University Hospitals of North Midlands NHS Trust

Briefing on the Impact of Pensions Tax

1.0 Introduction

The purpose of this paper is to set out to the Board the background and context to the problems being faced in relation to pension taxation.

2.0 Background

There are three elements to the pension reforms of 2014 and then 2016 that are causing significant concerns to scheme members but have only really taken effect from 2018. Below is a simple definition of the two types of annual allowance thresholds and the lifetime allowance changes that are now causing significant concern to many staff.

2.1 Lifetime Allowance

The lifetime allowance (LTA) is the total amount that an individual can have in all their pension savings, during their lifetime, without incurring an additional penal tax charge. The lifetime allowance limit is currently £1,030,000 for the 2017/18 tax year and will be increased in line with the consumer price index (CPI) to £1,055,000 from 6 April 2019. Prior to the pension tax changes the total lifetime allowance was £1.8 million.

If an individual's total pension savings exceed the lifetime allowance, a tax charge may be incurred on any benefits in excess of the allowance. Any lump sum taken will be taxed at 55 per cent and pension will be taxed at 25 per cent. (NB – it is the exceeded pension and lump sum that would be taxed at 55% for a person with a 40% marginal rate).

2.2 Annual allowance

The annual allowance is the amount of pension savings an individual can make in one year before receiving a tax charge. The standard annual allowance limit has been set at £40,000 since 6 April 2014. Employees may be subject to a lower tapered annual allowance, depending on their taxable income.

If an individual's pension savings are more than the annual allowance (in one scheme year), they will receive a tax charge on the additional amount. The tax rate charged will reflect the individuals' marginal tax rate.

It is possible to carry forward any unused annual allowance, provided the individual was a member of a qualifying pension scheme, at some time during all of the three previous tax

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years. An individual can carry forward unused annual allowances for a maximum of three years.

2.3 Tapered annual allowance

The tapered annual allowance was introduced in April 2016 with the intention of reducing pension tax relief for high earners. It applies to those with adjusted incomes (taxable income and pension savings) of over £150,000 and threshold incomes (taxable income excluding the value of pension savings) of over £110,000. It is important to know that these figures are based on all taxable income. If for example a consultant undertakes private practice or has any other form of income for example a rental property, this will count to the annual allowance.

The rate of reduction in the annual allowance (from the current maximum of £40,000) is by £1 for every £2 that the adjusted income exceeds £150,000, up to a maximum reduction of £30,000 at £210,000. This means an individual's tapered annual allowance will be between £40,000 and £10,000.

Benefits are tested against the tapered annual allowance by applying a factor of 16 to the increase in the benefit (the pension input amount) over the year.

2.4 Carry Forward Allowances

In the definitions above there is reference to the potential carry forward of unused tax allowances. Indeed since the changes of 2016 high earners have been knowingly, or in most cases unknowingly, using their carry over allowances. 2018 is the year when nearly all high earners have used their allowances and are now liable for in year tax bills. In many cases the allowances were used up years ago and the tax liability has been growing year on year.

2.5 Scheme Pays

The scheme pays option allows members to ask their pension scheme to pay their annual allowance tax charge to HMRC on their behalf. In return, the member’s benefits in retirement are reduced by a corresponding amount. Scheme pays may be attractive to staff who don’t have the funds available to pay their annual allowance tax charge upfront.

Scheme pays is available to all members of the scheme who breach the annual allowance and incur a tax charge, including:

- high earners who are subject to a lower, tapered annual allowance
- employees who incur a tax charge below £2,000.

Employees must notify NHS Pensions of their intention to use scheme pays before the relevant annual deadline for each tax year. Members planning to use scheme pays for a tax

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charge relating to the 2017/18 tax year, must submit their request to NHS Pensions by 31 July 2019.

The scheme pays option brings in its own set of calculations and considerations. If scheme pays is utilised it is questionable, when the number of years the scheme will pay is calculated (and the pension is therefore reduced) what this actually corresponds to in terms of an annual interest rate equivalent. Advice to younger scheme members is that scheme pays in the long term may not be the best option.

For those staff breaching the lifetime allowance, there is no scheme pays option. In these situations if a member of staff has breached this allowance they will continue to receive a tax liability unless they come out of the scheme and therefore opt out of future accrual. If the member of staff does not take their pension, and the pot grows with inflation, they will continue to receive an annual liability until they access the pension.

2.6 HMRC Notification of Liabilities

Unlike other tax charges, HMRC do not write to the individual to say they have a liability. Each year in September most scheme members, but not all, receive a statement from the pension agency which contains a range of figures. The recipient must then find an individual or company who can perform the series of detailed calculations to examine if there is a liability. There has been a distinct lack of companies/individuals who can undertake these calculations. In most cases these people are not accountants and therefore the scheme member has to then find an accountant who can verify the calculations and advise on methods of payment. Such is the complicated nature of these calculations the full extent of the scheme liabilities has only really been understood for many in 2018. Even now staff are coming forward who have no real understanding of the intricacies of the changes and are then finding out they have significant liabilities.

Some of the staff members most vulnerable to large tax charges are those with long service and or who have received promotions, especially promotions with significant pay increases over a short period of time. These long serving employees who have accrued pension of say 50% of final salary can breach the annual allowance if they are promoted, even if their earnings are relatively modest, because the increase in salary benefits the pension derived from every prior year of pensionable service. For example, if an employee who has already accrued pension equal to half salary is promoted and their salary increases from £40k to £50k, the pension already accrued increases by £5k from £20k to £25k, with a capital value of £80k based on the 16:1 multiple.

3.0 Impact of Changes

Staff likely to be impacted by these liability are the highest earners in the organisation who are likely to earn over £110k per annum, i.e. Consultants and Executive Directors. Reaction to these changes has been growing exponentially over the past 12 months. There has been widespread unhappiness and anger as understanding of the liabilities has grown. The implications of these liabilities have been far reaching and now has the potential to impact on clinical service delivery in some cases with many senior clinicians trying to reduce their earnings and therefore their liability. There are examples of doctors opting to not apply for

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leadership roles while many others will not undertake additional clinical activity (WLI) sessions. Discussions are on-going with Consultant colleagues currently regarding the option of establishing limited liability companies to undertake additional clinical activity.

There has been a significant impact on morale. All of these concerns have been raised nationally and options are now under review.

4.0 Awareness of Issues

The HR Directorate has worked extensively over the past year to help raise awareness and advise staff of these issues. Communication/briefings have been issued and workshops with Chase De Vere (specialist pensions advisors) have been arranged. Simple guides and advice documents on the pension scheme changes have been made available and extensively circulated.

5.0 Conclusion and next steps

There are two potential categories of solution: reforming the tax system or reforming the NHS Pension Scheme. Government has stated its preference for reforming the Scheme, giving members greater control over their pension growth, so they can manage pensions tax charges.

On 3 June 2019, Government announced a proposal to introduce a 50:50 option to the NHSPS. This would allow employees to halve their contributions for halving the rate of pension growth in the 2015 Scheme. However, the proposal is currently limited to senior clinicians. This wold help to 'decelerate' pension growth, reducing the risk of both Annual and Lifetime Allowance charges, but it may not protect those with significant past service already accrued from Annual Allowance charges related to salary increases. This option may not on its own allow an adequately sophisticated approach to allow effective tax management.

In the meantime, it is important to improve communications around the issue – including making employees aware of the pensions tax 'cliff-edge' which may be faced when annual taxable income goes over £110.000.

We will continue to work with colleagues nationally to raise concerns and to consider ways in which we can take mitigating actions to ensure risk to service delivery is avoided.

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