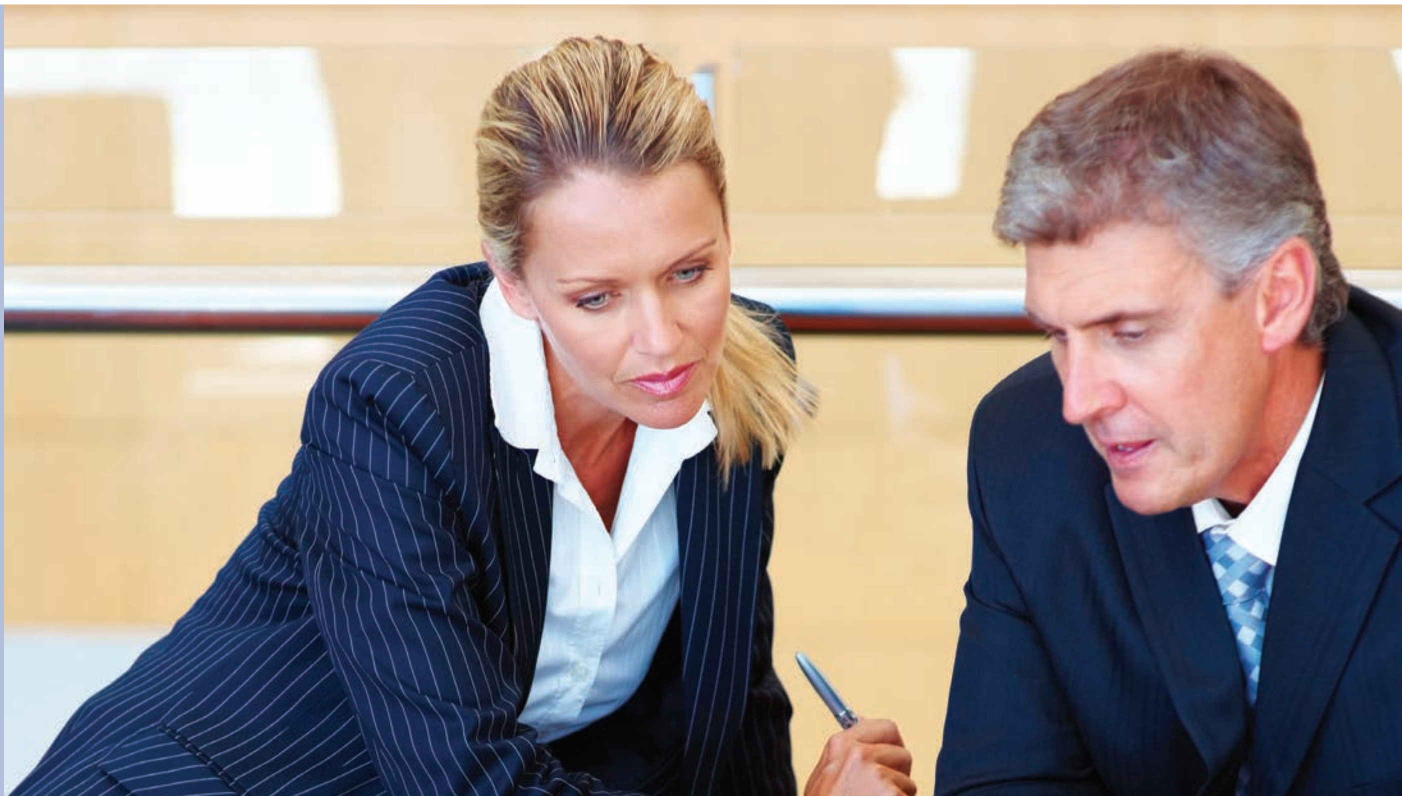
Havering
LONDON BOROUGH

London Borough of
Redbridge

Pension taxation **changes**

The 2009 Budget introduced changes which have an impact on taxation and pension savings. People are affected in different ways. If you earn over £100,000, you will be affected. If you earn close to £100,000 you may be affected in the future. It is important you read this leaflet carefully to understand how you may be affected.



lgps
look forward with confidence

HYMANS ROBERTSON

What are the **changes?**

Important definitions:

Relevant income - used for the purposes of the anti-forestalling measures from 22nd April 2009 to April 2011. It includes all your taxable income in a tax year, including income not related to your employment.

It is worked out as your income before personal allowances, less employee pension contributions of up to £20,000 (£30,000 in some limited circumstances) and less charitable donations you make.

For example, if your total pay is £140,000 per year and you do not make any other allowable deductions, then your relevant income would be worked out as:

Total pay
= £140,000

Less LGPS contributions at 7.5%
= £10,500

Total relevant income
= £129,500

Pre-tax income - total income from all sources before deduction of individual pension contributions and charitable donations.

For example
Total pay
= £140,000

LGPS contributions at 7.5%
= £10,500

Pre-tax income
= £140,000

From April 2010:

- The **personal allowance** will be phased out where taxable income exceeds £100,000. This means that anyone with income between £100,000 and £112,950* will have an effective marginal tax rate of 60%. In addition, if your pre-tax income is over £150,000 income tax will increase from 40% to 50%.

From April 2011:

- If your pre-tax income is £130,000 or more it is expected you will pay tax on the yearly growth in the value of your pension benefits due to tax relief being removed. It has not yet been defined exactly how this will be calculated. The Government is consulting on these changes and will issue more information shortly.

- It is also worth noting that employee and employer National Insurance contributions are both due to increase from April 2011 by 1%.

In the period between now and April 2011:

The Government has introduced interim measures that prevent people affected from taking advantage of tax relief on pension contributions before 2011 by increasing their contributions. These interim measures are known as "anti-forestalling" and will apply retrospectively from 22nd April 2009 until April 2011.

The interim measures will limit the tax-relief on your pension savings if you have relevant income of £150,000 or more (£130,000 or more from 9th December 2009) and wish to make additional pension savings higher than:

- your normal, "regular" pension saving; and
- the "Special Annual Allowance" (defined as the higher of £20,000 and the 3 year average of any "irregular" pension savings, subject to an overall maximum of £30,000).

All pension savings (i.e. employee and employer) above these levels will be subject to a special tax charge of 20% in the 2009/10 tax year. This is expected to increase to 30% in the 2010/11 tax year with the introduction of the new 50% top rate of income tax.

In some circumstances it may be possible to make additional pension contributions without becoming subject to the tax charge. An example of this would be if your pension savings is under the Special Annual Allowance.

Please note:
We have included some examples as part of the definitions section. For each of these examples it is assumed that your only income is from your LGPS employment and that you are a member of the pension scheme.

The LGPS employee contribution rate for scheme members earning £78,700 and above in 2009/10 is 7.5%. The figure of £78,700 is updated every year in line with inflation.

*based on 2009/10 personal allowances, so subject to adjustment in 2010/11.

How will these changes **affect me?**

To help you work out whether you are affected you should read the details below which are split into three groups according to your income.

Important definitions:

Gross income - gross pay from employment and income from any other source plus pension growth each year.

For example:

Total pay = £140,000

LGPS contributions at 7.5% = £10,500

Pension Growth = £23,000

Gross income = Total pay plus

Pensions growth = £163,000

Taxable income - gross pay and income from other sources less individual pension contributions and donations to charities.

This is the same calculation as 'Relevant income' and is used to determine your tax liability.

ARCs - Additional Regular Contributions. Allows you to purchase extra annual pension in the LGPS.

AVCs - Additional Voluntary Contributions. You can invest money through an AVC provider in all LGPS Funds with an insurance company or building society.

Group 1) Your taxable income is below £100,000 and expected to continue to remain below £100,000

The only change that will affect you is the increase to National Insurance contributions by 1% from April 2011.

Group 2) Your taxable income is over £100,000 but your pre-tax income is expected to remain below £130,000

The personal allowance reduction from April 2010 will affect you. This will increase the amount of income tax you pay. As your pre-tax income is less than £130,000, you may wish to consider paying additional pension contributions, rather than paying additional tax. Obviously this will still reduce the level of your net pay, but you would benefit from the additional pension income provided rather than lose the full reduction to income tax. The level of tax relief you will benefit from will depend on your level of earnings because of the way HMRC are phasing out the personal allowance. Those earning between £100,000 and £112,950 (2009/10 figure) can receive 60% tax relief.

Example:
If you earn between £100,000 and £112,950, for each £1 of salary in this band you will pay 60 pence in income tax. If you choose to make AVCs/ARCs of £1 the full value would be paid to your pension, giving you tax relief of 60%.

This is only an illustration to show you the tax relief available by paying AVCs/ARCs. The actual figures will depend on your circumstances. The amount of tax relief will be no less than 40% but it will depend on your level of taxable income and how much pension contributions and AVCs you are paying.

You will also pay additional National Insurance contributions as described under Group 1. The effects of the National Insurance contributions are not included in the example.

Group 3) If your pre-tax income is £130,000 or more there are 5 issues you need to be aware of

If you are in this group you will be affected the most.

1) Your personal allowance will be reduced from **April 2010**, as described for Group 2.
2) You will pay additional National Insurance contributions from **April 2011**, as described for Group 1.
3) You will pay income tax of 50% (instead of 40%) on income over £150,000 from **April 2010**.
4) If you arrange to pay new, or increase existing AVCs/ARCs, or are awarded **an increase** in pension benefits, for example, by additional years or additional pension between April 2009 and April 2011, you may be subject to a tax charge.
5) As your pre-tax income is £130,000 or more from April 2011 there may be restrictions on the tax relief available on the growth of your pension benefits.

To establish if you will be affected by this latter point there are two income tests to use to assess the impact of the tax relief restrictions.

a) If your pre-tax income is more than £130,000 but your pension growth takes your gross income to less than £150,000 you will not be affected by the restriction on tax relief on pension growth.
b) If your pre-tax income is more than £130,000 but your pension growth takes your gross income to £150,000 or more this restriction will apply to you.

The tax charge on pensions growth will be payable each year.

How this will be calculated and paid is subject to consultation. So we do not yet know the details of how it will work. What we do know is that this may result in lump sum payments for tax charges being paid through the self-assessment process at the end of each tax year.

If the tax charge is over £15,000, there may be scope for you to have this tax charge paid by a reduction in your pension benefits instead of having to pay it as a lump sum.

If you need further information about your benefits in the LGPS contact your pension department. You may wish to take independent advice about how these changes will affect you.

Anti-forestalling - Points to **consider**

- If the growth in your pension is under the Special Annual Allowance, you can make limited AVCs/ARCs to pension arrangements and still receive tax relief at your highest rate of tax.

- Please note that if you have primary protection or enhanced protection or both you will need to take advice about how that might interact with the changes set out in this leaflet. In particular, paying AVCs may mean you will lose your enhanced protection.

- If your relevant income is just above £130,000, you may be able to reduce it below the threshold. You could do this by increasing your pensions contributions up to £20,000 (ARCs and AVCs combined), and through other tax reliefs (e.g. making charitable donations through Give As You Earn will reduce your relevant income). However, this will just be of relevance in the period to April 2011 and you will still be subject to a tax charge from April 2011 as your pre-tax income will be greater than £130,000.

- Moving above the £130,000 threshold will affect the amount of tax relief you can receive on pension savings now and in the future.

- You need to take into account your relevant income for the two previous tax years. For example, if your relevant income was less than £130,000 in 2009/10, you could still be affected by the changes if your relevant income was £130,000 or more in 2007/08 or 2008/09.

If you are below the £130,000 pre-tax income threshold now, but think you will move above it in the future, you may want to review and update your medium-term retirement saving plans.

This note is intended to provide a high-level overview of the proposed tax changes announced in the Budget on 22nd April 2009 and updated by the Pre-Budget Report on 9th December 2009. The details of the changes are complicated and are not fully covered here. The proposed changes from April 2011 remain subject to consultation and could change before being finalised. It is therefore essential that you seek individual financial advice before taking any irreversible actions in relation to your pension benefits.