

Pensions planning

for senior NHS staff

With the many changes that have recently taken place in the pensions legislation directly affecting high-earners, many NHS staff are now facing tax charges on their ongoing pension savings.

This has been exacerbated since April 2016, as the £40,000 'standard' Annual Allowance (AA) has been reduced ("tapered") for high earners – down to as low as £10,000 for many.

At Barnett Waddingham we understand the challenges facing senior NHS staff in managing the tax burdens imposed by the complex pensions taxation legislation.

With our extensive knowledge of the issues surrounding pension provision for NHS staff, we can provide a bespoke and specialised service designed to meet each individual's requirements. We have been meeting senior NHS staff impacted by the adverse impact of pensions taxation – Tapered Annual Allowance and Lifetime Allowance (LTA).

You will also be aware of recent proposals further changing the options that NHS staff will have for their pension savings. We will be well placed to help you consider all the issues these proposals will introduce when full details of the proposals are known.

Understanding Tapered Annual Allowance – Threshold income and Adjusted income

The standard Annual Allowance (AA) has been £40,000 from the 2014/15 tax year, but since 2016/17 tax year it has been reduced for high earners whose "Threshold income" for the tax year exceeds £110,000 and "Adjusted income" for the tax year exceeds £150,000. The "Threshold" income is all taxable income less your own pension contributions and the "Adjusted" income is the "Threshold" income plus the value of your annual pension accrual (i.e. the Pension Input Amount shown on the Pensions Savings Statements). You can ask the administrators of NHS pensions for copies of your Pension Savings Statements if needed.

You need to calculate your taxable income at the end of a tax year in order to determine if your AA is reduced (i.e. tapered) for that year. Tapered AA calculation may be required for all tax years from 2016/17.



The table below shows the types of income you need to include (though not exhaustive), and highlights the difference between Threshold and Adjusted income. It assumes only Defined Benefit pension savings are made in the NHS Pension Scheme and no other pension savings made elsewhere.

Annual Income	Amount (£)
P60 earnings (before tax)	
Plus *Other income (including):	
Pension in payment (if any)	
Dividends	
Profits from self-employment	
Rental (after allowable expenses)	
Interest on savings	
Equals Threshold Income	

Plus Pension Input Amount (PIA) for pension savings in the NHS Pension Scheme

Equals Adjusted Income

(*) As mentioned, this is not an exhaustive list; it provides a broad indication only.

Your Threshold income can also be obtained from your tax assessment schedule upon completion of your tax return.

Please note that your AA will not be reduced if your Threshold income is less than £110,000. Your AA will be reduced if your Threshold income is more than £110,000 and you have an Adjusted income over £150,000 per year. The Tapered AA will result in a reduction of the standard AA of £40,000 by £1 for every £2 of Adjusted income over £150,000. The reduction in AA on specific Adjusted income amounts is illustrated on the following table:

Adjusted income	Annual Allowance
Less than £150,000	£40,000
£160,000	£35,000
£170,000	£30,000
£180,000	£25,000
£190,000	£20,000
£200,000	£15,000
More than £210,000	£10,000

You can carry forward unused AA from the previous three tax years. This carry forward is based on a standard allowance of £50,000 for tax years to 2013/14, £40,000 for 2014/15 and the amount of each individual's (potentially tapered) AA from 2016/17. Special rules apply for the 2015/16 tax year.

The issues relating to (tapered) AA are complex. NHS staff with higher salaries should take independent advice and request a pension savings statement from NHS pension schemes.

The Tapered AA is seen as a pension “tax trap” deterring senior NHS doctors from taking on additional shifts for fear of being hit with hefty tax bills. An example of this is illustrated below.

Impact of Annual Allowance tapering					
With additional non-pensionable work	Now	£1,500 extra	£10,000 extra	£20,000 extra	£40,000 extra
Gross Pay	£125,000	£126,500	£135,000	£145,000	£165,000
Less employee's pension contribution (14.5%)	-£18,125	-£18,125	-£18,125	-£18,125	-£18,125
Less professional subscriptions	-£1,200	-£1,200	-£1,200	-£1,200	-£1,200
Plus other taxable income (interest and dividends)	£3,000	£3,000	£3,000	£3,000	£3,000
Threshold income					
	£108,675	£110,175	£118,675	£128,675	£148,675
AA tapering	No	Yes	Yes	Yes	Yes
Pension Input Amount (increase in value of pension accrual during the tax year)	£60,000	£60,000	£60,000	£60,000	£60,000
Adjusted income					
	£168,675	£170,175	£178,675	£188,675	£208,675
Annual Allowance (before tapering)	£40,000	£40,000	£40,000	£40,000	£40,000
Amount of AA taper	£0	£10,088	£14,338	£19,338	£29,338
Tapered Annual Allowance					
	£40,000	£29,912	£25,662	£20,662	£10,662
Excess Annual Allowance usage	£20,000	£30,089	£34,339	£39,339	£49,339
Annual Allowance tax charge	£8,000	£12,035	£13,886	£16,636	£22,136
Increase in Annual Allowance tax charge for extra work	£0	£4,035	£5,886	£8,636	£14,136
Net income					
Extra gross pay	£0	£1,500	£10,000	£20,000	£40,000
Less extra employee's pension contributions (14.5%)	£0	£0	£0	£0	£0
Less employee National Insurance and income tax	£0	-£630	-£4,200	-£8,400	-£16,800
Net extra income before extra Annual Allowance taxcharge	£0	£870	£5,800	£11,600	£23,200
Net extra income after extra Annual Allowance tax charge	£0	-£3,165	-£86	£2,964	£9,064
Deemed tax rate on extra pay for extra work (%)	42%	311%	101%	85%	77%

As the example above shows, the impact of Tapered AA can result in a marginal rate of tax of more than 100% on extra earnings with no increase in pension if the extra earnings is not pensionable.

A woman and a man in business attire are looking at a tablet together. The woman is on the left, and the man is on the right. They are both smiling and appear to be in a professional setting. The image is overlaid with a blue gradient.

Understanding Lifetime Allowance

The LTA reduced from £1.8m to £1.5m from 6 April 2012. It reduced to £1.25m from 6 April 2014 and reduced again from 6 April 2016 to £1m. The LTA has increased in line with CPI from 6 April 2018 to £1.03m for 2018/19 and to £1.055m from 6 April 2019.

This means that individuals with pension savings which accumulate to greater than £1.055 million may face large LTA tax charges when they come to draw their benefits. Where an individual's benefits at 5 April 2016 exceeded £1 million, they should in most cases look to register for Individual Protection 2016 (IP16), in order to preserve an LTA in excess of £1 million (up to a limit of £1.25 million).

With IP16, there is no restriction on future benefit accrual, although benefits may still be subject to AA and LTA tax. There is no specific deadline for IP16 applications to HMRC. It is essential, however, that individuals wishing to register for this protection do so prior to accessing any pension benefits.

NHS Pensions – LTA charge examples

EXAMPLE 1

Dr Conrad is a 1995 Section member retiring on 1 July 2019 at age 63 with 40 years pensionable service and pensionable pay of £180,000. These provide him with a pension of £90,000 and a lump sum of £270,000. Dr Conrad has not previously used up any of the LTA and does not have LTA protection.

1995 Section benefits are valued, for LTA purposes, as follows:

Capital value of pension: £90,000 x 20	=	£1,800,000
Tax free cash sum:	=	£270,000
Total capital value:	=	£2,070,000
2019/20 LTA	=	£1,055,000
Excess over the LTA: (£2,070,000 - £1,055,000)	=	£1,015,000

The permitted maximum tax free cash sum is 25% of the lower of:

- i) the available LTA (i.e. £1.055 million or an amount from a protected LTA if higher less the value of any benefits already crystallised); and
- ii) the capital value of the member's NHS benefits being paid (after the commutation of pension).

Consequently, a member with no LTA protection and who has not previously begun to draw any pension benefits cannot receive a tax free lump sum from of more than £263,750 for the 2019/20 tax year.

Excess cash sum (£270,000 - £263,750):	=	£6,250
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The £6,250 cash sum excess will instead be an LTA excess lump sum and taxed at 55%.

Tax on LTA excess lump sum (£6,250 x 55%):	=	£3,437.50 payable to HMRC
Mr Conrad will receive a cash sum of: (£270,000 - £3,437.50)	=	£266,562.50
LTA charge on pension: [25% x (£1,015,000 - £6,250)]	=	252,187.50 payable to HMRC

The LTA charge is recovered by reducing the pension by the amount of the LTA charge divided by an actuarial factor of 20.16 (£252,187.50 / 20.16) = £12,509.30

This will result in a 1995 Section pension of £77,490.70 (£90,000 - £12,509.30) and a lump sum of £266,562.50.

The pension of £77,490.70 will be subject to income tax in the normal way.

Total LTA tax payable to HMRC: (£3,437.50 + £252,187.50)	=	£255,625
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NHS Pensions – LTA charge examples

EXAMPLE 2

Dr Conrad has LTA protection of £1.25m with Individual Protection 2016. The LTA tax and net benefits payable to him are:

Capital value of pension: £90,000 x 20	=	£1,800,000
Tax free cash sum:	=	£270,000
Total capital value:	=	£2,070,000
Protected LTA	=	£1,250,000
Excess over the LTA: (£2,070,000 - £1,250,000)	=	£820,000

Dr Conrad's tax free cash sum of £270,000 is not subject to LTA tax as it is within the permitted maximum of £312,500 (25% x £1.25m).

LTA charge on pension: (25% x £820,000)	=	£205,000 payable to HMRC
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The LTA charge is recovered by reducing the pension by the amount of the LTA charge divided by an actuarial factor of 20.16 (£205,000 / 20.16) = £10,168.65.

This will result in a 1995 Section pension of £79,831.35 (£90,000 - £10,168.65) and a cash sum of £270,000.

The pension of £79,831.35 will be subject to income tax in the normal way. The cash sum is tax free.

Total LTA tax payable to HMRC:	=	£205,000
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The actuarial factors, which are age related, are regularly reviewed and subject to change.

Please contact Bhargaw Buddhdev or Nilesch Shah if you would like to discuss any of the above topics in more detail via the following:

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The figures and information contained are illustrated examples and should not be construed as advice.

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