ASSOCIATION OF LOCAL AUTHORITY CHIEF EXECUTIVES AND SENIOR MANAGERS (ALACE)

ANNUAL GENERAL MEETING 6th JULY 2016

PENSIONS BRIEFING

1. Introduction

1.1 As will have been seen from the ALACE Consultants' Annual Report for 2015 – 2016, there was a large rise in the number of pension cases (up 71%) from 2014 - 2015 making this the highest number dealt with by the consultants in a single year. This is hardly surprising given the significant reduction the Government made to the standard Lifetime Allowance (LTA) from 5 April 2016 (down from £1.25 million to £1 million) and the new ways of calculating growth for the purposes of the Annual Allowance (AA) first for the 2015 -2016 financial year and then from 5 April 2016.

1.2 The LTA is the maximum amount of pension savings/benefits you can have in your pension pot without incurring an additional income tax charge. Savings and benefits are counted from all sources other than the national state pension (e.g. from the LGPS, returning officer pensions, occupational pensions from previous employments, private pensions, Additional Voluntary Contributions (AVCs), Additional Pension Contributions (APCs), awards of additional pension etc.). It is calculated by multiplying your annual pension(s) by 20 and adding on any "earned" lump sum(s) you are entitled to draw from your pension scheme(s). Taxes on the excess over the LTA can be very high – 55% if taken as a lump sum, 65% if taken as a pension; the costs can easily run into six figure sums for high earners with long service.

1.3 The AA is the amount by which your total pension pot (from all sources other than your national state pension) is allowed to increase during a "*pension input period or PIP"* (roughly equivalent to a single financial year) before the excess above it becomes subject to an income tax charge. Again these tax charges can be very high, especially if someone gets a significant pay rise or promotion.

1.4 The latest changes to the LTA and the AA have meant that many more "high-earners" are now exceeding these allowances and finding that they therefore have additional tax bills to pay. In particular, Chief Executives in the smaller District and Borough Councils, and Directors in all Councils, are now getting caught by the new levels. Again, it is not surprising therefore that, proportionally, the largest increase in pension cases over the last year relates to those at Strategic Director/Director level.

2. Lifetime Allowance (LTA) and Protections

2.1 Whenever the Government has lowered the standard LTA in the past it has given those who have already accrued large pension pots the opportunity to apply for protections which give them a personal LTA that is higher than the new standard ones. These protections can often save individuals six figure sums in tax charges. It is important therefore, if you are eligible to apply for these protections, that you seriously consider doing so as soon as possible.

2.2 To ameliorate the effect of the latest reduction in the LTA the Government has introduced two new versions of existing LTA protections –

a) Fixed Protection 2016 (FP16) and
b) Individual Protection 2016 (IP16).

a) Fixed Protection (FP)

2.3 In the past Fixed Protection has proved useful to many members. Fixed Protection 2012 (FP12) and Fixed Protection 2014 (FP14) gave those eligible to apply for them a personally protected LTA equivalent to £1.8 million and £1.5 million respectively. They both coincided with the previous occasions when the Government lowered the standard LTA.

2.4 It was, however, fairly easy to lose FP. If the growth in an individual's total pension pot, from all sources other than the national State pension, grew in any one financial year by more than the CPI percentage increase in the September of the previous year, then the person lost their FP.

2.5 In the past it was possible to avoid losing FP if one simply stopped accruing any more pension. This could be done by coming out of the LGPS (and other pension schemes) permanently and deferring your pension; or by moving in and out of the LGPS in any one financial year to keep the growth down; or, since April 2014 in England and Wales, by accessing the 50:50 option (paying 50% of the employee pension contributions but only accruing 50% of the growth in pensions).

2.6 A change in the LGPS Regulations, introduced by the Government in the course of the last year has, however, rendered the mechanism, of moving in and out of the LGPS to keep pension growth down, of little use. This is because now, when a person leaves the LGPS and then returns to it, if they were to be retired compulsorily on redundancy or efficiency grounds by their employer before their Normal Pensionable Age (NPA), which is now 66 or 67 for most ALACE members, their non-actuarially reduced benefits would be confined to the benefits they had earned since re-joining the Scheme and not, as in the past, their whole pensionable service. Nor has the 50:50 option been of any use as a means of retaining FP since the start of the current financial year. Today, the only effective way of retaining FP has been by coming out of the LGPS permanently.

2.7 The new FP16 is also of no use to ALACE members, except to those who came out of the Scheme permanently before 6 April 2016, because the CPI percentage increase in September 2015 was zero. This meant that anyone holding FP16 immediately lost it if they stayed in the LGPS after 5 April 2016. Indeed, anyone holding FP12 or FP14 will also have automatically lost it if they stayed in the Scheme after the end of the last financial year.

2.8 In the Scottish and Northern Irish LGPS Schemes, where the changes introduced to the English and Welsh Scheme in 2014 were introduced a year later in April 2015, anyone holding FP12 or FP14 automatically lost it if they stayed in the LGPS from 6 April 2015. This is because the new LGPS 2015 Schemes in Scotland and Northern Ireland were, because of general pension legislation that was introduced in 2014 -2015, regarded for FP purposes as a “new pension arrangement” whereas the new LGPS 2014 Scheme in England and Wales was not. Transfer into a “new pension arrangement” leads automatically to the loss of FP.

2.9 Many members appear to remain unaware that they have lost their FP. A significant number of pension cases in the last year have involved making those that have lost it aware of this and then guiding them through their need to notify HMRC of this while avoiding having to pay HMRC a large financial penalty for not notifying it sooner. Anyone who is now not sure that they have retained their FP (12, 14 or 16) should get in touch with our Consultant, Cheryl Miller, (contact details at the end of this briefing), who will be happy to help them check their position and explain the next steps they need to take.

b) Individual Protection (IP)

2.10 Since it was so easy to lose FP, ALACE suggested to its members a couple of years or so ago, that those who held it should consider taking out Individual Protection 2014 (IP14), if they were eligible to apply for IP14, as an insurance policy should they lose their FP. To be eligible to apply for IP14 the value of your pension pot from all sources (see para. 1.2 above) had to be worth at least £1.25 million as at 5 April 2014. If it was, then IP14 could give you a personally protected LTA equivalent to the value of your pot on that date up to a maximum of £1.5 million. The protected LTA figure could not increase further, but you could continue to accrue pension benefits into your pension pot, albeit that you might have to pay additional tax charges on the excess pension over your personally protected LTA when you retired.

2.11 Those eligible to apply for IP14 still have until 5 April 2017 to apply for it. So anyone who is eligible and who has not yet applied should seriously consider getting an application into HMRC quickly. This is certainly the case for anyone who held FP and has now discovered that they have, or may have, lost it, but also anyone else who didn’t hold FP (or one of the earlier protections – Primary Protection or Enhanced Protection) but, nevertheless had a pension pot worth more than £1.25 million on 5 April

2014. (Indeed, it is worth those who hold Enhanced Protection also applying for IP14 if their pension pots were worth more than £1.25 million on 5 April 2014 as an insurance policy should they lose their EP – which is possible).

2.12 IP14 is easy to apply for – just go onto the HMRC website, put "Individual Protection 2014" into the search engine and it will take you to the relevant form and Guidance Notes. You will need an accurate figure from your pension fund(s) for the total value of your pot as at 5 April 2014.

2.13 As indicated earlier the Government has now introduced another version of Individual Protection – Individual Protection 2016 (IP16) to coincide with it lowering the standard LTA from £1.25 million to £1 million from 6 April this year. This has been introduced to give some protection to those whose total pension pots were worth more than £1 million on 5 April 2016.

2.14 Like IP14, IP16 gives an individual a personally protected LTA equivalent to the value of their pension pot on 5 April 2016 (rather than, as with IP14, its value on 5 April 2014). With IP16 the maximum protection is up to £1.25 million (whereas with IP14 it is £1.5 million.) Again, it is possible for the person with IP16 to continue accruing pension benefits into their pot without any fear of losing their IP16.

2.15 To be eligible to apply for IP16 the total value of your pension pot has to be worth more than £1 million as at 5 April 2016. Again you will need an accurate figure for the total value of your pot on that date from your pension fund(s). Unfortunately HMRC was not able to get its online application process for IP16 in place at the start of the current financial year but it should be available from July. Those applying for IP16 should follow the process described in paragraph 2.12 above but type in "Individual Protection 2016" instead into the HMRC's search engine.

2.16 If anyone is intending to retire before the online application service for IP16 is up and running they should apply in writing to HMRC. Your LGPS pension fund should have template letters that you can use. You need to have IP16 before you retire if you are to save yourself up to £137,500 in additional tax charges.

3 <u>Annual Allowance (AA)</u>

3.1 In addition to lowering the standard LTA the Government has also introduced changes to the way pension growth in relation to the AA is calculated for high earners. A special method of calculation was introduced for 2015 -2016 which split the year into two portions to take account of the Chancellor's Budget announcements on 8 July 2015. A worked example of how to do the calculation can be found on the ALACE website as part of the Hymans Robertson presentation to the Pensions Seminars that were held in 2015.

3.2 A new way of calculating how the AA is applied to individual high-earners has come in from 6 April this year. Again a worked example can be found on the ALACE website in the presentation from Hymans Robertson at last year's Pension Seminars.

3.3 The new calculation means that many people earning 6 figure salaries will, in future, exceed the AA and have a tax charge to pay even if they don't have a significant pay rise. Anyone who does have a significant pay rise, even if they are on senior (or even middle) managers' salaries, may also find that they breach the AA.

3.4 The calculation is very complicated. Your pension fund does, however, have a statutory duty to inform you by the October following the relevant financial year, if you exceeded the AA in that year and if, after any unused AA from the three previous financial years has been taken into account, you are likely to face an additional tax charge. If the tax charge is over £2,000 you have a choice between paying the charge direct to HMRC or paying it through the "Scheme Pays" option. Under the latter the pension scheme pays the charge on your behalf and then makes a downwards adjustment to your pension to compensate for doing that. It is usually best to go for the "Scheme Pays" option, especially if you are likely to exceed the LTA when you retire as it may help to reduce your additional tax charges then.

3.5 Remember though that it is <u>your</u> responsibility, not the pension fund's, to check whether the growth in your pension pot from all sources has exceeded the AA, and then to declare this on your personal tax return. Any one fund will only know the position in relation to your benefits with that fund – they will not know what is happening in terms of growth in any other of your sources of pension. The AA is applied to the growth in your total pot when all these sources have been added together.

4 <u>Other Pension issues</u>

4.1 The other main queries in relation to pensions in the last year have been about:-

i) whether or not those retiring should commute some of their pension into lump sum and take the maximum tax free lump sum they can – this can help lower the value of their pension pot for LTA purposes and thus reduce, or, in some cases, eradicate, their additional tax charges;
ii) the effect on pension benefits of retiring, or being compulsorily retired, before one's NPA;
iii) the likely effect of the Government's impending <u>£95k cap</u> on public sector exit payments (see paragraph 10 of the main ALACE Consultant's Report for 2015 -2016) should one retire, or be retired, before one's NPA, not least because it looks likely that the cost of pension strain will be included within the cap (see paragraphs 4.2 to 4.6 below);
iv) whether one should leave the LGPS permanently (usually a bad idea);

v) whether there is an optimum time financially to retire?

4.2 As the ALACE Consultants' overall Annual Report for 2015 -2016 indicates, ALACE has been fighting, and is continuing to fight, jointly with other larger public sector trade unions, first, the introduction of the Government's proposed **£95k cap on public sector exit payments**, and second, if it is introduced, on what will be included within the cap.

4.3 As matters stand at the time of writing it looks inevitable that the cap will be introduced (the relevant legislation has been passed) though not before 1st October this year. We are, however, still awaiting information on what will be included within the cap and how, in detail, it will operate.

4.4 It seems highly likely that the cost of "pension strain" (that is the cost to the pension fund of someone retiring before their NPA), will be included in the cap. This tends to be larger the further you are from your NPA, the larger your salary, the longer your pensionable service and whether you are retired compulsorily by your employer on grounds of redundancy or business efficiency or whether you simply opt to retire early voluntarily. For high earners it can easily run into six figure sums, especially if they are retired compulsorily by their employer and their pension is not subject to actuarial reduction.

4.5 The cost of "pension strain" is borne by the employer. If that cost, together with other "exit payments" such as redundancy compensation or pay-in-lieu of notice, together total more than £95k, then the difference has to be paid back by the employee who is leaving to the employer. Quite how this is to be paid back is not yet known but, in many cases, the need to make a repayment to the employer could well significantly reduce the pension benefits the individual will receive.

4.6 An update on the latest position will be given at the ALACE AGM and any latest news will continue to be posted on the ALACE website.

5 Further information

5.1 For queries on any of aspects of the information in this briefing, the first port of call is the ALACE website – particularly in the Pensions FAQs document and its Appendices. Our consultant Cheryl Miller is then happy to help. She will do some rough (and unreliable) calculations for you to help you identify the information you need to request from, or the questions you need to ask of, your pension fund so that you can get accurate estimates and better understand the choices facing you. If appropriate and necessary she will also help you make contact with our pensions experts, Hymans Robertson, and/or our Financial Planning and Investment experts, Close Brothers, both of whom, for a fee payable by you, will be able to help you on such matters.

ALACE
June 2016

(Contact: cherylmiller@hotmail.co.uk or by 'phone on 01892 539650 or 07852 931451)