**Pensions**

**Summary**

Doctors will have relaxed a little due to the recent action of government with respect to the increases to threshold and adjusted income levels for the purposes of calculating the tapering of the annual allowance. This change is effective from the fiscal year 2021. Many however, are also trusting that the compensation clause sent out by the NHS employers for any loss in pension benefits due to extra work taken on in the NHS for the fiscal year 2020, will also cover any tapering effect. This is to be recorded by way of submitting an election to the pension schemes to pay any tax on excesses arising until the new limits come into effect.

A large proportion of consultants have suffered tax claw-backs for those with total taxable incomes in excess of £110,000 up to 5 April 2020, but now that limit has been increased to £200,000 which should cover the vast majority of consultant doctors. However the annual allowance limit remains in place at £40,000 so if your pension savings’ growth exceeds this you will be faced with a liability still. This level of growth is easily reached at the upper levels of consultant pay and for anyone enjoying a pensionable pay increase including back pay (make sure it is allocated to the correct pension year) or pensionable awards.

The tax claw-back is due to restrictions introduced with effect from 6 April 2016 and applies once specified limits are reached: Annual Allowance (AA) and Lifetime Allowance (LTA).

All doctors in NHS schemes accrue pension benefits by reference to levels of earnings rather than actual cash contributions paid as employees and employers. NHS schemes are called defined benefit (DB) pensions because the benefits are defined by reference to the scheme’s accrued pensionable pay on retirement after considering length of service and membership of different schemes across a whole career. It is almost impossible to manage the contributions made into any NHS pension arrangements as none of the schemes have flexibility in the regulations for managing pension growth. Yet it is this relevant annual savings’ growth, adjusted for Consumer Price Index (CPI), which is used when calculating adjusted income for the purpose of applying the pension tax relief restrictions.

Any doctor with annual pension savings’ growth which when added to their total taxable income, exceeds the adjusted income of £240,000, (2020 limit was £150,000) is subject to tax being recouped. This will be via the self-assessment tax return or the tax coding applied to employment income; or by asking the pension scheme to pay when the eventual savings’ pot is crystallised on retirement. Any request for the scheme to pay the tax charge carries an interest charge. Doctors can easily breach these limits because taxable income includes all sources of income plus the savings’ growth within the pension pot.

If contributions are paid into a defined contribution (DC) scheme it is the actual amount of the contribution itself during the pension input period (now in line with the fiscal year), which is added to the taxable income to test against the limit of the AA. If doctors pay into both, including AVCs and private arrangements, then it is the value across all schemes in the year in question, which is tested against the AA.

The other limit to consider is the LTA. This is the maximum amount an individual can accumulate, including contributions and growth, in all of their registered pension schemes, occupational and private, without incurring an additional tax charge. Originally set at £1.5m and increased to £1.8m, this has gradually reduced to £1.5m from 6 April 2012, £1.25m from 6 April 2014 and again to £1m on 6 April 2016 increased by (1 + CPI) each year thereafter. If the pension pot has accumulated more than these limits at relevant dates shown below, there are some basic protections which can be put in place. These usually mean freezing further contributions and such action may have unwanted side effects such as loss of death in service benefits.

This is a very complex area and requires advice from both independent financial advisors and your accountant to ensure you understand the effect any action may have on your pension as well as on your tax position. Added to this is a restriction on any tax planning to reduce total taxable income which results in the manipulation of income to avoid the tax claw-back.

**Some basic facts**

The Annual Allowance (AA)

• The AA as introduced with effect from 6 April 2006, is the maximum amount an individual can contribute (DC), or accrue (DB) in any 12 month period (tax year) without incurring a tax charge. This amount varies depending on the level of taxable income and contributions from employee and employer but the maximum is £40,000, reducing to £10,000 for every £2 the adjusted income exceeds £150,000. This limit has been extended for 2021 onwards to £240,000 for adjusted income but the tapering can now reduce to £4,000.

• Unused AAs from the preceding three tax years remain open to set off against excesses over the calculated limit.

• Pension savings which exceed the AA are taxable at the individual’s marginal tax rate.

• The member may choose to settle any charge directly via self-assessment or, if the amount exceeds £2,000, they may ask the Pension Scheme to settle the tax bill. This “debt” is then held on their pension account to be recovered at retirement, including any interest accrued. Within the NHS pension schemes a request for voluntary scheme pays can be made for any tax arising on amounts over tapered annual allowances for fiscal year 2018 onwards (fiscal year 2017 the annual allowance was restricted to amounts in excess of £40,000 only.) For 2020 a compromise compensation has been offered to those increasing their NHS commitments for the tax liability arising from a tapered annual allowance if the doctor submits an election to ask the pension scheme to pay the tax arising.

• Pension growth is formally known as the “Pension Input Amount” measuring the pension at the end of the PIP against the value at the start of the PIP plus inflation (CPI). This is calculated in accordance with the scheme rules, and is different for each scheme of which the doctor is a member.

Threshold income

Threshold income consists of:

1. The total gross income figure\* subject to income taxes; plus

2. Earnings/employment income given up for salary sacrifice or flexible remuneration arrangements made after 8 July 2015; less

3. Any contributions paid under the “relief at source” arrangements; less

4. The amount of any lump sum death benefit received which is subject to income tax under the new flexibility rules.

\*This is basically all earned and unearned income on which is subject to income tax is charged, so would include for example:

• Income from employment, including benefits in kind

• Income from self-employment

• Partnership income

• Property income (e.g. rental income)

• Certain foreign income

• Income from trusts

• Income from investments (e.g. interest, dividends)

If threshold income exceeds £200,000 for fiscal year 2021 and £110,000 up to fiscal year 2020, it will then be necessary to calculate “adjusted income.

Adjusted income equals:

Threshold income;

Plus either:

The contributions made the occupational pension schemes, by both employee and employer;

Or:

The employer value of accrual in defined benefit or cash balance pension arrangements.

 Or both if you have invested in more than one type of scheme!

If adjusted income is greater than £240,000 for fiscal year 2021 and £150,000 for fiscal year 2020, the AA will suffer a tapering effect resulting in a reduced minimum AA of £4,000 in fiscal year 2021 and £10,000 for fiscal year 2020

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The lifetime allowance (LTA)

• A test against the LTA is normally made at the time when member of a pension scheme first draws benefits from that scheme.

• The LTA has altered over time but currently stands at £1M with effect from 6 April 2016.

• Pension savings which exceed the LTA are subject to a one off tax charge:

 Funds above the LTA used to provide an income incur a tax charge of 25% and are then taxed at the members’ marginal rate.

 Benefits above the LTA taken as a lump sum incur a tax charge at 55%.

Choices

Action will depend on pension needs but could include:

 Pay the tax and carry on as before;

 Request that the tax charge arising on amounts in excess of the £10,000 limit be paid by the scheme (Scheme pays). This will result in a reduction in the final pension and lump sum;

 Opt out of the scheme or reduce added years’ contributions;

 Vary employment contracts with a view to reducing pensionable earnings and thus exposure to taxation e.g. change to part-time employment; refuse promotion; vary terms of employment;

 leave NHS employment and thus membership of the pension scheme and consider other avenues of income generation;

 apply for protection which may require them to “freeze” their pension growth. This will involve leaving the pension scheme as an active member with detrimental implications for drawing pension early, sickness and death in service benefits.

Protection

By applying for protection of the pension savings’ pot, no more value can be added to the pot. The types of protection include:

• Primary protection for those with pension rights in excess of £1.5m as at 6 April 2006. Closed 5 April 2009.

• Enhanced protection allowed retention of accrued rights on 6 April 2006 with proviso that only very limited further benefits could accrue. Closed 5 April 2009.

• Fixed protection April 2012 allowed retention of the original £1.8m LTA with only very limited further benefits which could accrue; so if at £1.8M already, that value was fixed. Closed 6 April 2012.

• Fixed protection 2014 similar to the 2012 protection but reduced the limits to £1.5M with limited further benefits allowed to accrue. Closed 6 April 2014.

• Individual protection 2014 again similar to above but with a minimum threshold of £1.25M and maximum of £1.5M. Closed 5 April 2017.

• Fixed protection 2016 and Individual protection 2016 allows individuals to apply online for protection before they take their benefits and whether or not they apply will be based on the size of their retirement pot when tested against the LTA in any year. Contributing beyond April 2016 to any scheme closes the fixed protection option.

**Example 1**

Sophie is a consultant radiologist earning £90,000 at the end of 2020

Annual Allowance (AA)

Sophie’s Total Reward Statement (accessible from the government gateway at www.gateway.gov.uk using access number).

Salary £90,000

On-call £2,700

Allowances £1,500

Total gross £94,200

Sophie's pension contribution (£12,600)

Total £81,600

**Adjusted income**

Employment £81,600

Less subscriptions £1,000

Add property profit (adjusted for interest paid restriction) £2,700

Private practice profits £45,000

Investment income £5,000

Threshold income £133,300

Threshold income >£110,000 so

Add PIP growth £35,036 (in 1995 scheme only)

Adjusted income £168,336

Limit £150,000

Excess £18,336

Restriction of £9,168 on AA

For 2021 this problem disappears for Sophie as her threshold income is less than £200,000.

Calculation of accrued benefits for 1995 Scheme member

Pension at end of year £23,625

Pension at start of year £21,250

CPI adjustment for inflation (although currently running at 0%!) £531

 £21,781

Increase £1,844

Value of increase

£1,844 x 16 £29,504

Add Lump sum (£1,844 x 3) £35,036

 AA limit £40,000 Restricted £9,186

Revised limit for Sophie. £30,832

Tax claw-back thereon at marginal rate £4,204\*

\*This claw-back is a charge in the self-assessment tax return which is payable both as part of the normal liability and affects the payments on account for the following year.

Sophie's salary at the start of the year was £85,000 and she had only 20 years pensionable service at the start of the PIP. She had no unused relief to carry forward.

Sophie does not breach the AA limit of £40,000 but she suffers a restriction in 2020 because her threshold income exceeds £110,000 and adjusted income exceeds £150,000. These limits have been raised to £200,000 and £240,000 respectively for 2021.

The NHS business Services would not ordinarily send out a statement to Sophie because her growth is less than £40,000. This growth should be requested even if you do not believe you have exceeded the limits because you need to keep an eye on the unused relief for the previous three years in the event of pension savings’ growth exceeding the AA in a year when your pensionable pay is increased. Sophie’s tax return may be inaccurate if she does not include an estimate of the charge to tax and if requesting Scheme Pays, the amount of this request.

Such growth statements can throw up anomalies where growth does not match income increments. These errors can arise because of things like back-pay being mis-allocated to the year in which it is paid rather than the year in which it should have been considered pensionable; CEAs being mis-allocated; in fact any time when pay is not as usual may cause issues. These are easily corrected but should be checked.

In the last couple of years Sophie has suffered tax increases on her property income because of the restriction on the interest she pays on the mortgage. She has also lost her personal allowance because she has taxable income in excess of £100,000 (£11,850 x 40%= £4,740). She has lost some of the dividend allowance (£3,000 @ 32.5%= £975) and the tax relief on her pension (£4,204 @40%= £1,682). On top she also pays just about £26,500 tax and class 4 National Insurance. Add all of this together on her "extra" income and Sophie may wonder if it is worth the effort to be taxed at an effective rate of nearly 60%! With effect from 6 April 2020 however she can relax a little knowing that the pension limits have increased and providing that her pension savings’ growth does not exceed £40,000 she will not have an extra liability arising on this.

**Example 2 Oliver**

Lifetime Allowance (LTA)

Pension scheme 1995 only

35 years’ service

Age 57 years

Pension £54,688

Lump sum £164,064

Pension savings pot:

LTA value of pension

£54,688 x 20 £1,093,760

Plus lump sum of £164,064

Value of pension pot £1,257,824

LTA (no protection) £1,000,000 (+CPI)

Amount liable to tax £257,824

Oliver may be eligible to apply for some form of protection on the size of the LTA depending on the value of his pension benefits as at 5 April 2016. Oliver has some choices to make but advice should be sought as this is a complex area. Further as Oliver is only 57 his pot will continue to increase in value until he draws on his pension at age 60.

Doctors should not take drastic action and leave their pension scheme without taking advice from both their accountant and an independent financial advisor who understands about the special circumstances of doctors.

You may use the attached draft letter which should be sent via email or in the post to obtain the necessary information. The total reward statement is insufficient currently for the purposes of calculating any potential tax charge.