Understanding the Tax Liability on your Pension

Guidance at a glance

This guidance contains important information for all ASCL members in the Teachers' Pension Scheme (TPS) or the Local Government Pensions Scheme (LGPS), regardless of age or proximity to retirement.

This information is for the personal use of ASCL members only. Please check your individual circumstances. If you think you may be affected, please access your online Benefit Statements and any secure messages in My Pension Online **before** contacting ASCL.

For professional taxation or financial advice, you will need to contact a suitably indemnified consultant. ASCL has **Premier Partners and Preferred Suppliers** who can provide this service.

This paper looks in more detail at the following:

Section 1 How your pension works

Section 2 Annual Allowance

Section 3 Lifetime Allowance

Section 4 Further information

GUIDANCE PAPER

1 How your pension works

When you pay into your pension, your contribution is deducted before any tax is taken. You are taxed on what remains after it is taken out. You will notice, therefore, that your annual P60 shows a taxable earning which is less than you actually earn. Moreover, your employer pays in their contribution on top.

However, His Majesty's Revenue and Customs (HMRC) places taxation limits on both the tax-free amount by which your pension can grow every tax year (annual allowance), and, prior to April 2023, the tax-free amount you can accrue overall (lifetime allowance).

Do not assume that this does not apply to you. Both the TPS and LGPS are defined benefit (DB) schemes. These are both excellent schemes not dependent on the risks of investment performance to provide for a comfortable retirement. This is because unlike a defined contribution (DC) scheme, (a private pension), there is no pot of invested money that grows and informs your pension dependant on its performance (or not). Rather, your guaranteed accrued benefits when you retire depend on years served, your age, and salary (plus any extras you may have elected to buy).

Consequently, as there is no 'pot', HMRC uses an actuarial formula to calculate the notional capitalised value of your pension for tax purposes. As a result of this algorithm, many ASCL members will be in scope for both annual allowance and, previously, lifetime allowance.

2 Annual Allowance

The annual allowance (AA) for the tax year 2023-24 is £60,000. This means that the tax-free amount by which your pension can grow in 2023-24, known as the pension input amount (PIA), is £60,000. Any growth above this is taxed at your personal marginal (ie. higher) rate according to HMRC tax bands. In immediately previous years it stood at £40,000.

The actuarial formula HMRC uses to calculate your PIA is **not the actual contributions you and your employer put into the pension**. For an idea of this, look at your annuity (annual pension) benefit statement for the start and end of the tax year. Multiply both by 16 (then add any automatic lump sum) and the growth is the difference between the two, after the calculation for the start of the tax year is compensated for by revaluation. There are **calculators on the HMRC website** that facilitate this calculation.

The TPS / LGPS administrator will flag up, usually in the early autumn, if your TPS /LGPS Pension has exceeded your AA in the previous tax year. This is usually via a secure message (PDF) in your inbox on their website called your pension savings statement (PSS). Please check this annually, **do not ignore it**.

A consistently high salary, a large one-off salary increase, or an extraordinary payment into a pension through enhancement could cause the AA to be exceeded. Also, do not forget to add any contribution you may have made to a private pension.

Moreover, the AA is tapered down for those earning a taxable income of more than £200,000 per annum, and if your pension growth when added also takes you over £260,000. This includes all sources of income, not just your salary, as well as any additional pensions. For every £2 you earn above tapering, your AA is reduced by £1 (before April 2023, the tapering threshold was £240,000 and before April 2020 it was £110,000). If you think you may be in this position, you are strongly advised to seek independent financial advice as this becomes complicated.

PIA

Any amount in your PIA below the AA threshold can be carried forward from the previous three years. The letter you receive should contain information for the current tax year, plus the previous three years to enable you to carry out the calculations.

ASCL encourages all members to check their AA contribution to make sure they are within the limit.

Tax liabilities

If you are liable for tax, it is your responsibility to declare this in an annual self-assessment tax return. A completed self-assessment tax return must be submitted by 31 January of the year following the notification of a liability. However, if you have enough unspent allowance from the previous three years, you have nothing to declare. Make a note on your letter and keep it safe.

If you owe more than £2,000, you can opt for TPS/LGPS to pay the tax for you and recoup it over time from your eventual pension. This is called mandatory scheme pays, and again the forms are available **here** (NB this should still be declared to HMRC). If it less than £2,000, there is a voluntary election but this is rarely a problem.

The Public Service Pensions (McCloud) Remedy

Specifically, in autumn 2023, the usual issuance of PSS will coincide with the first phase of The Public Service Pensions (McCloud) Remedy. This will initially roll back all members of the TPS into their (NPA60) legacy scheme for the years in which the discrimination was identified (2015-2022). Consequently, as this affects accrual and associated PIA, and by extension taxation, it is unlikely that PSS will be issued. Instead, a revised PSS is likely to be issued at a later date (and by October 2024), with any tax due reimbursed.

Finally, if you are simultaneously accessing flexible benefits and contributing to a separate DC pension arrangement, then the money purchase annual allowance rules may apply. For the tax year 2023 to 2024 onwards, the money purchase annual allowance limit has increased from £4,000 to £10,000.

3 Lifetime allowance

A similar paradigm may be applied to the total value of your pension. Up to 5 April 2023, HMRC placed a limit on the total value of a pension fund which may be held without a tax liability. This is called the lifetime allowance (LTA). It varied over the years but, in 2022-23 and the preceding three years, it was £1,073,100, with anything above that taxed at 25%. The ongoing pension payments were also subject to income tax.

From 6 April 2023, no-one will pay a lifetime allowance tax charge. **For the avoidance of doubt, this cannot be retrofitted**. LTA is chargeable at the point of crystallising a benefit. Consequently, pensions accessed on 5 April 2023 are subject to the LTA charge; pensions accessed on 6 April 2023 onwards are not. However, what has not changed is the limit that you can access from all and any pensions as a tax-free lump sum, which is £268,275.

However, some ASCL members may have untouched second pensions, such as additional voluntary contributions (AVCs) or an LGPS/TPS toggle. If these have not yet been accessed in any way, they will not longer be subject to an LTA charge.

Once again, as there is no actual defined pot of money invested in TPS/LGPS, an HMRC actuarial formula is used to capitalise your pension value.

At the point of retirement, the capitalised value of your pension is deemed to be your annuity (your annual pension per annum) multiplied by 20, plus any automatic tax-free lump sum. These figures are obtainable from your annual benefit statement, and pension websites have available calculators. The benefit statement should also tell you how close you are to (or have exceeded) your nominal LTA. Any LTA charge is taken off your annuity proportionately over time, usually around 20 years.

Prior to April 2023, actions taken to mitigate an LTA charge included taking a bigger tax-free lump sum at the expense of annuity. Scheme pays contributions were also deducted before LTA was calculated.

It may well be worth looking back at your actual benefit statement specifically from April 2016. If, on 5 April 2016, your capitalised pension value exceeded £1 million, you can still apply to HMRC for individual protection 2016 (IP16). This allows you to protect your LTA at its 2016 value up to £1.25 million and can be retrofitted even to a pension in payment. Going forward, although the lifetime allowance tax charge no longer applies, IP16 may still allow you to take a larger tax-free lump sum.

Once again, you are strongly advised to seek independent financial advice.

4 Further information

HMRC **Understanding Annual Allowance**

HMRC **Understanding Lifetime Allowance**

HMRC **Protect Your Pension Lifetime Allowance**

Alternatively, lists of independent financial advisers based on postcode information are available **here**.

Pension schemes should inform members who are at risk of these tax liabilities, however, it is prudent to make individual checks.

Lighthouse Financial Advice

Call 08000 858590 (with your ASCL membership number) for an appointment with a **Lighthouse Financial Group** local representative.

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