Tax changes affecting your Civil Service pension

Last year we issued a notice for staff 'Pension tax changes – October 2010 - Briefing for Civil Servants' about the changes to tax affecting pensions, including a reduction in the Annual Allowance and Lifetime Allowance. At that time, the Treasury was consulting on some issues.

This notice includes the earlier notice updated with the outcomes of those consultations.

Need to know – key messages

- Annual Allowance reduced to £50,000 in 2011/12
- If a tax charge does arise under Annual Allowance:
    - Individuals may take into account unused Annual Allowance from the previous 3 years to mitigate a potential tax charge.
    - If the tax charge in relation to the member's pension savings in the scheme is £2,000 or more, individuals may elect to use 'Scheme Pays' to meet the charge, with the cost being met by a permanent reduction in their pension.
- Lifetime Allowance reduces to £1.5m from 6 April 2012. Fixed protection is available, but applications must be made to HMRC by 5 April 2012 and the individual will need to give up any future increase to their benefits above the index linking.

Full information on the tax changes, and guidance for individuals is on the HMRC website: www.hmrc.gov.uk

Will this affect you?

Possible triggers for an Annual Allowance tax charge include:

- Buying a significant amount of added pension
- Transfer in of a previous occupational pension under the preferential Club Transfer terms
- Promotion which includes a pay increase
- Aggregation or linking of previous service in the Civil Service pension
- Ill health retirement
- High earners in the >£125,000 category (but depends on circumstances)

- see the questions and answers and examples below for more information. Full details are on the HMRC website. If you have any questions about your own tax position, please contact your Tax office, or consult an Independent Financial Adviser.

PENSION TAX CHANGES
BRIEFING FOR CIVIL SERVANTS
November 2011 update

In 2010, the Government announced some major changes to the pensions and tax regime.

- **From tax year 2011-12, the Annual Allowance for tax-privileged pension saving reduced from £255,000 to £50,000 (and the basis of the calculation changed)**
- **From 6 April 2012, the Lifetime Allowance will be reduced from its current level of £1.8m to £1.5m**
- **Individuals will be able to carry forward three years' of unused Annual Allowance.**

The following Q&A explains these changes and the impact that they may have.

ANNUAL ALLOWANCE

Q - Surely none of this means anything for me?
A - The changes are most likely to affect those on higher salaries but could also affect any members of **classic**, **classic plus** or **premium** who get significant pay rises which feed through into large increases in pension. This is particularly likely to be the case for people with long service. Please see the examples below.

You could be affected if your total "Pension Input Amount" across all pension arrangements of which you are a member exceeds your Annual Allowance in any tax year. If you don't use up your entire Annual Allowance in any year you can carry it forward to offset breaches in future years for up to a maximum of three years

See the attached examples for how this may affect you.

Q - What is the "Pension Input Amount"?
A - The Pension Input Amount (sometimes referred to as deemed contributions) is the total of:

- contributions you and your employer pay to defined contribution schemes such as the Civil Service AVC Scheme, the **partnership** pension account, a stakeholder pension or a personal pension in the relevant year; plus
- the value of benefits you have built up in the relevant year in any defined benefit scheme such as **classic**, **classic plus**, **premium** or **nuvos.**

The Pension Input Amount in a defined benefit scheme is based on:

- the pension built up over the relevant year (known as the pension input period) multiplied by 16, plus
- any automatic lump sum built up over that period.

To calculate pension built up over the year the pension at the start of the year is increased in line with an index (currently the Consumer Prices Index, CPI) and then deducted from the pension at the end of the year. Any lump sum built up (**classic** and **classic plus** members only) is worked out in the same way.

Q - What is the pension input period?
A - For the Civil Service pension scheme, the pension input period runs from 1 January to 31 December. The pension input period relevant for tax year 2011-12 (the first year for the new tax regime) is the calendar year 2011.

Q - How does the Annual Allowance work?
A - The Annual Allowance is the maximum amount of pension savings that can be built up in any one year before incurring a tax charge. This includes benefits built up in defined benefit schemes such as **classic**, **classic plus**, **premium** and **nuvos** and actual contributions by you and your employer to a defined contribution scheme (such as a **partnership** pension account or Civil Service AVCs with Scottish Widows or Standard Life).

For defined benefit schemes the pension input amount is based on benefits built up during the pension input period, as explained under the 'Pension Input Amount' answer above. This is worked out as set out below, where an assumed Consumer Prices Index (CPI) of 3.5% has been used (to increase a figure by 3.5% it is multiplied by 1.035).

Pension Input Amount =

16 x [(pension at end of period) **less** (pension at start of period x 1.035)]

plus (for members of **classic** and **classic plus** where there is an automatic lump sum)

(lump sum at end of period) **less** (lump sum at start of period x 1.035)

The written calculation above refers to CPI, as this is the current index used to increase benefits. Please note that the Annual Allowance examples that follow the Q&A refer to 'index linked increase' rather than CPI.

Q - What happens if my total Pension Input Amounts exceed the Annual Allowance?
A - Any excess (i.e. after offsetting the Annual Allowance and any available unused allowance from previous years) will be added to your taxable income for the tax year in question and subject to income tax in the normal way. You will need to tell HMRC about this by completing a self assessment tax return; please see the HMRC website, or contact your tax office, for further information.

Q - It seems very unfair to hit me with a tax charge just because I got a promotion
A - If you don't use up all your Annual Allowance for any tax year you can carry the unused allowances forward for up to three tax years. This will help protect people who wouldn't normally breach the Annual Allowance. Notional amounts, based on an assumed Annual Allowance of £50,000, will apply for tax years 2008-9, 2009-10 and 2010-11 for use in 2011-12.

Q - I have a deferred pension in another pension scheme. What happens to that?
A - Deferred pensions are exempt from the new AA regime as long as they do not increase by more than CPI or by a rate included in the pension schemes rules at the date the change to the Annual Allowance was announced (14 October 2010).

Q - I am a classic member with a preserved Civil Service pension which I expect to aggregate when I retire. That will give me a big increase to my pension. What happens to me?
A - If you decide to aggregate and this takes you over the Annual Allowance in the relevant tax year you will be subject to tax but this may be mitigated if you have any unused allowance from previous years to carry forward. (See example 7)

Q - I registered for Enhanced Protection back in 2006 to avoid the Annual Allowance, am I OK?
A - HM Treasury announced that Enhanced Protection will no longer give protection against Annual Allowance tax. You can surrender your Enhanced Protection and apply for Fixed Protection but you will need to do this before 6 April 2012. See the HMRC website for details.

Q - Are there any exemptions to the Annual Allowance?
A - Unlike the previous arrangements, the Annual Allowance test will also apply in the year of retirement. The Annual Allowance will not apply in the year of death or in the case of pensions or lump sums paid where individuals are diagnosed with serious (terminal) ill-health. The Government has also exempted severe ill health retirement benefits from the Annual Allowance tax charge; more on this in the following question.

Q - Will the Annual Allowance apply if I leave on ill health retirement?
A - There is no automatic exemption from the Annual Allowance tax charge if you leave on ill health retirement, and because an enhancement may apply in some cases this potentially increases the chance of someone being at risk of breaching the Annual Allowance. As mentioned above, individuals can be exempt from the Annual Allowance tax charge if they meet the HMRC severe ill health criteria; however the criteria for Civil Service pension ill health retirements are not aligned with the HMRC ill health retirement criteria. To mitigate the potential tax charge for individuals, the Scheme Management Executive has decided that individuals who we estimate are at risk of breaching the Annual Allowance in the year in which they leave on ill health retirement will be offered an additional ill health assessment which could confirm the criteria to meet the Annual Allowance exemption. Individuals do not have to take up the additional assessment, and if they do, they may still not be assessed as meeting the required criteria for exemption, and could potentially incur a tax charge. (See example 4).

A fact sheet that fully explains this issue will be sent to everyone going through the ill-health retirement process and who we have estimated to be at risk of breaching the Annual Allowance.

Q - How might the Annual Allowance affect someone buying Added Pension?
A - When someone buys Added Pension they are increasing the value of their pension on top of the normal increase in their pension. If you are buying by monthly contributions this is unlikely to have an impact unless you are a high earner. However, if you are buying by lump sum you should be aware that if the amount of pension you are buying is more than around £2500, then this could use up most of your Annual Allowance before the normal increase in pension is taken into account. If you are a higher earner it is possible that any amount of Added Pension bought by lump sum could potentially result in you breaching the Annual Allowance. (See example 6)

Q - How will I find out if I have breached the Annual Allowance?
A - MyCSP, the scheme pensions administrator, must send a Pension Saving Statement to anyone who breaches the Annual Allowance. They are obliged by law to send this by the October following the end of the tax year in which the breach occurs. For 2011-12 only, schemes will be allowed more time to produce these statements,

and so the first statements are not required to be issued until October 2013. Any tax charge applicable will then need to be included in the self assessment tax return for the appropriate year. For 2011-12, if members have not received a statement from MyCSP, they will need to include an estimate of the amount liable to the Annual Allowance charge and the amount of Annual Allowance charge due on their self assessment tax return for that year. Once they have received their Pension Savings Statement they will (subject to normal time limits) be able to amend their self assessment tax return to show the actual amount. Members who consider that they may have breached the Annual Allowance can request a Pension Saving Statement from their MyCSP Pension Service Centre.

Q - How is the Annual Allowance charge paid?
A - Members who have breached the Annual Allowance must account for the tax to HMRC under Self Assessment. If they have not yet taken their pension, and the tax charge in relation to their benefits in the Civil Service pension scheme is £2,000 or more, they can request to use the 'Scheme Pays' facility. Members would still need to tell HMRC on a self assessment tax return that they have done this.

Q - What is 'Scheme Pays'?
A - HMRC rules allow that if an individual's pension savings in a scheme are in excess of the Annual Allowance and the resulting Annual Allowance tax charge is £2,000 or more, and they have not yet taken their pension, they can ask their scheme to pay the Annual Allowance charge by requesting to use the 'Scheme Pays' facility. In these circumstances the Civil Service pension scheme would pay the individual's tax charge direct to HMRC on their behalf and permanently reduce the individual's Civil Service pension, in line with factors supplied by the scheme actuary, to cover the cost. For more details please see the HMRC website or contact your tax office. If you wish to use the 'Scheme Pays' facility, you should contact your Pension Service Centre.

LIFETIME ALLOWANCE

Q - Remind me how the Lifetime Allowance works
A - Everyone has a Lifetime Allowance. Whenever you take a pension (on retirement) you use up some Lifetime Allowance. Once you have used up all of your allowance, a Lifetime Allowance tax charge is payable. Pensions are generally valued using a factor of 20, but a factor of 25 applies to any pension which came into payment before 6 April 2006 (see example at end of this briefing). The Lifetime Allowance is currently £1.8m for the tax year 2011/12, but will be reduced to £1.5m for anyone taking a pension after 6 April 2012.

Q - Is there any protection available against the reduction in the Lifetime Allowance?
A - Yes; HMRC has introduced a new form of protection called Fixed Protection. You need to apply to HMRC for Fixed Protection by 5th April 2012 at the latest in order to be granted Fixed Protection. You must also give up any future benefit accrual above the index linking. This effectively means that you would have to opt out of the Civil Service pension scheme. If you already have Primary Protection you cannot also apply for Fixed Protection (but your Primary Protection will continue to be linked to a Lifetime Allowance of £1.8m). If you already have Enhanced Protection (but not Primary Protection) you will have to surrender your Enhanced Protection (by writing to HMRC) if you want to apply for Fixed Protection. The HMRC website gives further details, and also has a link to the Fixed Protection application form and completion notes.

Q - I am planning to retire in March 2014. I estimate my pension will be worth around £1.6m in 2014, so I had expected to be clear of Lifetime Allowance tax. Does this mean I have to bring my retirement forward to March 2012 to avoid having to pay extra tax?
A - Decisions on retirement should be taken carefully; while tax is definitely one consideration, it is not the only one. You could apply for Fixed Protection as described in the above paragraph, but in order for you to guarantee that you do not breach the Fixed Protection criteria you would need to opt out of the Civil Service pension scheme. We cannot provide advice on what is the best option for individuals, and if you think you may be affected, you may wish to consult an Independent Financial Adviser. Please see the example on Lifetime Allowance where we have provided an illustrative example of how opting for Fixed Protection, or not, could have an impact on your future benefits.

Q - What are the consequences for my scheme benefits if I apply for Fixed Protection and opt out of the Civil Service pension scheme?
A - Any existing pension would be preserved for payment when you leave the Civil Service at, or after, your scheme pension age. People who have opted out of the pension scheme do not pay pension contributions. However, they pay the higher rate of National Insurance contributions and they are not covered by the ill-health retirement and death-in-service provisions.

EXAMPLES

ANNUAL ALLOWANCE EXAMPLES

Annual Allowance – Effect of promotion and Added Pension / AVCs
Example 1:

Jane is a member of **classic**. On 31 December 2010 Jane has 30 years' reckonable service and her pensionable earnings are £50,000. On 31 December 2011 she has 31 years' reckonable service and her pensionable earnings have risen to £54,000 following a promotion. During the year Jane bought £300 of Added Pension (she did not have any previously) and also contributed £5,000 to Additional Voluntary Contributions (AVCs).

For Jane's **classic** membership:
    pension at end = 31/80 x £54,000 = £20,925
    lump sum at end = 3 x £20,925 = £62,775
    pension at start = 30/80 x £50,000 = £18,750
    lump sum at start = 3 x £18,750 = £56,250
The index linked increase used in this example = 2.5%

Jane's Pension Input Amount for her **classic** membership
    = 16 x [£20,925 – (£18,750 x 1.025)] + £62,775 – (£56,250 x 1.025)
    = £32,419

Jane's Pension Input Amount for her Added Pension = 16 x £300 + lump sum of £900 = £5,700

Jane's contributions to her AVCs = £5,000

Jane's total Pension Input Amount in the Civil Service pension arrangements = £32,419+ £5,700 + £5,000 = £43,119

Jane's Annual Allowance for 2011-12 is £50,000. Jane has used up £43,119 of this, leaving her with £6,881 of unused allowances. Jane can carry forward this unused allowance for the next 3 tax years.

Annual Allowance – effect of high earner's promotion
Example 2:

Debbie is a member of **premium**. On 1 January 2011 Debbie has 25 years' reckonable service and her pensionable earnings are £130,000. On 31 December 2011 she has 26 years' reckonable service and, following a promotion, her pensionable earnings have increased to £140,000.

For Debbie's **premium** membership:
    pension at end = 26/60 x £140,000 = £60,667
    pension at start = 25/60 x £130,000 = £54,167
The index linked increase used in this example = 2.5%
Debbie's Pension Input Amount for her **premium** membership
    = 16 x [£60,667 – (£54,167x 1.025)] = £82,333

Debbie has made no other contributions to pensions, so her total Pension Input Amount = £82,333

Debbie's Annual Allowance for 2011-12 is £50,000 and she uses it all, leaving her with £32,333 potentially liable to tax. If Debbie has unused (notional) Annual Allowance for 2008-9, 2009-10 and/or 2010-11 she can offset those unused allowances against the £32,333 excess.

If Debbie had no unused Annual Allowance, she will be charged tax (through Self Assessment) on £32,333. As Debbie's salary is £140,000 it is likely that she will pay at least some tax at 50% and this tax (potentially over £16,000 if all taxed at 50%) would be due by 31 January 2013. As Debbie is still an active scheme member, she could request 'Scheme Pays'.

Annual Allowance – effect of previous year pay rise
Example 3:

This example shows that actions already taken during 2010 may impact on the new Annual Allowance calculation. This particular example reflects the current pay freeze – in the "normal" environment, the tax position could be less benign.

James is a member of **classic**. On 30 June 2010, James is promoted and his salary goes up from £160,000pa to £180,000pa. On 31 December 2010, James has 30 years' reckonable service. James's last year is his best, so his pensionable earnings applying at 31 December 2010 are £170,000 (6 months @ £160,000 and 6 months @ £180,000).
By 31 December 2011, James has built up 31 years of reckonable service. The pay freeze means that he has not had a pay rise, and his pensionable earnings (again, his last year) are £180,000.

The pension input period for tax year 2011-12 is (for the Civil Service pension scheme) the calendar year 2011.

pension at end = 31/80 x £180,000 = £69,750
lump sum at end = 3 x £69,750 = £209,250
pension at start = 30/80 x £170,000 = £63,750
lump sum at start = 3 x £63,750 = £191,250

The index linked increase used in this example = 3%,

James's Pension Input Amount for his **classic** membership
= 16 x [£69,750 – (£63,750 x 1.03)] + £209,250 – (£191,250 x 1.03)
= £77,662

James will be potentially liable to tax on £27,662 but he can offset against this any (notional) unused Annual Allowance from 2008-9, 2009-10 and 2010-11 (see Example 2 above)

Annual Allowance – effect of being retired on ill-health
Example 4

Marvin is a member of **classic.** Marvin has gone through the medical retirement procedure and the Scheme Medical Adviser has assessed that Marvin meets the criteria for ill-health retirement from **classic.** They have also assessed that he does not meet the more stringent HMRC severe ill health criteria, so Marvin does not get exemption from the Annual Allowance tax charge. Marvin's last day of service is agreed as 31 December 2011.

Marvin is 42 years old and has exactly 11 years service at the last day of service. His pensionable earnings at 31 December 2010 were £42,000, which have increased to

£43,500 at 31 December 2011. Marvin gets an enhancement of 9 years' service on ill health retirement, taking his service up to 20 years.

Marvin's Pension Input Amount for tax year 2011/12 will be as follows:

pension at end = 20/80 x £43,500 = £10,875
lump sum at end = 3 x £10,875 = £32,625
pension at start = 10/80 x £42,000 = £5,250
lump sum at start = 3 x £5,250 = £15,750

The index linked increase used in this example = 3.1%

Marvin's Pension Input Amount for **classic** is therefore:

16 x [£10,875 – (£5,250 x 1.031)] + £32,625 – (£15,750 x 1.031) = £103,783.

Marvin will potentially be liable to tax on £53,783. However as he is not a high earner, and has not had any other major spikes to his benefits over the past three years, he will have available annual allowance to carry forward which means that he will not have to pay a tax charge. The notional Annual Allowance for each of the years 2008/09, 2009/10, and 2010/11 is £50,000, and although Marvin has used some of his allowance in each of those years, he hasn't used up the full £50,000. Marvin's unused Annual Allowance amounts from the past three years notional Annual Allowance are £41,000 (2008/09), £37,000 (2009/10), and £36,000 (2010/11). In this instance Marvin would use up all of the unused allowance from 2008/09 and £12,783 of the unused allowance from 2009/10.

Annual Allowance – effect of bringing in a transfer under the Club Transfer terms Example 5

Please note that bringing a transfer into the scheme that is not covered by the Club Transfer terms will not have any effect on whether an individual breaches the Annual Allowance. A transfer under the Club terms could however have an impact and this example explains how this could happen.

Karen is 55 years old and started a new job with a Civil Service pension scheme employer on 1st January 2011, and joined **nuvos**. She previously had 30 years' membership of a pension scheme that was part of the Club Transfer arrangements, and used the Club terms to transfer that service into the Civil Service pension scheme. The old scheme had a pension age of 65 and a 1/60th accrual rate, and so the club transfer mirrored the reckonable service in the old scheme. When she left the old scheme Karen was on a salary of £22,000 and the value of her pension when she left was £22,000 x 30/60 = £11,000, and it is this amount that will be used to calculate a deduction from the closing value when the Pension Input Amount is calculated. Karen's new salary is £29,000, and the pension she accrued in **nuvos** at 31 December 2011 is £667.

The Pension Input Amount for tax year 2011/12 will be as follows, with there being no pension at start and no three year carry forward in relation to the Civil Service scheme.

nuvos pension at end = £29,000 x 2.3% = £667
linked pension at end = £29,000 x 30/60 = £14,500
value of pension in old scheme = £11,000

Karen's Pension Input Amount in the Civil Service is as follows:
(16 x £667) + (16 x £14,500) – (16 x £11,000) = £66,672

Karen is potentially liable to tax on £16,672. There is no unused carry forward available from the Civil Service scheme in this example as there were no previous

pension benefits in the scheme. Karen may well have some carry forward to mitigate the potential tax charge but she will have to contact her previous pension scheme to obtain the figures, so that she can work this out herself.

Annual Allowance – effect of buying large amount of Added Pension by lump sum
Example 6:

Buying any amount of added pension by lump sum will increase the amount of Annual Allowance used in any year, and in various situations could mean that an individual exceeds the Annual Allowance and potentially incurs a tax charge. This example shows how a relatively low earner who buys a large amount of added pension by lump sum could potentially breach the Annual Allowance.

Lucy is a member of **premium** and on 31 December 2010 has 5 years' reckonable service and her pensionable earnings are £22,500. On 31 December 2011 she has 6 years' reckonable service and her pensionable earnings have remained at £22,500. During the year Lucy inherits some money and decides to use some of it to buy £5,500 (the maximum allowed) of Added Pension.

For Lucy's **premium** membership:
pension at end = 6/60 x £22,500 = £2,250
pension at start = 5/60 x £22,500 = £1,875
The index linked increase used in this example = 3.1%

Lucy's Pension Input Amount for **premium**
= 16 x [£2,250 – (£1,875 x 1.031)] = £5,070

Lucy's Pension Input Amount for her Added Pension = 16 x £5,500 = £88,000

Lucy's total Pension Input Amount in the Civil Service scheme for 2011/12 is £5,070 + £88,000 = £93,070

Lucy's Annual Allowance for 2011/12 is £50,000. She has used all of this and has an excess of £43,070 which is potentially liable to tax. Because Lucy is a relatively low earner it is likely that she would have enough unused Annual Allowance from the previous three years (carry forward) to mitigate an actual tax charge.

If, for any reason, Lucy does not have any unused Annual Allowance from the previous three years she needs to declare the amount she exceeded the Annual Allowance by through a self assessment tax return. The amount of the excess will be added to Lucy's income for the year, and so if the £22,500 salary is Lucy's only taxable income for the year her total taxable income will now be £22,500 + £43,070 = £65,570. Because this now takes Lucy over the 20% threshold of £35,000 the Annual Allowance tax charge would be charged as follows: £12,500 x 20% = £2,500 and £30,570 x 40% = £12,228, making a total tax charge of £14,728. Lucy could pay the tax bill herself, or ask the scheme to pay the tax charge and have her future pension reduced to reflect this.

Annual Allowance – effect of aggregating two periods of service on departure (classic only)
Example 7:

Michael is a member of **classic**. On 31 December 2010 Michael has 11 years' reckonable service and his pensionable earnings are £37,000. Michael is retiring on 30 November 2011, and his reckonable service is then 11 years 11 months and his

pensionable earnings have risen to £40,000. Michael had a previous, preserved, period of service in **classic** of 12 years ending in 1995, and he opts to aggregate the two periods before he takes his pension. Michael's pensionable earnings when he left in 1995 were £14,500, and his pension was £2,175 with a lump sum of £6,525. The value of the pension at 30 November 2011, after being increased for inflation, is £3,285 with a lump sum of £9,855.

> pension at end = 23.9151/80 x £40,000 = £11,958
> lump sum at end = 3 x £11,958 = £35,874
> pension at start of current service) = 11/80 x £37,000 = £5,088
> pension at end of previous service = (12/80 x £14,500) x 1.5102 (inflation factor) = £3,285
> lump sum at start of current service = 3 x £5,088 = £15,264
> lump sum at end of previous service = 3 x £3,285 = £9,855

The index linked increase used in this example = 3.1%

Michael's Pension Input Amount for classic
> = 16 x (£11,958 – ((£5,088 + £3,285) x 1.031)) + (£35,874 – ((£15,264 + £9,855) x 1.031)) = £63,184

Michael's Annual Allowance for 2011/12 is £50,000 which he has completely used up, and has an excess of £13,184 potentially liable to be taxed. As Michael is a moderate earner it is likely he will have enough unused Annual Allowance from previous years to offset the tax charge.

LIFETIME ALLOWANCE EXAMPLE

<u>Lifetime Allowance Example:</u>

This example shows the difference between applying for Fixed Protection and opting out of the scheme, and staying in the scheme and paying the Lifetime Allowance tax charge on retirement. It is an example only and each individual case could be different. You should seek independent financial advice if you are concerned about your own circumstances. If your total pension savings have exceeded the Lifetime Allowance, the excess amount is taxed at either 25% if the excess amount is taken as pension or at 55% if the excess amount is taken as a lump sum.

Shirley is 55 and is planning to retire in September 2016 when she will be 60. Shirley is in **classic**, and at the end of March 2012 has 35 years' reckonable service and pensionable earnings of £160,000. Her pension is £70,000 with a lump sum of £210,000. If she applies for Fixed Protection and opts out of the scheme, the pension is preserved and will be increased with Pensions Increase (PI) in April each year until she retires. It is difficult to forecast what PI will be in the four years but for this example we have assumed 3% for each year. The pension at retirement would therefore be £78,786, with a lump sum of £236,358.

If Shirley decides not to opt out of the scheme, she will have 40 years' reckonable service by the time she retires and her pensionable earnings are assumed to have increased to £180,000. Her pension on retirement would be £90,000 with a lump sum of £270,000. This example ignores any proposed changes to benefit structure as part of the planned public sector pension reforms.

Calculating benefits with Fixed Protection (and opting out of the scheme) – example

The pension and lump sum (as projected – see above) are valued for Lifetime Allowance purposes as (20 x pension) + lump sum:

(20 x £78,786) + £236,358 = £1.812m

The Lifetime Allowance before 6 April 2012 is £1.8m, and so Shirley will still have breached it by £12,000, and will be due to pay tax of 25% on this amount. The tax is paid by the scheme and Shirley's pension is reduced to account for this by dividing the amount of tax by 20:

£12,000 x 25% = £3,000 Lifetime Allowance tax charge
£3,000 /20 = £150 to be deducted from pension
Revised pension is £78,786 - £150 = £78,636 (lump sum is unaffected at £236,358)

Calculating standard benefits – no Fixed Protection or opting out – example

The pension and lump sum are valued for Lifetime Allowance purposes as (20 x pension) + lump sum:

(20 x £90,000) + £270,000 = £2.07m

The Lifetime Allowance from 6 April 2012 is £1.5m and we have assumed for this example that it remains at that level. Shirley will have breached the Lifetime Allowance by £570,000, and will be due to pay tax of 25% on this amount. For LTA purposes the tax-free lump sum entitlement is deemed to arise before the pension entitlement. The maximum tax-free lump sum is £375,000 (25% of £1.5m). Shirley's lump sum is £270,000 so it can all be paid as a tax-free lump sum. So the £570,000 excess is paid as pension and is taxed at the 25% rate. The tax is paid by the scheme and Shirley's pension is reduced to account for this by dividing the amount of tax by 20:

£570,000 x 25% = £142,500 Lifetime Allowance tax charge
£142,500/20 = £7125 to be deducted from pension
Revised pension is £90,000 - £7,125 = £82,875 (lump sum is unaffected at £270,000)

Learning from the example

Opting for Fixed Protection will result in a lower Lifetime Allowance tax charge, but this is only part of the overall picture, and may not necessarily maximise retirement Income. For people some way from retirement, the impact of freezing their service (on opting for Fixed Protection) may not compensate for retaining the current £1.8m Lifetime Allowance.

Please note that the above is only an example and the results are highly sensitive to the projected levels of Pension Increase and pay rises that are used.

People who have opted out of the pension scheme do not pay pension contributions. However, they pay the higher rate of National Insurance contributions and they are not covered by the ill-health retirement and death-in-service provisions.

MyCSP may not provide financial, investment or other professional advice to members. Nothing in this communication should be interpreted as constituting financial advice. You should obtain independent advice on any specific issues concerning you.