

## Lifetime Allowance and your LGPS Benefits

HMRC set the threshold on how much pension savings you can have before they become subject to a tax charge (over and above any tax due under the PAYE system on a pension in payment). This is achieved through personal taxation allowances. The Lifetime Allowance is concerned with pension savings in excess of the threshold over the working life of an individual and covered in detail within this guidance note. Details of the Annual Allowance which is concerned with increases to pensions beyond the threshold in a single year is explained in a separate guidance note, 'Annual Allowance and your LGPS benefits'.

### What is the Lifetime Allowance?

The lifetime allowance is the total capital value of all your pension arrangements which you can build up without paying extra tax. If the value of your benefits\* when you draw them exceed your lifetime allowance, a tax charge will be made against the excess.

*\*not including any state retirement pension, state pension credit or any spouse's, civil partner's or dependant's pension you may be entitled to.*

The lifetime allowance (capital value) from 2014 reduced from **£1.5 million** to **£1.25 million**. However, as this legislation is intended to apply to those with significant pension savings, the vast majority of LGPS scheme members will not be affected by these changes.

### How is the value of pension benefits calculated for Lifetime Allowance purposes?

At retirement the value of pension benefits is measured against the Lifetime Allowance (LTA). To determine the value of pension benefits (Personal Lifetime Allowance) the following formula is used:

**Personal Lifetime Allowance**  
= 20 x pension + lump sum +  
Additional Voluntary Contributions Fund Value

### Example 1

If a member retires with a pension of £60,000 pa and a lump sum of £180,000 their Personal Lifetime Allowance is, **20 x £60,000 + £180,000 = £1.38m**

If this member retired before 6<sup>th</sup> April 2014 their Personal Lifetime Allowance would be measured against the current LTA threshold of £1.5m and no tax charge would apply.

However, if this member retired on or after 6<sup>th</sup> April 2014, their Personal Lifetime Allowance would be measured against the reduced LTA of £1.25m and as this is greater they would face a tax charge.

The measure of Personal Lifetime Allowance against LTA is only carried out at retirement; however, we do include the percentage used on your Annual Pension Forecasts. This is intended as a running total and is designed to help you plan for retirement.



## HMRC Protection Certificates

LTA was introduced in 2006 and originally it was intended to increase in line with the cost of living. In recent years and in response to Government policy on pensions taxation the LTA has been reduced in order to increase tax revenues. Inevitably at the point the LTA is reduced some people find themselves with a Personal Lifetime Allowance between the old and the new limits and if nothing were done these people would find themselves with a tax liability that didn't exist before the change.

For these people HMRC offer two types of protection and these are described below.

### (1) FIXED PROTECTION

Fixed Protection is a means by which you can retain a Personal Lifetime Allowance of up to £1.5m.

To benefit from Fixed Protection HM Revenue and Customs must be in receipt of a written **application before 6<sup>th</sup> April 2014**. They have made it clear that late applications will not be considered.

The benefit of Fixed Protection is to secure the Personal Lifetime Allowance already built up without being subject to additional taxation. For this reason there are very strict limits on the rate at which your pension benefits may grow or else the Fixed Protection will be lost.

Fixed Protection will be lost if the value of pension benefits in any tax year grows by more than the annual increase in the Consumer Price Index (CPI). For the tax year 2014/15 the maximum by which the value of your benefits may grow, without losing Fixed Protection, is 2.7%.

The LGPS is a defined benefit scheme. Pension growth occurs with each additional day of membership and any increase in pay. This makes remaining in the scheme and retaining Fixed Protection somewhat difficult to achieve.



Fixed Protection will also be lost if a member makes any contribution to a Defined Contribution (Money Purchase) arrangement including Additional Voluntary Contributions (AVC's) regardless of the amount paid.

The following example illustrates how pension growth affects Fixed Protection:

### Example 2

#### Value of benefits at 5 April 2014

Membership	Pay	Pension	Lump Sum	Value of benefits (20x pension plus LS)
34 yrs	£135,000	£60,750	£141,750	£1.36m*

In this example the member has a Personal Lifetime Allowance over £1.25m but has obtained a Fixed Protection Certificate.

For 2014/15 the member is allowed pension growth of 2.7%. This effectively limits any increase in Personal Lifetime Allowance to £1.40m\*

**\*£1.36m + 2.7% = £1.40m (rounded)**

But, what happens if the member receives a pay rise of 2.0%?

#### Value of benefits at 5 April 2015

Membership	Pay	Pension	Lump Sum	Value of benefits (20x pension plus LS)
35 yrs	£137,700	£64,259	£144,585	£1.43m

In the course of the year the member has built up another year's pension membership plus their benefits are now linked to a higher pay figure. The growth in their pension value is actually 5.5% which is greater than the CPI figure of 2.7%.

In this case the member has **Lost Fixed Protection** and when they retire any value above the standard LTA of £1.25m will be taxed.

## Opting Out of the Scheme and Fixed Protection

Fixed Protection cannot be lost if a member opts out of the pension scheme. At the point of opting-out the member is awarded a deferred benefit that only grows in line with Consumer Price Index increases and therefore will never exceed the maximum growth allowed.

However, by leaving the scheme a member will also be giving up valuable life insurance benefits for their family, an enhanced retirement package should they fall ill, tax relief on all pension contributions plus a generous contribution from their employer towards retirement.

In addition there could be circumstances where remaining in the pension scheme and losing Fixed Protection may still provide better benefits than opting-out. To illustrate why, we return to the individual in *Example 2*.

### Example 3

Suppose the member actually retired on 5<sup>th</sup> April 2015 with a pension of £64,259 and a lump sum of £144,585. As seen in *Example 2* the member has lost fixed protection and so must pay tax on the value of benefits over £1.25m.

In this example the effect of paying that tax would be to reduce their annual pension to £62,011. However, say annual index linking of benefits for 2015 was 1.5% the member's deferred benefit as a result of opting-out would only amount to £61,661 (£60,750 + 1.5%) which is £350 per year less than if they had paid the additional tax.

Everybody's circumstances are unique, but in this case the extra benefits the member earns being in the Scheme outweigh the effects of the tax charge.

### Should I apply for fixed protection?

There is no penalty for applying for fixed protection and then losing it, but if you apply and then experience pension growth in excess of the permitted maximum you must inform HM Revenue and Customs or face a penalty.

Whether Fixed Protection will be of value to you is a complex decision. South Yorkshire Pensions Authority will be able to supply you with information about the value of your pension benefits but we cannot advise you on whether you should apply.

The decision will depend on your individual circumstances. The following list is not intended to be exhaustive but some of the things you might like to consider in reaching a decision are:

- The current value of your pension benefits.
- How far you are from retirement and what your anticipated career progression is during that time. The further you are from drawing benefits, the more difficult the decision as more variables come into play.
- Your intentions at retirement. For example do you expect to maximise the amount of tax free cash you take or are you anticipating taking the largest annual pension available.



There are also a number of external factors which will be out of an individual's control but which will have an effect on whether tax is paid.

- What will CPI be between now and retirement?
- Will the Government increase the LTA limit of £1.25 million in the future?
- How will future changes to the LGPS interact with the LTA rules?

Unfortunately, the answer to these will only be known in hindsight.

Within the LGPS is it probably unlikely but where a member has previously applied for Primary Protection and/or Enhanced Protection they cannot also apply for Fixed Protection. If you have either of these other types of protection you are strongly advised to seek financial advice as to which protection best meets your needs.



## How is the tax charge calculated?

The amount of any tax charge payable is highly dependent on individual circumstances and decisions made at retirement. Broadly speaking though, if the tax charge is recovered through pension the excess value is taxed at 25% and if it is recovered through lump sum it is taxed at 55%.



## (2) INDIVIDUAL PROTECTION 2014 (IP14)

As well as fixed protection 2014, the Government has announced that individual protection 2014 will be available when the lifetime allowance is reduced to £1.25 million from April 2014.

To claim individual protection the value of your benefits at 5<sup>th</sup> April 2014 must be at least £1.25 million. This will protect a Personal Lifetime Allowance equal to the value of pension rights on 5<sup>th</sup> April 2014 up to an overall maximum of £1.5 million.

### Features of Individual Protection 2014

- Personalised Lifetime Allowance based on savings at 5<sup>th</sup> April 2014 (up to £1.5m).
- Must apply by 5<sup>th</sup> April 2017.
- Can continue to make contributions/accrue benefits without losing the protection but taxation will apply on benefits accrued over and above the amount protected.
- Can apply for both Fixed Protection 2014 and Individual Protection.
- Cannot apply if have Primary or Enhanced Protection.

## Why take out individual protection?

Individual protection allows members to protect what they've got so far, and still build up further benefit accrual - albeit when members take benefits they will have to pay the LTA charge on anything above their Personal Lifetime Allowance (the value of their fund at 5<sup>th</sup> April 2014). The basic idea is that by accepting the 55% LTA charge (on the excess) the member is still getting 45% of something, rather than no benefit accrual at all. A further example illustrates this point.

### Example 4

A member obtains individual protection so fixes their personal LTA at 5<sup>th</sup> April 2014 which for this member is £1.4m. The member builds up further benefit accrual and at retirement the value of their benefits is £1.6m and so their protected Personal Lifetime Allowance is exceeded by £200,000.

With Individual Protection this member has a tax liability based upon the excess of £200,000 whereas a member who had lost Fixed Protection would now be looking at a tax liability based on £350,000 (£1.6m - £1.25m).

## COULD YOU BREACH THE LIFETIME ALLOWANCE?

**It is not just about the value of your LGPS benefits.**

**Do you have several pension pots with other pension providers?**

**Do you have a history of large pension contributions, even a single contribution?**

**Do you make Additional Voluntary Contributions?**

*If the answer is yes, then you may wish to seek independent financial advice.*

## Find out more

Having read the information in this leaflet you will have gathered that this is a highly technical and complex issue and will only affect a small number of our members. If you think pension taxation may apply to you it is essential that you obtain advice from a qualified tax adviser or an independent financial adviser.

To apply for either of the protections you will need to contact HMRC via their website which also contains more information about the options that are available and the purpose of this form of pension taxation. The appropriate links are shown below.

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

Apply for fixed protection 2014 follow the link below

<http://www.hmrc.gov.uk/pensionschemes/fp14online.htm>

## For more information please contact us at;

South Yorkshire Pensions Authority  
Floor 8, Gateway Plaza,  
Sackville Street,  
Barnsley.  
S70 2RD

**Telephone:** 01226 772923

**Email:** [admin@sypa.org.uk](mailto:admin@sypa.org.uk)

**Web:** [www.sypensions.org.uk](http://www.sypensions.org.uk)

**Text:** 07786 204697

(always quote your national insurance number and subject)



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