } £44,710$$

This amount is multiplied by the defined benefit factor of x16:

$$£44,710 \times 16 = £715,360$$

And then increased by CPI of 3%

$$£715,360 \times 1.03 \text{ (CPI)} = £736,821$$

By March 2011 the value of the officer's pension has grown due to a pay increase and longer pensionable service. The officer's pensionable pay is now £80,913 and s/he has 28 years' service, which is equivalent to 36/60ths.

$$36/60 \times £80,913 = \text{an annual pension of } £48,548$$

This is multiplied by the defined benefit factor of x16:

$$£48,548 \times 16 = £776,765$$

The increase in the value of the pension is therefore:
 $£776,765 - £736,821 = \mathbf{£39,944}$ which is below the AA of £50,000

Example 9

In April 2010 the pensionable pay of a top of scale commander in the MPS is £105,438. The officer has 27 years' pensionable service in the PPS 1987, which is equivalent to 34/60th.

$34/60 \times £105,438 =$ an annual pension of £59,748

This amount is multiplied by the defined benefit factor of x16:
 $£59,748 \times 16 = £955,971$

And then increased by CPI of 3%
 $£955,971 \times 1.03$ (CPI) = £984,650

By March 2011 the value of the officer's pension has grown due to a pay increase and longer pensionable service. The officer's pensionable pay is now £108,126 and s/he has 28 years' service, which is equivalent to 36/60th.

$36/60 \times £108,126 =$ an annual pension of £64,876

This is multiplied by the defined benefit factor of x16:
 $£64,876 \times 16 = £1,038,010$

The increase in the value of the pension is therefore:
 $£1,038,010 - £984,650 = \mathbf{£53,360}$ which is above the AA of £50,000

If the officer has unused AA from the last three years he/she can carry it forward to the current tax year. If, after taking into account any unused AA from the past three years, the officer still exceeds the AA s/he will be taxed on the amount above the AA.

Please note that there is a limit on the amount of salary that can count as the pensionable pay of a police officer who joined the PPS 1987 on or after 1 June 1989. This limit is called the 'earnings cap' and pension contributions are only paid on earnings up to the cap. The earnings cap in 2010/11 is £123,600. There is no earnings cap under the NPPS 2006.

7 March 2011