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UNDERSTANDING ANNUAL ALLOWANCE

This fact sheet will help explain how you, as a member of the NHS Pension Scheme, could be affected by the pensions Annual Allowance. If you think you might be affected, ask for a review with a specialist Hospital Doctor Financial Consultant who will help you understand your options and alternatives.

What is Annual Allowance?

The Annual Allowance – currently £40,000 a year – is the maximum amount of pension savings that benefits from tax relief each year.

Both your NHS pension, made up of your employee and employer contributions, as well as any personal pension savings you might have, count towards it so it is important to check regularly how much you are saving for retirement.

If you exceed the annual allowance you will need to declare your pension savings amount on your tax return. You will be taxed on the amount you go over at your marginal rate of income tax

What's changed? – the reduction in the Annual Allowance

High earners saving for their retirement have been impacted in recent years as the Annual Allowance has reduced from a high of £255,000 in the 2010/11 tax year, to £50,000 between 6 April 2011 and 5 April 2014 and now £40,000 from 6 April 2014.

Although £40,000 might seem a generous amount, because of the nature of the NHS Pension Scheme and the way in which accrued pension savings are calculated, many doctors could unknowingly exceed it due to career events such as pay increases or clinical excellence awards.

How does this affect me?

As a member of the NHS Pension Scheme, your annual allowance will be calculated by how much your benefits grow in a year.

The vast majority of NHS Pension Scheme members will not breach their annual allowance, as it is primarily high earners who are impacted. However, there are instances where moderate earners could be affected due to their length of pensionable service and the rate of pensionable pay increase in a year. Common triggers for this are:

- Receiving clinical excellence awards (CEAs) – Awarded to those who perform over and above their normal role
- Pay increases – Often triggered by a promotion
- The purchase of added years and additional pension – Used to increase the value of a pension
- Additional savings into a private pension – Used to top up a pension
- Length of service – May apply to those doctors who have a long career in the NHS

Case studies: how NHS pension scheme members could be affected

1995 Section

A doctor with a salary of £165,000 and 33 years in the NHS Pension Scheme receives a promotion, increasing their salary to £175,000.

They are a member of the **1995 Section** of the NHS Pension Scheme and CPI is at 2.7%

- Value of their annual pension increases from **£68,063** to £74,375.
- Value of their lump sum increases from £204,188 to £223,125.
- The deemed increase in the value of their pension during the year is £85,012 – £45,012 more than the Annual Allowance. As an additional rate tax payer they will be liable for 45% of the excess, which is £20,255.

2008 Section

A doctor with a salary of **£100,000** has been working in the NHS for 36 years. They receive a Clinical Excellence Award taking their salary to £135,000.

They are a member of the 2008 Section of the NHS Pension Scheme after switching schemes during the choices exercise. Their minimum lump sum is £101,004. CPI is at 2.7%.

- Value of their annual pension increases from £51,583 to £74,833.
- The deemed increase in the value of their NHS pension during the year is £372,000 – this is £332,000 more than the Annual Allowance.
- As a higher rate taxpayer they will be liable for 40% of the excess, which is £132,800

What to do if you have an Annual Allowance charge

If you exceed the Annual Allowance, and you have any unused Annual Allowance from the previous three years, you are allowed to carry this forward to offset part or all of your excess contributions.

For example, if you have £10,000 unused Annual Allowance in each of the past three years, you will be able to contribute a maximum of £70,000 to your pension savings for the tax year 2014/15 without being taxed.

However, if you exceed the Annual Allowance, and do not have any unused annual allowance to carry forward from the previous three tax years, you will be taxed on any amount you contribute above the Annual Allowance at your marginal rate of tax, which could be as high as 45%.

There are a number of options available if you are faced with a tax charge for going over the Annual Allowance.

Pay the tax as part of your tax return	Pay it as part of 'scheme pays'
This is often the easiest option as it will be included as part of your annual tax bill. However, you do still need the funds available to pay the tax bill by the deadline	If you do not have the cash available to pay, and the tax charge is more than £2,000, the tax charge can be debited against the pension scheme in certain circumstances. However, while the tax bill will be paid, it will also mean your pension pot is reduced. This solution may be suitable in the later stages of your career, but is not something that is recommended earlier on as regularly dipping in to your pension pot to pay the tax bill will impact on your retirement income later in life.

66%

Percentage of doctors who describe knowledge of their pension schemes as 'poor' or 'could be better'

£48,242

The average amount doctors believe they will need to live on in retirement

56%

Percentage of doctors who are worried they won't have enough to live comfortably in retirement

42%

Percentage of doctors who are unaware they could face a tax bill if they exceed their pension savings allowances

What can you do going forward? – Pros & Cons

Options	Pros	Cons
Stop paying into any private pension schemes	The easiest option as it immediately reduces the amount paying into your pension, unless those private pensions also contain benefits or guarantees	You may not now achieve the retirement income you were hoping for. Consider other ways of saving for retirement, such as ISAs.
Reduce your superannuation earnings	Going part time to reduce your earnings will mean you will be paying less into your pension savings pot.	Going part time too soon may mean you will not have enough money to maintain your standard of living before you start claiming your retirement income. It could also mean the final pay used to calculate benefits is also reduced.
Withdraw from the NHS Pension Scheme	If you are near the end of your career and have built up a good pension pot, this will reduce the amount that is being paid into it.	Deciding to withdraw from the NHS Pension Scheme is a major decision and is unlikely to be the best option for most people and is not recommended. You may miss out on higher pension income that comes from any pay rises in the final years.You will also have reduced additional benefits such as enhanced ill health retirement payments, and benefits for your partner or family.

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* Data from Wesleyan own research, March 2014.

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