ASSOCIATION OF LOCAL AUTHORITY CHIEF EXECUTIVES AND SENIOR MANAGERS

PENSIONS — FREQUENTLY ASKED QUESTIONS

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ANNEX 1
THE LIFETIME ALLOWANCE (LTA)

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1. What is the lifetime allowance (LTA)?

The lifetime allowance (LTA) is the maximum amount of pension savings/benefits you can have in your pension pot without incurring an additional income tax charge. Pension savings and benefits are counted from all sources other than the national state pension (e.g. from the Local Government Pension Scheme (LGPS), returning officer (RO) pensions, occupational pensions from previous employments, private pensions, Additional Voluntary Contributions (AVCs), Additional Pension Contributions (APCs), awards of additional pension etc.). If the value of your pension benefits when you draw them (not including any state retirement pension, pension credit or any partner's or dependant's pension to which you may be entitled) is more than the LTA, or more than any LTA protections you may have, you will have to pay tax on the excess benefits (see questions 9 and 10 below).

2. What is the level of the LTA?

The current (2016-17) level of the standard LTA is £1 million. The standard LTA is the limit that applies to all UK taxpayers unless they have additional special protection (see question 11 below), which gives them a higher personal LTA level.

The LTA was first introduced on 6 April 2006, known as "A day", since when its level has been changed by Parliament several times. The table below shows the value of the standard LTA for each year since 2006-07.

Tax Year	Standard LTA
2006-07	£1.5m
2007-08	£1.6m
2008-09	£1.65m
2009-10	£1.75m
2010-11	£1.8m
2011-12	£1.8m
2012-13	£1.5m
2013-14	£1.5m
2014-15	£1.25m
2015-16	£1.25m
2016-17	£1.00m

The Government has said that the standard LTA will be increased in line with inflation from April 2018.

3. How do I calculate my pension pot for LTA purposes?

For pensions that start to be drawn on or after 6 April 2006 the capital value of your pension pot is calculated by multiplying your annual pension by 20 and adding on any "earned" lump sum you are entitled to draw from the pension scheme. (An example of how to calculate the value of your LGPS pension pot is shown in the box on the next page.)

Remember, however, that you have to add on any other pension entitlements, from any source other than the national state pension, to get the full value of your total pot, which is what has to be used for LTA purposes.

For pensions already in payment before 6 April 2006, the capital value of these benefits is calculated by multiplying the current annual rate, including any pension increases, by 25. Any lump sum already paid is ignored in the valuation.

When any LGPS benefit, or any other pension arrangement you may have, is put into payment you use up some of your LTA – so, even if such pensions are small and the capital value of them is well below the LTA, you still need to keep a record of them. If you have a pension that came into payment before 6 April 2006, this will still count as having used up some of your LTA.

If you were in the LGPS prior to April 2014 the pension benefits you earned up to that time will be increased to reflect the growth in your final salary/pensionable pay at retirement. In April 2014 the LGPS in England and Wales (April 2015 in Scotland and Northern Ireland) changed to a Career Average Revalued Earnings (CARE) scheme. From April 2014 (April 2015 in Scotland and Northern Ireland) the value of your pot at the end of each financial year will need to be calculated on the basis of your pensionable pay in that financial year and added to your pot from April 2015 (April 2016 in Scotland and Northern Ireland) revalued by the relevant CPI figure for each subsequent year.

How to calculate the value of your pension pot from the LGPS

(in England and Wales. There are similar calculations in Scotland and Northern Ireland but different years apply for some elements of the formula. The formula assumes that you have continuous service since before 2008.)

The rough basis of the calculation is that you multiply your current earned pension value by 20, then add your lump sum.

The calculation formula is:

Current earned pension value(g) = (b/80 x a) + (c/60 x a) + (d/49)* + (e/49)* + (f/49)

Lump sum value(h) = 3 x (b/80 x a)

Value of your pension pot for LTA purposes = (g x 20) + h

where

a is your annual pensionable pay for the last calendar year before the date of the calculation

b is your continuous service in years and days before 1 April 2008 (days being expressed in 365ths)

c is your service in years and days between 1 April 2008 and 31 March 2014

d is your pensionable pay in 2014-15

e is your pensionable pay in 2015-16

f is your pensionable pay in 2016-17

g is the value of your pension earned to date

h is the value of your lump sum in the LGPS earned before April 2008 (if you have pension related lump sums from sources other than the LGPS you will need to add in these too).

*These figures need to be increased by the inflation increase as announced in September for each subsequent financial year. For example the figure for 2014-15 will need to be increased by the CPI% increase figure for September 2016 and every subsequent year's pension increase.

The formula in the box above will give you a rough estimate of the total size of your LGPS pension pot for LTA purposes, **but it is essential, before making any binding decisions, that you get accurate figures from your own pension fund authority or, for a fee, from ALACE's Pensions Calculations Service** (currently provided by Hymans Robertson, and to be contacted through ALACE consultants Cheryl Miller or Pete Morris and *not directly.* If neither Consultant is available and the matter is urgent, please contact the Honorary Secretary.

Remember the LTA covers <u>all</u> your pensions earned and saved excluding your state pension.

4. How is my LGPS pension pot tested against the standard LTA?

As indicated in question 3 above, the current earned value of your LGPS pension is multiplied by a factor of 20 and added to any tax-free lump sum you have earned. The resultant figure is referred to as "*the capital value*" of your benefits.

The LTA is tested against your pension pot, based on the pension and lump sum amounts that you are going to receive –

- after any commutation (reduction) in pension to increase the tax free lump sum (see question 6 below);
- after the application of any actuarial reduction (as a result of retiring before your normal pensionable age – see question 5 of the main *Pensions: FAQs* document);
- after the application of a pension debit on divorce; and
- after any deduction made for utilising the "*Scheme Pays*" facility (see question 10 in the *Pensions: FAQs* Annex 2 on the -Annual Allowance).

Remember that you also need to include in the calculation any pension benefits from any other source other than your national state pension (see question 1 above).

5. What is the maximum lump sum available?

Since 6 April 2006 the maximum tax-free lump sum is restricted to –

- 25% of the capital value of the benefits to be paid; or
- 25% of the LTA that applies to you – this will be the standard LTA unless you have special protection for a personal higher LTA (see questions 11 and 12 below).

In 2016-17 the standard LTA is £1 million, so the largest tax-free lump sum you can take if the standard LTA applies to you is £250,000. If, however, you have retained (see question 16 below) 'fixed protection 2012' for a personal LTA of £1.8m then the largest tax-free lump sum you can take is £450,000; or if you have 'fixed protection 2014' for a personal LTA of £1.5m it is £375,000; or if you have 'fixed protection 2016' for a personal LTA of £1.25 million it is £312,500. If you have primary, enhanced or individual protection, the sum protected will vary and be individual to you; you are permitted to take up to 25% of that figure as a tax-free lump sum.

6. What effect will taking a larger tax-free lump sum have on my pension?

If you were a member of the LGPS prior to 6 April 2008 you will have earned a tax-free lump sum equivalent to three times your pension as at that time, up-rated by your pensionable pay at retirement. This will usually be below the maximum tax-free lump sum you are able to take (see question 5 above). For every extra £12 of lump sum you take your pension will be reduced (commuted) by £1.

So if, for example, the current standard LTA of £1 million applies to you, and you are due to receive a tax-free lump sum of £100,000 for your pre-2008 service but decide to "commute" (reduce) your pension so as to take the maximum permissible tax-free lump sum (£250,000), you would be taking an extra £150,000 as tax-free lump and would therefore lose £12,500 annually from your pension.

If you decide to commute some of your pension into lump sum you do not have to choose the maximum option. You can take a tax-free lump sum of any amount between that which you had earned up to April 2008 and the maximum to which you are entitled. Clearly if you take less than the maximum amount your pension will be reduced by less.

You can take up to 25% of the total capital value of all your pension benefits in the form of a lump sum if you wish, even if that figure exceeds 25% of the LTA that applies to you, but any excess over the 25% LTA tax free figure will be subject to tax.

7. What are the main pros and cons of taking a larger lump sum?

Many actuaries argue that, as most people expect to live for more than 12 years after retirement, it may not make financial sense to commute some of your pension into a larger lump sum. Before making this important decision you should consider taking professional independent financial advice and bear in mind a range of issues, such as –

- what do you want to do in retirement – if, for example, you want to buy a property abroad, or help your children onto the 'property ladder' then a larger lump sum may be attractive to you;
- you will be paying income tax on your pension (probably at a higher rate), so the reduction in pension will not be as great as it may first appear, and your lump sum will be tax-free. (For example the reduction in pension after income tax at the higher rate in the example in question 6 above will, at current tax rates in England and Wales, be 60% of £12,500 or £7,500 pa.) It may therefore be many years before you are actually 'out of pocket' in cash terms;
- remember, however, that your pension will increase in line with inflation, whereas your lump sum payment, as a single payment, will not be;
- you may be able to invest your additional lump sum and generate returns on your investment which may make up some, or all, of the reduction in pension. (It would be prudent to take independent financial advice on the options open to you before making any decisions. You may therefore like to avail yourself of ALACE's Financial Planning and Investment Service provided by Close Brothers (see last sentence of this answer below);
- your state of health.

It is also worth bearing in mind that, if your pension pot for LTA purposes exceeds the LTA that applies to you, you may, by commuting some of your pension into lump sum, be able to reduce the value of your pension pot below the LTA level that applies to you, or at least to a level nearer your LTA, thus reducing any additional tax charges. This is because in the calculation for assessing the size of your pension pot for LTA purposes your pension is multiplied by 20 but your lump sum is not – it is simply added on to the pension x 20 figure (see question 3 above).

For example, if the standard LTA of £1 million applied to you, and if your pension were £50,000 pa and your lump sum £100,000, then the value of your pot would be [(£50,000 x 20) + £100,000] or £1.1m (£100,000 over the standard LTA – which could attract additional tax charges of £55,000 – see question 9 below). If, however, you took the maximum tax-free lump sum of £250,000, then your pension would reduce by £12,500 pa to £37,500 pa, and the value of your pot would reduce to [(£37,500 x 20) + £250,000] or £1 million – thus being at the standard LTA of £1 million and attracting no additional tax charges. A loss of £12,500 pa in pension may sound a lot but you would have been paying income tax of £3,900 on the lost pension so the real loss pa is only £8,600 pa. You would, however, have received an extra £150,000 in tax free lump sum and saved £55,000 in LTA additional tax charges – a total of £205,000. If this is divided by the annual cash loss in pension it would be some 23 years before you were out of pocket in cash terms and that assumes you get no return on investing your larger lump sum. As indicated above, however, what really matters is what you want to do in retirement and whether a large pension or a large lump sum is of most value to you. ALACE's Financial Planning and Investment Service which is supplied by Close

Brothers will be happy to advise you on such matters and can be accessed through our Consultants Cheryl Miller or Pete Morris. (If neither Consultant is available and the matter is urgent, please contact the Honorary Secretary.)

8. What is a protected lump sum?

If, on 6 April 2006, you had lump sum benefits totalling more than £375,000, from all your pension providers, you could have applied to HMRC to protect your lump sum from tax charges. If you did this then you would also have applied at the same time for either primary or enhanced protection (see questions 11, 12, 13 and 14 below), and would have received a certificate from HMRC confirming that you held such protection. That certificate would also advise you of your lump sum protection.

9. What additional tax charges are applied if the capital value of my pension benefits/pension pot exceeds the LTA?

If your total pension benefits (taking account of all sources of pension other than the state pension - see question 1 above), and the results of any of the tests in question 4 above, and any decision you take on commuting some of your pension into tax free lump sum – see questions 6 and 7 above) exceed the LTA that applies to you, then an additional tax charge, known as the *lifetime allowance charge*, will apply.

The charge is applied only on <u>excess</u> benefits – that is, only on those above the LTA that applies to you.

The rate of tax you pay on pension savings above your LTA depends on how your savings are paid, the rate is:

- 55% if you take it as a tax free lump sum; and
- 25% if you take it by way of pension (and your pension then has current tax rates applied).

The tax charge is designed to be neutral irrespective of whether it is taken from your lump sum or as a reduced pension as illustrated below.

Say pension savings are £100,000 greater than the LTA.
Thus tax due if £100,000 excess is taken as a lump sum = £55,000 (£100,000 x 55%)

If taken from the pension, £100,000 lump sum equates to £5,000 pension (HMRC factor for valuing pension is 20)
Tax charge is 25% of £5,000 = £1,250 (this will normally be paid by your pension fund to HMRC.
Pension subject to income tax, assuming higher rate payable, is taxed at 40%
Thus tax paid on remaining £3,750 pension is £3,750 x 40% tax = £1,500
The total tax paid on the pension at an annual equivalent = £2750 (£1,250 reduced pension + income tax at £1500).
Lifetime equivalent cost = £2,750 x 20 (HMRC factor for valuing pension) = £55,000

10. How do I pay the LTA charge if I take my excess benefits in the form of pension?

The 25% charge is deducted from your pension when it is paid to you. You do not need to meet the charge before your pension is paid to you. The LTA charge is divided by a factor of 20, and your LGPS pension is reduced by this amount.

For example, if the standard LTA of £1 million applies to you, and if you have a pension of £50,000 pa and a lump sum of £100,000 and you decide not to commute any of your pension into a larger lump sum, then the capital value of your pension pot equals [(£50,000 x 20) + £100,000] or £1.1m. The excess over the standard LTA is £100,000 (£1.1m - £1m). The tax charge payable is £25,000 (£100,000 x 25%). This is divided by 20 to give a reduction in pension of £1,250 pa – so the reduced pension is £48,750 pa – on which you then have to pay income tax in the usual way.

You should get a statement from your pension administrator telling you how much tax you owe if you go above the LTA. Your pension provider will deduct the tax before you start getting your pension. You will need to report the tax deducted to HMRC by filling in a self-assessment tax return.

11. What type of personal LTA protections have been available?

On 6 April 2006 two types of protection were available – **primary protection** and **enhanced protection**. You had to apply to HMRC for either of these before 6 April 2009.

You could apply for **primary protection** if your pension benefits were already worth more than the then standard LTA of £1.5 million on 5 April 2006. You could apply for **enhanced protection** regardless of the value of your accrued benefits as at 5 April 2006. You can hold both primary protection and enhanced protection, but see question 12 below.

When the standard LTA was reduced from £1.8m to £1.5m on 6 April 2012 you could apply for **fixed protection 2012 (FP12)** to give you a personal LTA of £1.8m, provided you applied to HMRC before the deadline of 5 April 2012. You could not apply for FP12 if you already held primary or enhanced protection.

When the standard LTA was reduced from £1.5m to £1.25m on 6 April 2014 you could apply for **fixed protection 2014 (FP14)** to give you a personal LTA of £1.5m, provided you applied to HMRC before the deadline of 5 April 2014. You could not apply for FP14 if you already held primary or enhanced protection or FP12.

12. What types of personal LTA protections are currently available?

There are 3 different types of protections that you can consider applying for. These are:

Fixed Protection 2016
Individual Protection 2014
Individual Protection 2016

The HMRC website explains what each protection does and whether you can keep building up your pension. Some background information is set out below.

When the standard LTA was reduced from £1.25m to £1m on 6 April 2016 the HMRC announced it would be introducing a new fixed protection, **fixed protection (2016) (FP16)** to give you a personal LTA of up to £1.25m**.** No deadline for applications for FP16 has yet been set. The HMRC has introduced a new online service for pension scheme members to apply for FP16. Applicants will be given a reference number by the HMRC which it will be important for them to keep safe. You cannot apply for FP16 if you already hold primary or enhanced protection or FP12 or FP14. However, (see Q19 below) there is no point in applying for FP16 unless you left the LGPS before 6 April 2016 because the percentage increase in the CPI in September 2015 was negative, which means that you would automatically lose your FP immediately.

When the standard LTA was reduced from 6 April 2014 a new form of LTA protection was introduced **individual protection 2014 (IP14).** You could apply to HMRC for this provided the capital value of your pension pot exceeded £1.25m on 5 April 2014**.** IP14 gives you a personal LTA equivalent to the capital value of your pot on 5 April 2014 up to a maximum of £1.5m. **You can apply for IP14 until 5 April 2017**. You can hold IP14 *and* enhanced protection, or IP14 *and* FP12 or FP14 or FP16. You cannot, however, hold both IP14 and primary protection.

When the standard LTA was reduced from £1.25m to £1m on 6 April 2016 the Government announced that it was also introducing a new individual protection, **individual protection 2016 (IP16).** You can apply to HMRC for this provided the capital value of your pension pot exceeded £1m on 5 April 2016**.** IP16 gives you a personal LTA equivalent to the capital value of your pot on 5 April 2016 up to a maximum of £1.25m. As with FP16, the HMRC has introduced a new online service for pension scheme members to apply for IP16. HMRC will send you a reference number rather than a certificate once you have successfully applied for IP16 which you need to keep safe. You can still apply for IP16 if you already have enhanced protection, FP12, FP14, or FP16. You cannot apply for IP16 if you have either primary protection or IP14. If you have any of the above protections other than FP16 and IP16 you should have a personal certificate from the HMRC confirming that you hold that protection, and outlining the rules that relate to it.

More details about each of these types of protection are given in the questions below.

13. What is primary protection?

You can only have primary protection if you had built up pension savings of more than £1.5m before 6 April 2006 *and* if you applied to HMRC for it before 6 April 2009.

You can hold both primary protection and enhanced protection, but not primary and fixed protection or individual protection.

If you hold primary protection you will have received a confirmation certificate from HMRC unless you also applied for enhanced protection. If you applied for both primary and enhanced protection you'll have been sent a certificate showing that you have enhanced protection. Enhanced protection takes precedence over primary protection. If you lose or give up enhanced protection you must tell HMRC. They will then send you your primary protection certificate. Your primary protection certificate will state the amount of your protected lump sum and your ‘enhancement factor’ to be used in the calculation of the value of your personal LTA.

You can lose primary protection if you get divorced and your pension savings are reduced below £1.5m because of a pension sharing order.

Your personal LTA is expressed as a factor which is calculated as set out in the box below

Even though the standard LTA has been reduced three times from £1.8m to £1.5m in April 2012, from £1.5m to £1.25m in April 2014, and from £1.25m to £1m in April 2016, HMRC has confirmed that individuals with primary protection should continue to measure their personal LTA with reference to the previous standard LTA of £1.8m.

Unless you have a protected lump sum (see question 8 above), the details of which will be shown on your primary protection certificate, the maximum tax-free lump sum you can take is the lower of:

- 25% of the standard LTA of £1.5m; or
- 25% of the capital value of the benefits to be paid.

How to calculate your LTA with Primary Protection

You're given a LTA factor based on the value of your pension savings on 5 April 2006. This factor is worked out on the difference between your savings on 5 April 2006 and the lifetime allowance for 2006-07 of £1.5 million.

Your revised LTA limit is worked out using the following formula:

(1+ lifetime allowance factor) x £1.8 million.

If, in the future, the LTA increases to more than £1.8 million the calculation of your revised lifetime allowance limit changes to

(1+ lifetime allowance factor) x lifetime allowance.

Example

Judy's pension savings were £2.55 million on 5 April 2006.
This was 1.7 times the £1.5 million lifetime allowance rate for 2006-07.
This means her lifetime allowance factor is calculated as 0.7. If her savings had been 1.9 times the £1.5 million rate, the factor would have been 0.9.
The maximum amount of pension savings she can take without paying the lifetime allowance charge is calculated as:

(1 + 0.7) x £1.8 million = £3.06 million.

14. What is enhanced protection (EP)?

Enhanced protection (EP) was introduced for those who at 5 April 2006 expected that their pension pot value would be over the newly introduced LTA when they expected to retire, and wanted to avoid paying an additional tax charge.

Anyone could apply for EP, regardless of their pension pot value, until 5 April 2009. It has the effect of eliminating any LTA charge, so that effectively a member could take a pension based on their total pension pot post-April 2006. As with primary protection you must have applied to HMRC for EP within the time limit, and you will have a certificate to prove that you acquired it.

Providing EP is not lost or revoked, then no test against the LTA needs to occur and there will never be an additional tax charge payable.

Under most pension schemes, once you have taken out EP you cannot accrue more benefits into your pension pot after 5 April 2006. The LGPS, however, is different. As a ‘defined benefits’ pension scheme you can continue to pay contributions, but the amount of the benefits you can accrue after 5 April 2006 is limited. The value of your benefits from 5 April 2006 can increase until they come into payment by the greater of two measures –

i) 5% pa (compound) - or the increase in the Retail Prices Index (RPI) if greater, and

ii) an amount based on your pensionable service and scheme accrual rate on 5 April 2006 and your final salary when benefits first come into payment.

This limit is known as 'the appropriate limit'. If you exceed this limit then you will lose your EP and your pension benefits will be tested against the current standard LTA (unless you have dormant primary protection or individual protection). The test for this limit is very complicated so, if you think that you may be in danger of losing it, **you need to take advice from your pension fund.**

15. Are there other ways in which I can lose enhanced protection (EP) in addition to exceeding the "appropriate limit"?

Yes; EP may be lost if, after 5 April 2006, you –

- accrued benefits in other money purchase pension schemes, including buying AVCs or a personal pension plan etc.;
- have built up further benefits in the LGPS or another defined benefits scheme or a cash balance pension that exceed the appropriate limit;
- have made a transfer that is not "permitted" from one pension scheme to another; or
- have started saving in a "new pension arrangement". (When the LGPS changed in England Wales in April 2014 the new LGPS was not considered by HMRC to be a "new pension arrangement". However, when the LGPS in Scotland and Northern Ireland was changed in April 2015, the HMRC did regard the new Scottish and Northern Irish LGPSs as "new pension arrangements" and anyone who therefore remained in the Scottish or Northern Irish LGPS after 6 April 2015 will automatically have lost their EP.)

Again the rules are very complicated and, **if you have any concerns that you might have lost (or be in danger of losing) your EP, you should check your position with your pension fund.** This is especially the case if, since acquiring EP, you have moved between different pension schemes, have purchased AVCs, APCs, been awarded additional pension etc., or if you have taken out any private pension arrangement – or are considering any of those actions.

Unless you have a protected lump sum (see question 8 above), EP does not increase the available tax free lump sum, but from April 2014 you are permitted to access the lower of –

- 25% of £1.5 million; or
- 25% of the capital value of the benefits paid.

If you have lost your EP you have an obligation to inform the HMRC within 90 days of doing so. Failure to do so incurs a financial penalty.

If you lose your EP and have primary protection you can apply to HMRC for your EP to be disregarded, and you can activate your primary protection.

Some ALACE members who took out EP when their salaries were much lower than at present have discovered that the total LTA protection afforded by EP is much less than they expected. If you hold EP it may therefore be worth checking with your pension fund the amount that your EP protects. If this is less than you expected and your pension pot was worth more than £1.25m at the end of March 2014, you might wish to consider applying for individual protection 2014 (IP14); or if it was not worth £1.25m or more at the end of March 2014, but was worth more than £1m at the end of March 2016, you might want to apply for individual protection 2016 (IP16) (see questions 25-28 below).

16. What are fixed protection 2012 (FP12), fixed protection 2014 (FP14) and fixed protection 2016 (FP16)?

When Parliament lowered the standard LTA from £1.8m to £1.5m in April 2012 many ALACE members took out fixed protection 2012 (FP12); when it again lowered the standard LTA from £1.5m to £1.25m at the beginning of April 2014 more members took out fixed protection 2014 (FP14); and when it again lowered the standard LTA from £1.25m to £1m in April 2016 more members considered taking out fixed protection 2016 (FP16). An individual cannot hold more than one form of FP at the same time. If you apply for a later form of FP while still holding an earlier form, HMRC will reject the new application. Nor can an individual hold both enhanced protection and any form of fixed protection.

FP12 gives an individual a protected LTA of £1.8m; FP14 one of £1.5m and FP16 one of £1.25m.

Anyone who stayed in the LGPS after 5 April 2016 (5 April 2015 in Scotland and Northern Ireland) will automatically have lost their FP12, FP14 or FP16 (see questions 19, 22 and 24 below).

17. In what circumstances can I lose fixed protection (FP)?

You cannot give up FP voluntarily, but from 5 April 2012 (in the case of FP12), from 1 April 2014 (in the case of FP14), and from 1 April 2016 you can lose it if you –

- make further contributions to a money purchase pension arrangement (e.g. AVCs or into a personal pension plan);
- built up further benefits in the LGPS that exceeds “benefit accrual” (see question 18 below);
- built up new benefits in a defined benefits scheme other than the LGPS or in a cash balance pension scheme above benefit accrual; or
- join a new pension scheme – unless you are transferring pensions within the LGPS (note that moving from the England and Wales LGPS to the Northern Ireland or Scotland Schemes, or vice versa, counts as joining a new scheme).

18. What is “benefit accrual”?

In most pension schemes “*benefit accrual*” simply refers to accruing, or paying in, more benefits in your pension pot. In the LGPS it has a different meaning because the LGPS is a “*defined benefits*” pension scheme. In a defined benefits pension scheme it is possible to accrue more benefits into a pension pot provided the “relevant percentage” is not exceeded. The relevant percentage for any one financial year is the percentage increase in the Consumer Price Index (CPI) in the September of the previous financial year. Only after the growth in your pension pot has exceeded this figure does “*benefit accrual*” for the purposes of a defined benefits pension scheme occur.

A few ALACE members believe that, in the past, they were incorrectly advised by some independent financial advisers operating in the private sector who were used to dealing with other types of pension schemes, that, in order to retain FP12 or FP14 they would have to leave the LGPS before taking them out as they could not accrue any more benefits in the LGPS without losing them. This was not then the case, **although, with the CPI percentage increase for September 2015 being negative, anyone who wished to retain their FP12 or FP14 would have had to have come out of the Scheme before 6 April 2016** (see question 22 below).

19. How do I check to see if the growth in my pension pot has exceeded the "relevant percentage" and I have lost, or will lose, my FP?

When FP12 was first introduced in April 2012 inflation was running at over 5% and very few ALACE members were receiving any pay rise. There was therefore very little chance of people losing their FP unless they had a pay rise. In 2013-2014 the CPI figure for September 2012 dropped to 2.2%. It was therefore quite easy for people to lose their FP even without a pay rise as the percentage increase in their pension pot could be greater than 2.2% simply as a result of accruing an additional year's pensionable service.

ALACE circulated reminders advising people to check that they had not lost their FP12. Some had lost it and were in time to apply for FP14 which, while not as good as FP12, was still better than the application of the new standard LTA. The chances of losing both FP14 and FP12 were also high in 2014-15, since the CPI for September 2013 was only 2.7% and growth in pension pots as a result of one additional year's pensionable service at the new LGPS accrual rate of $1/49^{th}$ was greater than when the annual accrual rate was $1/60^{th}$. In 2015-16, the relevant CPI figure (for September 2014) was even lower at 1.2%, and there was therefore a very high chance of anyone holding FP12 or FP14 losing their protection. In September 2015 the CPI actually fell. **<u>This has meant that anyone holding FP12 or FP14 who stayed in the LGPS after 5 April 2016 will automatically have lost their FP because any additional accrual in 2016 -17 will mean that the "relevant percentage" had been exceeded</u>**.

It also means that anyone applying for FP16 who stayed in the LGPS after 5 April 2016 will also have automatically lost their FP16.

If you did leave the LGPS by 5 April 2016 and believe that you still retain FP12 or FP14 you need to confirm this by calculating whether the growth in your total pension pot exceeded the relevant growth in the CPI in any of the years you remained in the LGPS while holding FP12 or FP14. The way to calculate whether your total pension growth exceeded the relevant percentage in any one financial year is shown in the following box. **You can ask your pension authority to do this calculation for you.** If they will not or cannot, then you can access ALACE's Pensions Calculations Service provided by Hymans Robertson for a fee payable by you to them via ALACE (see question 3 above).

Prior to April 2016 and the introduction of FP16 you could have retained FP12 or FP14 by leaving the LGPS *permanently* at some point before your pension benefits had exceeded the relevant CPI percentage increase figure for the year in which you left the LGPS, and by then not re-joining the LGPS or any other pension arrangement. Leaving the LGPS permanently and not re-joining it before you retire is, however, a serious decision. It is important therefore to take professional financial advice before making such a decision in order to ensure that you are aware of the full financial and other consequences of doing so. (See also question 32 below.)

How to calculate whether your pension pot has increased by more than the CPI.

To calculate whether the growth in your total pension pot has increased by more than the CPI you need to do the following calculation –

a – b = c

b x d = e

If c is greater than e then you will have lost your FP.

Where: a - is the value of your pension pot at the end of the financial year

b – is the value of your pension pot at the end of the previous financial year

c – is the difference between a and b

d – is the relevant CPI % figure from the September preceding the financial year for which you are doing the calculation

e – is the amount by which your pension pot can grow without you losing your FP

To work out the value of your pension pot for LTA purposes see question 3 above – remember you have to add up pension benefits from all sources (other than the state pension) not just from the LGPS..

As with enhanced protection, if you lose your FP you have an obligation to inform HMRC within 90 days of doing so, otherwise you will face a financial penalty.

In the past there were a number of ways you could avoid losing your FP if the growth of your pension pot in the current, or future, financial years was likely to exceed the relevant CPI figure, including moving in and out of the LGPS in any one financial year in order to keep the growth in your pension pot down below the relevant CPI% increase figure. New LGPS regulations introduced in 2015 meant, however, that, if anyone re-joined the LGPS after leaving it and was then retired early compulsorily (i.e. before their Normal Pensionable Age – now normally 66 or 67) by their employer on redundancy or efficiency grounds, only the pension they had earned since re-joining the LGPS would be protected from actuarial reduction (although some partial protection might be provided to their earlier benefits if they were eligible for the 85 year rule protections – see question 9 of the main *Pensions: FAQs* document). This meant that, for most people, there was little point in using this method to retain their FP12 and FP14. With the CPI% increase for September 2015 being negative however, as indicated above, the only way to retain FP since the start of the 2016-2017 financial year has been by coming out of the LGPS by 5 April 2016. If the CPI% increase figure for September 2016 is positive it may be possible for someone to re-join the Scheme in 2017-2018 and still retain their FP12 or FP14 by then coming out of the Scheme before the growth in their pot exceeds the September 2016 CPI figure. If, however, you did this you would still be affected by the revised regulations that mean only any pension earned after you re-joined the Scheme would be protected from actuarial reduction if you were retired early compulsorily on redundancy or efficiency grounds, so this route would probably not be attractive to most people.

20. What happens if I lose my fixed protection (FP)?

You will revert to the standard LTA (£1m in 2016-17) applying at the time of your retirement, and pay additional tax charges on any benefits in excess of that figure rather than the protected figure you had under your FP (unless you have individual protection for a higher personal LTA than the standard LTA – see questions 25--30 below).

21. What are the penalties for failing to notify HMRC that I have lost my fixed protection (FP)?

If the growth in your pot exceeds the relevant CPI figure you need to establish exactly when it did so. You are required to notify HMRC that benefit accrual has taken place within 90 days of this date, and that you have lost your FP. Failure to do so may result in a penalty of up to £300.

It is not an automatic penalty, and each case will be considered by the HMRC on its own merits.

Once the initial penalty is issued, however, there is an automatic daily penalty for non-payment of up to £60.

Because the calculation for checking that the growth in one's pension pot has not exceeded the relevant CPI% increase figure, and because pension funds will not necessarily know you hold FP and even if they do they have no obligation to inform you if you have lost it, most people do not realise that they have lost their FP until long after the date they have done so. Provided you have not "crystallised" (taken) any of your benefits since losing your FP, HMRC will usually not impose the financial penalty. Anyone who thinks they have lost their FP should ask their pension fund to help them calculate the date on which they lost it; should then contact HMRC explaining that they have "only just become aware" that they have lost it and they have not crystallised any of their pension benefits since losing it; and ask HMRC, in those circumstances, if they will waive the financial penalty.

If you have lost your FP but also hold Individual Protection (IP) then that will then come into play. If you have lost your FP and don't hold IP then you should check whether you are eligible to apply for it and, if you are eligible, apply for it as soon as possible (see questions 25-30 below).

22. If the growth in my pension pot is likely to exceed the relevant CPI figure what action can I take to avoid losing my fixed protection (FP)?

As indicated earlier (see question 19 above) if you did not leave the LGPS before 6 April 2016 (6 April 2015 in Scotland and Northern Ireland) you will automatically have lost your FP (whether FP12 or FP14).

If you did leave the LGPS before 6 April 2016 in order to retain your FP12 or FP14 you could continue to retain it by remaining outside the LGPS and not joining any other pension scheme. (If you joined any other pension scheme, or took out any new pension arrangements such as buying AVCs, this would be regarded by the HMRC as you having joined a new pension arrangement and you would therefore automatically lose your FP – see question 17 above.)

If you left the LGPS before 6 April 2016 in order to retain your FP12 or FP14 then, as indicated in question 19 above, you may, if the CPI% increase figure in September 2016 becomes positive, be able to re-join the LGPS in 2017-2018 and retain your FP provided you avoid the growth in your total pension pot in that financial year exceeding the relevant CPI% increase figure. (This may also be true in subsequent years.) This could be done by leaving the LGPS again before the growth in your pot exceeds the relevant CPI figure - you would need to calculate carefully exactly when to leave the LGPS in that financial year so as not to lose your FP; or, if this would keep the growth in your pot below the CPI figure, opting for the 50:50 option (see question 31 below); or combining these two options in some way so as to keep the growth in your pot below the appropriate limit. Any of these approaches would be very risky and could, if you get the calculations wrong, result in your losing your FP.

23. If I have opted out of the LGPS, permanently or temporarily, to retain my fixed protection (or enhanced protection), will the auto-enrolment arrangements affect my ability to retain FP or EP?

If you are automatically enrolled by your employer back into the LGPS, you have one month to opt out again to avoid losing your protection.

24. Will HMRC consider belated applications for fixed protection (FP)?

It is very unlikely that HMRC will approve any retrospective application for FP12 or FP14: you had to apply for the former by 5 April 2012 and the latter by 5 April 2014. No deadline has, however, yet been set for applying for FP16 but, as indicated in question 19 above, FP16 is of no use to anyone who did not leave the LGPS by 5 April 2016 as the fact that the relevant CPI% increase figure in September 2015 was negative means that anyone staying in the LGPS from 6 April would automatically exceed the relevant CPI figure and lose their FP (12, 14 and 16) anyway.

25. What is individual protection (IP)?

The original individual protection (IP) was introduced by the government from 6 April 2014. It is only relevant for those whose total pension pot was worth £1.25m or more at 5 April 2014. The original IP gives you a protected LTA equal to the value of your pension pot on 5 April 2014 – up to an overall maximum of £1.5 million.

When lowering the standard LTA from £1.25m to £1m from 6 April 2016 the Government announced it would be introducing a new form of individual protection – individual protection 2016 (IP16). As a result the original IP is now referred to as IP14.

IP16 gives a protected LTA equivalent to the value of your total pension pot on 5 April 2015 provided that exceeds £1m up to a maximum protection of £1.25m.

If you do not have any form of personal LTA protection, including if you have now lost your original enhanced protection or fixed protection, and your pension pot was worth more than £1.25m as at 5 April 2014, or £1m as at 5 April 2016, then you should seriously consider applying for IP14 or IP16 respectively.

26. How do I apply for individual protection 2014 (IP14)?

If your pension pot was worth more than £1.25m on 5 April 2014 you can apply online to HMRC for IP14. (Go on the HMRC website, put "*Individual Protection 2014*" into the search engine and it will take you to a list which includes *"Pension schemes: protect your lifetime allowance".* Click on this and it will take you to the relevant guidance notes and form.)

You will need to have an accurate total value of your pension pot as at 5 April 2014 from all your pension sources, (other than the national state pension), for example from the LGPS, returning officer pension, private pensions, AVCs etc.

The maximum protection you can apply for under IP14 is £1.5m even if the value of your pension pot as at 5 April 2014 exceeds this figure.

You can apply for IP14 up to 5 April 2017 – although your protected LTA can only relate to the value of your pension pot as at 5 April 2014 and not to any benefits accrued after that date.

27. How do I apply for individual protection 2016 (IP16)?

If your pension pot was worth more than £1m on 5 April 2016 you can apply online to HMRC for IP16. (Go on the HMRC website, put "*Individual Protection 2016*" into the search engine and it will take you to a list which includes *"Pension schemes: protect your lifetime allowance".* Click on this and it will take you to the relevant guidance notes and form.)

You will need to have an accurate total value of your pension pot as at 5 April 2016 from all your pension sources, (other than the national state pension), for example from the LGPS, returning officer pension, private pensions, AVCs etc.

The maximum protection you can apply for under IP16 is £1.25m even if the value of your pension pot as at 5 April 2016 exceeded this figure.

28. Can I lose individual protection (IP)?

No – unlike fixed protection you will not lose IP (14 or 16) if the growth in your pension pot exceeds the CPI% increase. Any pension savings, however, in excess of your protected LTA under IP will be subject to an additional lifetime allowance tax charge.

29. Can I hold other types of protection in addition to individual protection (IP)?

Yes. You can apply for IP if you also hold enhanced protection (EP) or fixed protection (FP12, FP14 or FP16).

You cannot apply for IP if you already hold primary protection.

You cannot hold both IP14 and IP16 – you should apply for the one most appropriate to you depending on the value of your pension pot as at 5 April 2014 and 5 April 2016.

30. If I already have enhanced protection (EP) or fixed protection (FP12, FP14 or FP16), is it worth also applying for individual protection (IP)?

Probably, although it depends on your own particular circumstances.

If your pension pot was worth more than £1.25m on 5 April 2014, or £1m on 5 April 2016, even if those values are not as great as the protected LTA you have through your EP or FP, IP could still act as a form of insurance should you lose your EP or FP (which, with FP you will have done if you have stayed in the LGPS after 5 April 2016 – see question 19 above). While it may not be as good as the protection you have under EP or FP, it will be better than the new standard LTA of £1m.

31. If, despite acquiring LTA protection, I will still face additional tax charges in respect of the LTA when I retire, should I utilise the 50:50 option?

The 50:50 option was introduced into the LGPS from April 2014 in order to encourage low paid employees to stay in LGPS. It is also helpful to high earners who are trying to contain the growth in their pension pot. Under it you pay half your normal rate of contribution and, in return, build up half pension during that period. So, if you opted for it for the entire year, the growth in your pension pot would only be half what it would otherwise have been.

You can opt for it on a monthly basis, from the start of each pay period, and choose when to opt back into full contributions. It is therefore possible in any one year to adjust the time you are using the 50:50 option to help reduce the growth in your pension pot.

While you are using the 50:50 option you still retain the full value of your other benefits such as the death grant and, if you are aged 55 or over, you also retain the possibility of immediate access to your pension benefits, and without them being actuarially reduced, if you are prematurely retired on redundancy or business efficiency grounds (see question 8 in the main *Pensions: FAQs* document). You may therefore consider this option preferable to leaving the LGPS permanently (see question 32 below).

Before utilising the 50:50 option it might be worth considering getting some detailed forward estimates done to see if the tax charges you would need to pay at retirement would outweigh the net (after the tax charges had been taken into account) financial benefit of the additional pension benefits you would have earned if you had not gone for the 50:50 option, especially if you also commuted some of your pension into a larger tax free lump sum (see questions 5-7 above).

Such estimates would have to be based on a range of assumptions which could change before you retire e.g. your salary at retirement, the date of your retirement, whether you had had to pay any tax charges in respect of the Annual Allowance in the meantime (See Appendix 2 to the main *Pensions: FAQs* document), whether the LGPS or level of the standard LTA or the tax rules had changed in the meantime etc. etc.. Your pension fund would probably be unwilling to do such detailed estimates for you, certainly at no cost to you, but you could, for a fee payable by you, use ALACE's Pension Service supplied by Hymans Robertson, and accessed through our consultants Cheryl Miller or Pete Morris, to do some estimates for you. If you had also signed up to ALACE's Financial Planning and Investment Service supplied by Close Brothers, they too would be able to advise you on what to do.

32. If, despite acquiring LTA protection, possibly utilising the 50:50 option and taking the maximum tax free lump sum I can, I will still face additional tax charges in respect of the LTA when I retire, should I leave the LGPS?

A decision to leave the LGPS permanently should not be taken lightly and only after taking sound independent financial advice.

Before any decision is taken to leave the LGPS it would be worth checking out the tax liability position should you decide at the time you retire to commute some of your pension into a larger tax free lump sum as this could significantly reduce or even eradicate your additional tax charges (see questions 5-7 above). (Remember the LTA is applied after account has been taken of commutation.)

Even if commutation does not totally eradicate your tax charges detailed estimates would need to be done to see if the charges you would need to pay at retirement would outweigh the net (after the tax charges had been taken into account) financial benefit of the additional pension benefits you would have earned if you had stayed in the LGPS up to retirement.

As with the answer to question 31 above, such estimates would have to be based on a range of assumptions which could change before you retire e.g. your salary at retirement, the date of your retirement, whether you had had to pay any tax charges in respect of the Annual Allowance in the meantime (See Appendix 2 to the main *Pensions: FAQs d*ocument), whether the LGPS or the level of the standard LTA or the tax rules had changed in the meantime etc. etc.. Your pension fund may be unwilling to do such detailed estimates for you, certainly at no cost to you, but you could, for a fee payable by you, use ALACE’s Pension Service supplied by Hymans Robertson, and accessed through our consultants Cheryl Miller or Pete Morris, to do some estimates for you. If you had also signed up to ALACE’s Financial Planning and Investment Service supplied by Close Brothers, they too would be able to advise you on what to do.

If you do leave the LGPS permanently your pension pot will then be preserved/deferred and become payable in full from your “normal pension age” which for most members will currently be age 66 or 67. Earlier payments of benefits will normally lead to actuarial reduction in their value unless retirement is due to ill health.

Preserved benefits are increased in line with inflation so that they hold their value when they eventually come into payment. Some members may have reserved rights to an earlier pensionable age if they have the protections afforded by the “85 year rule” (see question 9 in the main *Pensions: FAQs* document).

Take note, however, of the following implications of leaving the LGPS –

If you are retired by your Council early through redundancy or on business efficiency grounds, and you have opted out of the LGPS, you may **not** be able immediately to receive your pension benefits before your normal pension age. Had you remained in the Scheme and were aged 55 or over, your pension benefits would have been paid in full immediately.

If you are retired early on ill health grounds your preserved benefits could be paid from any age, but the benefits would be greater had you not opted out of the Scheme because of the possible enhancements arising from ill-health retirement.

If you die in service the normal death benefits include a death grant of three times salary under regulation 40(3) of SI 2013, No 2356. If you have opted out of the Scheme, however, and are therefore a deferred member, the death grant under regulation 43(3) is five times the amount of annual pension that you would have received if you could have drawn it on the date of death – this is likely to be a significantly smaller amount.

If you leave the LGPS you will not, of course, have to make any further contributions from your pay to your pension, although you will see an increase in your income tax (which is the loss of tax relief on your pension contributions). Your deferred benefits will increase in line with inflation which would be helpful if future pay increases were less than inflation.

Leaving the LGPS will also save your employer money (as there are significant employer contributions to your pension). Some ALACE members who have left the LGPS have negotiated new pay arrangements with their employers.

Under such arrangements the employer pays direct to the employee what would have been the employer contributions as an increase to the ALACE member's salary. Although HMRC regard such an arrangement as acceptable, and mentioned it on their website when consulting about reducing the LTA in 2014, the practice has been challenged by the Welsh Auditor as being unlawful. The alleged unlawfulness does not appear to refer to the practice itself but to the fact that in the particular cases examined the decision to enter into such an arrangement may not have been taken appropriately (i.e. in a properly constituted committee with all the facts and figures being presented to the committee even in confidential session); that it infringed equality legislation because the arrangement was not open to all council employees; and that the decision was inconsistent with the Council's fiduciary duty.

ALACE does not recommend this practice, however arranged, and particularly if it is not open to all employees. Even if lawful it is likely to lead to strong public criticism of the Council and the individual concerned by the public, the media and auditors.

Deciding to leave the LGPS is therefore a very important decision and it is advisable to take independent financial advice before making such a decision. ALACE's Financial Planning and Investment Service can, for a fee, provide you with such advice. This can be accessed via our consultants Cheryl Miller and Pete Morris but not directly**.** (If neither Consultant is available and the matter is urgent, please contact the Honorary Secretary.)

33. Can I reduce my LTA additional tax charges by taking Flexible Retirement?

If you are aged 55 or over and, with your employer's consent, reduce the hours you work, or the grade in which you are employed, you can make a request in writing to your employer to receive all or part of your pension benefits. This is known as flexible retirement – see question 10 in the main *Pensions: FAQs* document. As set out there, if the payment of benefits takes effect before your normal pension age, the benefits payable will normally be actuarially reduced in accordance with guidance issued by the Government Actuary on *Flexible Retirement*, although your employer may in certain circumstances waive, in whole or in part, any such reduction as long as to do so is in accordance with the authority's published policy.

You continue to earn pension benefits on your part-time salary following flexible retirement which will be taken into account against the LTA that applies to you when you finally retire. **You will therefore want to check with your pension fund whether this will mean that, at that time, you will incur additional tax charges and what they will be.**

Flexible retirement may help prevent your pension pot increasing by as much as it would have done if you had just kept on working full-time until your normal pensionable age, and therefore reduce the total amount of additional tax charges that you eventually pay in respect of the LTA. It is important, however, to look at the full implications of such a move – financial, legal, managerial and reputational.