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**Tower Hamlets – Annual and Lifetime Allowance 2023 newsletter**

Welcome to the 2022/23 Annual and Lifetime Allowance newsletter. The purpose of this newsletter is to aid your:

* Understanding of the fundamentals relating to the annual and lifetime allowances; and
* Knowledge on your personal responsibilities as it relates to pension taxation.

Several major changes to both the annual and lifetime allowances were included in the Government’s March 2023 budget announcement. Details of these changes are included in this newsletter.

It is important that you read this newsletter carefully to understand how you might be affected.

**Fundamentals – Annual and Lifetime Allowance**

**Annual Allowance (AA)** is the value of annual pension savings you can make each year and still receive tax relief. If the value of your pension benefits in any one year grows by more than the Annual Allowance, then you will likely become subject to a tax charge – unless you have any **unused** annual allowance amounts from the previous 3 tax years that can be used to offset or reduce the impact of any breach.

For the purposes of the Annual Allowance your pension growth includes:

• Your pension benefits in the Local Government Pension Scheme (LGPS), including additional voluntary contributions (AVCs); and

• Any other pension savings you make, for example to a personal pension arrangement.

The Annual Allowance threshold for the tax year 2022/23 tax year just ended is still £40,000. Following the March 2023 budget, the annual allowance threshold for the 2023/24 tax year is increasing to £60,000.

**Lifetime Allowance (LTA)** has historically been the maximum value of retirement benefits an individual can build up over their lifetime without paying a tax charge.

Before the 6 April 2023 members with lifetime pension savings valued at more than the lifetime allowance threshold of £1,073,100 would be liable for a tax charge. The Government announced in the March 2023 budget that from 6 April 2023 the lifetime allowance tax charge has been **removed** meaning that there is no level of lifetime pension savings that will trigger a tax charge.

The Government also announced in the March 2023 budget that from 6 April 2024 the LTA will be removed completely.

**NB. Knowing how any salary changes impact your pension ‘value’ is key for both the Annual and Lifetime Allowances**

**Annual Allowance**

**How is it calculated? Broad principles**

The tax rules that govern pension taxation are complicated, but we have detailed below the broad process used to calculate your pension growth in a tax year.

**Process**

Tower Hamlets will calculate your pension growth for the period 6th of April to the 5th of April.

Firstly, we calculate the value of your standard benefit entitlement in the Fund as at 6 April and increase this to account for inflation.

We then calculate the value of standard benefits at the end of the period (5th April) – taking the starting period value away from this end period value

Where the resulting number is greater than zero, we multiply that value by 16 to obtain a capital value and then add in the growth to any basic lump sum and the value of any AVC contributions paid.

This will then tell us if you have breached the annual allowance threshold for that tax year (remember it is **still** **£40,000** for the 2022/23 tax year)

Where you have breached the Annual Allowance, we will advise you of this by the 6th of October following the end of the tax year assessed, also providing details of any carry-forward you may have available (so for the 2022/23 tax year this would be by 6 October 2023)

You will then need to assess by how much you have breached the annual allowance, taking into account any other pension savings you have made during the tax year, work out the tax charge due and notify HMRC (by no later than 31 January) via your self-assessment tax return

If you wish for the Fund to meet the cost of any tax charge on your behalf, you will need to confirm this to HMRC as part of your tax return and also confirm this to the Fund

**Basic process used by the Tower Hamlets Pension Fund for the 2022/23 input period**

**Annual Allowance – Carry forward**

The Government allows for any **unused** Annual Allowance from the previous 3 years to be carried forward, which can then be used to offset or extinguish a breach of the Annual Allowance where it occurs.

**Example – Carry Forward**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Tax Year | Annual Allowance | PIA (growth in pension) | Unused annual allowance | Remaining unused allowance for next tax year |
| 2022/23 | £40,000 | 47,000 | 0 | £2,000 |
| 2021/22 | £40,000 | 39,000 | £1,000 |
| 2020/21 | £40,000 | 37,000 | £3,000 |
| 2019/20 | £40,000 | 35,000 | £5,000 |

In the example above the member had not breached their annual allowance until tax year 2022/23. In 2022/23 they breached by £7,000. However, they can offset that breach by using the unused allowance built up in the 3 previous tax years (Total of £9,000).

The member therefore suffers **no tax charge** in 2022/23 due to carry forward offset.

The member also has £2,000 remaining balance to carry forward into tax year 2023/24 due to unused allowance in tax years 2020/21 and 2021/22. Tax year 2019/20 drops off ‘carry forward’ by the 2023/24 review, although it had all been used up in this example in offsetting the 2022/23 breach.

**Annual Allowance – key issues we have seen with members in recent years**

|  |
| --- |
| **Salary jump**   * Promotions and large salary increases can impact your annual pension ‘growth’ even if you are not a ‘high earner’ and consequently result in you breaching the annual allowance threshold. This is particularly so if you have significant pre-2014 LGPS final salary membership. ‘Carry forward’ of unused annual allowance in the previous 3 years may offset or reduce any tax charge for these one-off spike cases. The increase in the annual allowance threshold to £60,000 from 6 April 2023 should see a reduction in the number of scheme members impacted by the effects of promotions and large salary increases. |
| **High salary – potentially continuous high AA pension growth**   * The annual allowance calculation looks at your opening pension position at the start of the tax year and compares that against the closing pension position at the end of the tax year. The opening position will be adjusted for inflation. Generally, for those members who are on a salary of around £90,000 you are already using around £30,000 of your £40,000 annual allowance by virtue of your LGPS Career Average Revalued Earnings (CARE) growth in that one year – but this is dependent on inflation in comparison to any salary increase you have received. This CARE growth does not account for any growth in pre-2014 benefits you may also hold. * It is worth noting that from the 2023/24 input period where the annual allowance increases to £60,000 you would need to be on a salary in excess of £153,000 in order to achieve growth of £50,000 by virtue of your LGPS CARE growth alone in that one year. |
| **Transfer impact – increase in salary**   * If you transfer from a previous LGPS fund and have come into the Fund with a larger salary and significant pre-2014 membership, then this may impact your annual allowance growth in that tax year the transfer is applicable, possibly resulting in a tax charge applying. |

**Tapered Annual Allowance**

Tapering of the annual allowance has been in place since 2016/17 for those individuals with significantly high salaries. The result of tapering is a reduction to the annual allowance the more your earnings exceeded certain thresholds, resulting in some cases the allowance being reduced to £10,000.

From the 2020/21 tax year the thresholds were increased, meaning that in order to be impacted by tapering you would have to have earnings in excess of £228,000. Consequently, unless an individual has another source of income as well as a significant salary with an LGPS scheme employer they are unlikely to be affected by the taper annual allowance.

**What will the Tower Hamlets Pension Fund provide with regards to Annual Allowance?**

Tower Hamlets Pension Fund will advise you by the **6th of October 2023** whether you have breached the annual allowance for the period 6th April 2022 to 5th April 2023. This will be your annual Pension Saving Statement.

We will also advise you if you have any carry forward remaining to offset that breach.

If you do trigger an Annual Allowance tax charge and you have no unused allowance remaining or not enough to offset the tax, then it is your responsibility to assess the amount of the tax charge and to confirm with HMRC how you with to pay the amount of tax due.

Please note, the Fund is not authorised to provide any financial advice to our members.

**How can I pay this tax charge and by when?**

It is your personal responsibility to ensure that any tax payment due has been paid to HMRC. You can either:

* settle this tax charge by a direct payment from yourself to HMRC (by 31st of January in the following year), or
* use an option where your Fund makes the payment of the tax charge to HMRC on your behalf and you suffer a proportionate reduction you can use a reduction to your pension benefits – this is called a **Scheme Pays** option.

**Scheme Pays**

Scheme pays comes in two variants **Mandatory** and **Voluntary**.

* **Mandatory** scheme pays – the value of your tax charge must be above £2,000. If paid by the Fund this will result in an ongoing reduction to your annual pension. The Fund is only obliged to pay the element of tax charge that relates to your membership of the Tower Hamlets Pension Fund. Strict time limits apply (please see deadline section below).
* **Voluntary** scheme pays – this is available at the Funds discretion. Normally this relates to tax charges under £2,000, or where an individual has made an election outside the prescribed time limits. There is technically no time limit on Voluntary scheme pays elections being made, although you should be mindful of the HMRC overriding rules around self-assessment and the possibility for fines if a tax charge that is not covered by a mandatory scheme pays election is paid after the 31 January deadline.

At present, Tower Hamlets will **only** accept use of **Mandatory** Scheme pays. **You** will have to advise Tower Hamlets that this is the method that you wish to use.

**Scheme pay deadlines**

Below are the dates that would apply to a tax charge relating to a breach of the AA in the tax year 2022/23.

This is following the issuing of your Pension Saving statement by the Tower Hamlets Pension Fund on the 6th October 2023.

|  |  |  |
| --- | --- | --- |
| Date | Mandatory | Voluntary |
| 31 January 2024 | Tax must be accounted for, and confirmation given that you intend the Fund to pay the tax charge on your behalf. | Tax must be accounted for and paid by this date if there is to be no late payment interest.  **NB** this is also the final date that you can make a personal direct payment to HMRC for a tax charge and not suffer late payment interest. |
| 31 July 2024 | The latest date the member may make an irrevocable election to the Fund |  |
| 31 December 2024 | The latest date the Accounting for Tax return relating to the tax charge must be submitted (Fund responsibility) |  |
| 14 February 2025 | The latest date by which tax relating to the breach may be paid |  |

Different deadlines may apply where it has been necessary to recalculate your pension input amount where the information used to calculate your pension growth is retrospectively amended as a result of your employer providing us with incorrect information. Should this happen, we will liaise with you directly to discuss the timescales that would apply.

**You are considering making use of pension freedoms with another pension.**

You should also be aware that if you intend to make use of pension freedoms by accessing defined contribution pension benefits, there may be a further impact on your Annual Allowance arrangements. If you do have defined contribution benefits and intend to use them to draw down cash, then you should seek independent financial advice.

**Lifetime Allowance**

**What is the Lifetime Allowance?**

Historically the lifetime allowance was a measure of the total value of all pension benefits you can earn without triggering a tax charge. Before the 6 April 2023 if your lifetime pension savings were valued at more than the lifetime allowance threshold of £1,073,100 you would be liable for a tax charge at the point that you started to receive those benefits. The Government announced in the March 2023 budget that from 6 April 2023 the lifetime allowance tax charge has been removed meaning that there is no level of lifetime pension savings that will trigger a tax charge.

The Government also announced in the March 2023 budget that from 6 April 2024 the LTA will be removed completely.

**Maximum tax-free lump sum following removal of the lifetime allowance**

If you have benefits valued in excess of the lifetime allowance the maximum tax-free lump sum available to you was 25% of the lifetime allowance.

From 6 April 2023 this limit has been retained meaning that if you have benefits valued at more than £1,073,100, the maximum tax-free lump sum you will be able to receive from your pension savings is limited to £268,275.

The maximum tax-free lump sum is cumulative. This means that if you have already taken a tax-free lump sum from a previous pension arrangement and then return to work and build up more pension benefits, the maximum tax-free lump sum you can take second time round is reduced to take account of the tax-free lump sum you’ve already taken.

**Protections**

Over the years the LTA has been reduced. Each time it was reduced, protections were put in place for those members who had saved up to the old limit so that they didn’t face a retrospective tax charge.

To some extent those protections are no longer necessary since the LTA charge has been removed. However, the protections do also have the effect of allowing members to take a larger tax-free lump sum. If you have valid Enhanced Protection, Fixed Protection 2014 or Fixed Protection 2016 which had been applied for before 15 March 2023, you will **retain** the ability to take a larger tax-free lump sum. Where you had either of the fixed protections you will also be able to accrue new pension benefits, join new arrangements or transfer benefits without losing this protection.

**Lifetime Allowance excess lump sums**

In most cases you will have an absolute maximum lump sum that you can receive from the LGPS equal to the tax-free limit of £268,275 (or more if you have lifetime allowance protections).

However, there are certain circumstances when it is possible to take a lump sum greater that the maximum tax-free amount. This can happen when at the point of retirement, you had already exceeded the lifetime allowance and are drawing a lump sum. Any lump sum above the tax-free maximum is called a Lifetime Allowance Excess Lump Sum (LTAELS)

Before 6 April 2023 an LTAELS was taxed at 55% of its value. From this date any LTAELS will be taxed as if it is pension income. This effectively means it is taxed at your marginal income tax rate. Further detail on how this will work in practice is still awaited and we will let you know once everything has been confirmed.

**Pension tax is complicated but hopefully now (more) understandable!**

We hope the above information has given those of you previously affected or that may potentially be affected by pension taxation, some much needed information on this issue.

If you have any questions regarding this or any other issue, please get in contact via

[pensions@towerhamlets.gov.uk](mailto:pensions@towerhamlets.gov.uk)

For further information on this topic and many others please visit [www.LGPSmember.org](http://www.LGPSmember.org).

**Disclaimer**

This Newsletter is provided as a high-level overview of the latest tax rules pertaining to the Annual and Lifetime Allowances, as at June 2023. The details of the changes are complex and are not fully covered here. The contents of this newsletter should not be treated as a complete and authoritative statement of the law. It is, therefore, essential that you seek individual financial advice before taking any irreversible actions in relation to your pension benefits.