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 GP 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 make, 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 the annual allowance at your highest 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, some members of the NHS scheme will exceed the annual allowance just by having an additional year’s accrual. The likelihood of exceeding it is also increased if the member has had any increase in pensionable earnings.

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. Common triggers for this are:

- 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; and
- as the NHS Pension Scheme is linked to CPI inflation, a large jump will lead to an increase in pension benefits, which will count towards your Annual Allowance.

Case studies: how NHS pension scheme members could be affected

1995 Section
A GP with pensionable earnings of £150,000 accumulated up rated earnings of £3 million (including any Hospital Service benefits) and is a member of the 1995 Section of the NHS Pension Scheme. At the start of the Pension Input Period, CPI is at 3.1% but rises to 5.2% over the year. This equates to a dynamisation factor of 6.7%:

- value of their annual pension increases from £42,000 to £46,914
- value of their lump sum increases from £126,000 to £140,742; and
- the deemed increase in the value of their pension during the year is £68,628 – £28,628 more than the Annual Allowance. As an additional rate tax payer they will be liable for 45% of the excess, which is £12,883

2008 Section
A GP with pensionable earnings of £57,000 accumulated up rated earnings of £500,000 (including any Hospital Service benefits) and is a member of the 2008 Section of the NHS Pension Scheme. At the start of the Pension Input Period, CPI is at 2.5% but rises to 5.2% over the year. This equates to a dynamisation factor of 6.7%:

- value of their annual pension increases from £9,350 to £11,042; and
- the deemed increase in the value of their pension during the year is £23,337
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.

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<th>Pay the tax as part of your tax return</th>
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<td>This is often the easiest option as it will be included as part of your annual tax bill. However, you still need the funds available to pay the tax bill by the deadline.</td>
<td>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.</td>
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What can you do going forward? – Pros & Cons

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<td>Stop paying into any private pension schemes</td>
<td>The easiest option as it immediately reduces the amount paying into your pension, unless those private pensions also contain benefits or guarantees.</td>
<td>You may not now achieve the retirement income you were hoping for. Consider other ways of saving for retirement, such as ISAs.</td>
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<td>Reduce your superannuation earnings</td>
<td>Going part time and cutting back on any locum, out of hours or private work you do to reduce your earnings will mean you will be paying less into your pension savings pot.</td>
<td>Reducing the amount of work you do 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.</td>
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<td>Withdraw from the NHS Pension Scheme</td>
<td>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.</td>
<td>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.</td>
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* Data from Wesleyan own research, March 2014.

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