Annex A

OFFICE NOTICE

Civil Service Pensions

New tax rules on pensions - will they affect you?

From 6 April 2006 HM Revenue and Customs (HMRC) are changing the current tax rules that limit pension contributions and the amount of benefits that you can build up in a pension scheme.

For most people, the tax changes will be beneficial as they will increase the amount you can save in pension schemes without paying income tax on your contributions. We will be issuing a further notice on 'Topping up your Civil Service pension benefits from April 2006' shortly.

What are the new rules?

There will be just 2 controls on pensions saving, the Lifetime Allowance and the Annual Allowance.

The **Lifetime Allowance** (LTA) – From 6 April 2006, everyone will have a Lifetime Allowance (LTA) – this is the total capital value of all pension benefits (except the State pensions) before you pay extra tax. If your pension takes you over your LTA, you will have to pay tax on the excess benefits. As the LTA will be £1.5m to start with, **most people will be able to save as much as they wish**. On current figures, unless your pensions in total are likely to be over around £70,000 a year, you are unlikely to exceed your LTA. If you only have **classic** benefits the corresponding figure is around £65,000

How is your pension valued for the LTA?

Any occupational pensions where the scheme is promising to pay an amount of pension on retirement in the future are valued by **multiplying the current pension earned by 20**. Any lump sum benefit (for instance in **classic**) is taken at its current value. This formula applies to 'frozen' pensions from previous employments as well as any pension being built up in current employment. Money purchase pensions such as personal pensions or Additional Voluntary Contributions (AVCs) have a fund value associated with them. The value of these pensions is the **fund value**.

Any pensions in payment on 6 April 2006 are valued by **multiplying the annual amount by 25**.

Example

A **classic** member earns £40,000 and has 20 years' service so has built up a pension of £10,000 plus a lump sum of £30,000. The member also has AVCs valued at £15,000. The value of these benefits for LTA purposes is:

Pension: £10,000 x 20 = £200,000

Lump sum	= £30,000
AVC fund	= £15,000
Total	= £245,000

How will the LTA affect you?

Everyone who brings a pension into payment, whether it is an occupational pension or a personal pension, will use some of their LTA. **Even if your pensions are small and will not exceed the LTA, you must keep records of any pensions that are paid to you.**

- When you come to draw your pension:

  - it will be assessed against your remaining LTA to check whether extra tax is due (even though most people's pensions will not reach anywhere near the LTA).

  - Every pension you draw will use up part of your LTA (the only exception to this is the State pension). When you want any new pension payments to begin you must tell the administrator the percentage (%) of the LTA that has been used up by any pensions you already have in payment, and any benefits you are about to take in other schemes. You will be given information showing the amount of LTA used for any pension paid after 6 April 2006 by the relevant administrator.

  - If you do not provide information promptly about the LTA you have already used up (if any), this will delay your administrator paying your pension.

- Please note that, if you have a pension in payment before 6 April 2006, this will be treated as having used up part of your LTA. The relevant pension provider will tell you how much LTA this represents. You will need to keep information about such pensions that you have, so that you can provide it to your pensions administrator.

- If you already have a pension credit in respect of a divorce before 6 April 2006 you can apply to HMRC to increase your LTA. This is because the pension credit will use up part of your LTA when it comes into payment.

The **Annual Allowance** (AA) - is a limit on the increase in the value of pension rights or benefits that you can have in any tax year without paying extra income tax at 40%. The Annual Allowance will be £215,000 in tax year 2006-7. **As with the LTA, the majority of members will not be affected.**

AA Key points:

- To check whether you have exceeded the AA, you add up:

  - The increase in value of your defined benefit (e.g. **classic**) pension multiplied by 10,

        - plus the increase in value of any automatic lump sum, plus

        - the amount of any contributions you (and your employer for **partnership** members) make to a money purchase pension.

    - **If you exceed the AA in any tax year you will be responsible for reporting this to HMRC by completing a self-assessment return and paying income tax at 40% on the excess**. Self-assessment tax returns sent out from April 2007 will include questions about the Annual Allowance. Your pensions administrator will be able to give you information to help you complete your post April 2007 tax form if this applies to you.

- For more information - see the Pensions and Tax pages on the Civil Service Pensions website **www.civilservice-pensions.gov.uk/lta**

Scheme changes as a result of tax simplification

Changes to Compulsory Early Retirement (CER) and Flexible Early Retirement (FER) - There are some minor technical changes to CER and FER as a result of tax simplification rules. See Annex A (1) for details.

OPTIONAL TEXT – DO NOT INCLUDE IF YOU HAVE NOT ISSUED ANY CER/FER ESTIMATES

- If you may be leaving after 6 April 2006 and have had an estimate that did not include an explanation of the changes, please contact *[HR contact details……………………..]* if you would like to receive further details.

Changes to payment of WPS (widows' pension scheme) refunds - After 6 April 2006 these refunds will be paid as part of the retirement lump sum when you first draw your pension. See Annex A (2) for details.

Change to age limit for dependent children's pensions - Any new dependent child's pension paid after 6 April 2006 stop at age 23 even if the child is still in full time education or training. Special rules will apply to dependent children's pensions already in payment or beginning before 6 April 2006.

New age limit - We will not be able to pay tax-free lump sums to **members who have reached age 75**. We will require members to draw their pension before their 75th birthday and we will not abate (reduce or suspend) their pension if they carry on working past 75.

Further scheme changes - There are further scheme flexibilities permitted by the new tax rules and Cabinet Office will consider these, but in the meantime, the following elements of **classic**, **premium** and **classic plus** rules will **<u>not</u>** change:

- the maximum amount of the tax free lump sum that you can take when you retire
- the limit on the maximum number of years of reckonable service you can earn
- the amount of added years you can buy
- the earnings cap that limits the amount of salary on which you can build up scheme benefits
- the time limit on transfers from an occupational (employer-sponsored) scheme

Where to find more information:

- See the Civil Service Pensions' website www.civilservice-pensions.gov.uk for:
  - 'pensions and tax' pages about the Lifetime Allowance and Annual Allowance;
  - general information about the Civil Service pension arrangements
- See HM Revenue and Customs' website: www.hmrc.gov.uk/pensionschemes/newsletter1.htm

  for details of the legislation, but **please note that the some of the changes to the tax rules will only apply if schemes change their rules.**

ANNEX A to Office Notice

A(1) Changes applicable to staff in **classic,** aged 50 or over, with 5 or more years' service leaving on **Compulsory Early Retirement (CER) and Flexible Early Retirement (FER)** –

- Under current rules, the compensation payable on CER and FER to members of **classic** is paid as a mix of compensation payments and enhanced pension. On CER, the benefits payable are:

  - an enhanced pension and tax-free pension lump sum. The lump sum is paid immediately, but the pension is frozen for payment at age 60. An annual compensation payment (ACP), generally equivalent to the enhanced pension, is payable from the date of departure until the pension begins at age 60; plus

  - a lump sum compensation payment of 6 months' pay on leaving.

The same benefits are payable on FER apart from the compensation of 6 months' pay.

- Because of the new tax rules, Cabinet Office has to make some technical changes to the arrangements for **classic** members who leave on CER or FER. We will not be able to pay a tax-free pension lump sum early to anyone leaving on CER or FER without also bringing their pension into payment early. This means that we must pay an enhanced early pension rather than an annual compensation payment (ACP) to members of the **classic** scheme who leave on CER or FER, where a tax free lump sum is payable, on or after 6 April 2006. Any WPS refund for single people must also be paid at the same time (see A (2) below).

- For most people this will only mean a change in the name of the benefit rather than any change of substance. There will generally be no change in the way that the benefits are calculated or taxed, but the new tax rules will mean that they will not be able to repackage or commute their benefits. (When pension is paid early, there will be no ACP to exchange for a higher lump sum compensation on departure).

- The immediate payment of an enhanced pension may not suit everyone – for example, those whose pension benefits are close in value to or exceed the Lifetime Allowance or whose pension benefits will be reduced as a result of a court order following divorce. They will therefore be able to choose instead to preserve their **classic** pension benefits to be paid at pension age and take the additional early exit benefits solely in the form of compensation (in the same way that **premium**, **classic plus** or **partnership** members leaving on CER or FER do). Our pensions administrator will include information about this option when they provide members who have been offered CER or FER with an estimate of the benefits they will receive.

A(2) Changes to payment of WPS refunds – applicable to all staff in ***classic*** and staff in ***classic plus*** who were single* on 30 September 2002 and have remained so ever since

- If you remain single until you leave service, you may be eligible for a refund of some or all of the WPS contributions you have paid. From 6 April 2006 these refunds will be treated as part of your retirement lump sum entitlement and, therefore, will be paid at the time you start to receive your pension.

- In some cases this will mean that some or all of the WPS refund will be paid earlier or later than would otherwise be the case. The amount of the refund will be adjusted to reflect the early or late payment.

- If it is not possible to pay the refund at the time the pension commences (e.g. where a member is already in receipt of their pension before 6 April 2006, but some or all of the refund is not due until they reach age 60 sometime after that date), we will have to convert the refund into a small additional pension and lump sum.

* Single' means you are neither:
  - married; nor
  - in a civil partnership (i.e. a same-sex relationship that has been registered under the Civil Partnership Act 2004).

A (3) Change to age limit for dependent children's pensions

From 6 April 2006 any dependent child's pension that may be payable must stop at the latest by the child's 23rd birthday. Transitional rules will apply where a dependent child's pension is already in payment on 5 April 2006. The change will not affect invalidity pensions to children payable under **classic** (for which members contribute an additional 2% of pay), whenever the pension begins.