

Information about tax relief, limits and your pension

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Law and tax rules relating to pensions have changed. The information here is based on our understanding in March 2016. Your personal circumstances also have an impact on tax treatment.



This document contains information on:

- ▶ Tax relief and the potential impact of paying over the annual allowance into your pension
- ▶ The different levels of annual allowance that can apply
- ▶ Income Drawdown
- ▶ Tax on large pension funds
- ▶ Your retirement options
- ▶ Potential tax charges on death
- ▶ What Pension Input Periods were and how they worked

We can help you understand how the above might affect you. You should also speak to your financial adviser or tax specialist.

Key facts at a glance

Fact - all pensions

- 04** The standard Annual Allowance for the current tax year is £40,000.
- 05** You can carry forward unused allowances from the previous three years.
- 08** Tax on lump sums payable on death where you have reached age 75 is the rate of income tax that applies to your beneficiaries.
- 08** The Lifetime Allowance is currently £1 million. From tax year 2018/19, the Lifetime Allowance will be linked to the Consumer Prices Index.
- 09** £10,000 is the small 'stranded pots' limit to claim a pension fund as a lump sum.

Fact - pensions with a drawdown option

- 07** For anyone who accesses pension flexibility and takes anything above their tax-free cash, normally 25% of the fund, their Annual Allowance drops to £10,000 and is known as the Money Purchase Annual Allowance.
- 08** Tax on lump sum death benefits from pensions in drawdown depends on your age when you die.

Annual Allowance

The annual allowance for the current tax year is £40,000. For 2014/15 and 2015/16 it had been £40,000. For 2013/14 the annual allowance was £50,000. This includes payments you personally make, payments from your employer and payments from third parties such as family members.

Other points to be aware of are:

- ▶ For tax relief purposes personal and third party payments cannot exceed 100% of earnings, even if this is lower than the Annual Allowance.
- ▶ If you have elected for flexi-access drawdown, you can make further pension payments, but your Annual Allowance will drop to £10,000 if you take anything above your tax free cash, normally 25% of the fund. This is known as the Money Purchase Annual Allowance. If you are also a member of a Defined Benefits scheme, your overall annual allowance stays at £40,000 including any Money Purchase Allowance.
- ▶ Unused Annual Allowance from the previous 3 tax years can be carried forward to let you pay more in the current tax year. You can't do this

if you are subject to the £10,000 Money Purchase Annual Allowance. See 'What are the carry forward rules?' on page 6.

- ▶ A variable Annual Allowance tax charge of up to 45% applies to any pension payments above the Annual Allowance.
- ▶ There are only exemptions from the Annual Allowance test on death, serious ill-health or severe ill-health

Tapered Annual Allowance

- ▶ From 2016/17 an individual with total income and employer pension contributions that come to more than £150,000 will have a reduced Annual Allowance.
- ▶ The standard £40,000 Annual Allowance is reduced by £1 for every £2 of 'income' you have over £150,000 in a tax year, until your allowance reaches £10,000.
- ▶ The definition of income for this test is called Adjusted Income. It includes total income before tax from all sources and the value of employer pension payments.

Example

- ▶ Robert has income made up of salary £125,000, P11D benefits of £8,000, a bonus of £5,000, rental income from a

buy-to-let property of £9,600 and he received dividend income of £1,200. Overall that puts his total income for the year at £148,800. However, his employer also pays in 8% of his basic salary which adds on another £10,000. This means that he will be assessed as having Adjusted Income of £158,800 - this exceeds the limit of £150,000 by £8,800 so his annual allowance will be reduced by $(£8,800/2)$ £4,400 down to £35,600.

There are some circumstances where the tapering to the annual allowance can be removed, for example by making a personal payment into a pension. If you think you are going to be affected by this tapering, please speak to your tax adviser.

Carrying forward of unused allowances from previous tax years is also available with the tapered annual allowance.

What was a Pension Input Period?

The purpose of a Pension Input Period (PIP) was to identify which tax year's Annual Allowance the payments made in that period would be tested against. The Budget which took place on 8 July 2015 means that all PIPs are now aligned to tax years and the benefits brought by being able

to amend a PIP are no longer available. The information at the bottom of this page is now only for historical tax reporting reference.

PIPs now run in line with tax years. In 2015/16, there was a one-off opportunity to pay in up to £80,000 explained as follows.

Here's how the transitional PIP rules worked:

- ▶ All open (pre-budget) PIPs ended on 8 July 2015 and count against the 2015/16 Annual Allowance.
- ▶ A new (post-budget) 2015/16 PIP runs from 9 July 2015 to 5 April 2016.
- ▶ All PIPs are now fixed and can no longer be amended.

The 2015/16 tax year is split into two 'mini tax years' either side of the Budget. Any open PIP automatically ends on 8 July 2015. A new PIP then starts from 9 July and ends on 5 April 2016. You could also have had a PIP already end in the period of 6 April 2015 to 7 July 2015. So there could be one or two PIPs that relate to the first part of the year, and just one that relates to the second. The total annual allowance for all the PIPs that relate to the first part is £80,000. The available annual allowance for the PIP that relates to the second part is the remainder of the unused £80,000 from the first part, but up to a maximum of £40,000.

What are the carry forward rules?

Here's how it works if you wanted to pay in more than £40,000

in the current tax year and you are not subject to the Money Purchase Annual Allowance or the tapered Annual Allowance.

- ▶ **Step 1** - You must pay in at least £40,000 in 2016/17.
- ▶ **Step 2** - Go back to the 2013/14 tax year and check to see what was paid in for the Pension Input Period ending in that tax year. If lower than the Annual Allowance for that tax year you have an unused allowance you can carry forward and use in the 2016/17 tax year.
- ▶ **Step 3** - Do the same for the 2014/15 tax year.
- ▶ **Step 4** - Do the same for the 2015/16 tax year.

Example		
Tax year	How much you paid	How much you can carry forward
2013/14	£35,000	£15,000
2014/15	£20,000	£20,000
2015/16	£15,000	£25,000
Carry forward total		£60,000

So,

- ▶ **Carry forward total = £60,000**
- ▶ **Annual Allowance = £40,000**
- ▶ **Total allowance = £100,000**

You need to have the earnings to support the payment as you can't personally pay in more than 100% of your earnings in the current tax year.

If you think this is something you want to consider using please speak to your financial adviser for more details.

Money Purchase Annual Allowance

From 6 April 2015, if you access your money purchase funds flexibly and take anything above your tax-free cash, normally 25% of the fund, you will have a Money Purchase Annual Allowance of £10,000 and you won't be able to

use carry forward in your money purchase arrangements.

It's important to note that this only applies to money purchase pension schemes. For final salary (defined benefit) schemes, the annual allowance is still £40,000, and carry forward is still available.

So, in the above example, there is a maximum of £60,000 that can be paid into a pension with carry forward, but because the reduced MPAA was triggered, this only applies to final salary schemes. If the individual has any money purchase pensions, the maximum that can be contributed to them is £10,000 in total.



When you first flexibly access your benefits, the scheme administrator has to provide you with a statement within 31 days. You then have to notify any money purchase schemes that you're an active member of within 91 days of receiving your statement, so that they're also aware that the £10,000 Money Purchase Annual Allowance will apply. Failure to do so will result in a fine from HMRC.

If you previously flexibly accessed benefits and join a new scheme, you have to tell the scheme administrator within 91 days. However, if the new scheme is established by a transfer, it's the

duty of the scheme administrator of the transferring scheme to tell the receiving scheme administrator within 31 days of the date of transfer.

What happens if I pay more than I should?

If you pay in more than you are entitled to you could end up with a tax charge. The rate of tax is on a variable basis up to 45%. The rate depends on the rate of income tax you would be paying if the overpayment was added to your income. It's complicated so here are some examples to illustrate how the tax works.

Example 1

Susan has a total income of £41,000 in 2016/17. She has paid in £10,000 to her pension but her employer has been particularly generous and paid in £45,000 giving a total of £55,000. However, her allowance was only £40,000, so she has an overpayment of £15,000.

To work out the charge, she is allowed to deduct her personal payment to the pension from her income so:

$$\text{▶ } \mathbf{£41,000 - £10,000 = £31,000}$$

However, the overpayment must be added back in to establish what level of tax is to be paid so:

$$\text{▶ } \mathbf{£31,000 + £15,000 = £46,000}$$

£3,000 of this falls into the 40% tax bracket, leaving £12,000 of the overpayment in the 20% tax bracket.

- ▶ **£3,000 x 40% = £1,200**
- ▶ **£12,000 x 20% = £2,400**
- ▶ **Total tax charge = £3,600**

Example 2

Fred has a total income of £135,000 in 2016/17. He has paid in £30,000 to his pension and his employer has paid in £60,000 giving a total of £90,000. However, again his allowance was only £40,000, so he has an overpayment of £50,000.

To work out the charge he is allowed to deduct his personal payment to the pension from his income so:

- ▶ **£135,000 - £30,000 = £105,000**

Again the overpayment must be added back in so:

- ▶ **£105,000 + £50,000 = £155,000**

£5,000 of this falls into the 45% tax bracket, leaving £45,000 of the overpayment in the 40% tax bracket.

- ▶ **£5,000 x 45% = £2,250**
- ▶ **£45,000 x 40% = £18,000**
- ▶ **Total tax charge = £20,250**

The tax charge should be declared and paid through your self assessment. If you think this is something that could affect you please speak to your financial adviser for more details.

The Scottish Rate of Income Tax (SRIT)

The Scottish rate of Income Tax applies to you if you live in Scotland. It is currently 10% and you'll pay the same overall rate of income tax as people in the rest of the UK, but this 10% is paid over to the Scottish Government. For the purposes of pension tax relief, the rules as outlined above will apply until 2018/19. From 2018/19, if the SRIT changes from 10% (which means that your overall rate of income tax would also change) then the level of tax relief you'll benefit from will also change.

Losing out on tax relief

Tax relief is important as personal payments made to a pension which are higher than 100% of your earnings are not eligible for that relief, meaning you will lose out on an important benefit. In fact most pension providers will simply refund personal payments which exceed the 100% of earnings limit.

The way in which tax relief operates will depend on the type of pension you have. Some pensions operate on what is called the 'gross from gross' basis and others on the 'net from net' basis. The difference being was the payment taken gross from your income before tax was calculated, or taken net after tax has been calculated.

The gross basis (also known as the "net pay arrangement") means that your tax rate position is taken into account immediately. For example, if you are a higher rate taxpayer and you want to make a payment of £200 a month, £200 is taken from your income before your tax liability is calculated so the amount of tax you pay is reduced. This basis is normally used with occupational schemes provided by an employer.

The net basis (also known as the "relief at source method") is different. You decide you want to physically pay £80 a month. This is the net payment and is taken from your income after your tax liability has been calculated. We then claim the basic rate relief at 20% from HM Revenue & Customs (HMRC). This means that a further £20 is then added to your pension making an overall monthly gross payment of £100.

If you are a higher or additional rate taxpayer you can normally claim further relief by contacting HMRC. Using our example, this means a higher rate taxpayer can claim back a further 20% on each payment they make in a tax year.

This table will help you see varying 'gross' amounts based on the current basic-rate tax relief of 20%. So if, for example, you pay £100 each month to your pension, the 'gross' amount is actually £125.

Your net monthly payment	Gross monthly payment
£20.00	£25.00
£50.00	£62.50
£100.00	£125.00
£150.00	£187.50
£200.00	£250.00

Retirement options

You can take your retirement benefits at any age from 55. This includes your tax-free lump sum.

Fixed income

You can buy an annuity with your whole pension pot, or you can take your tax-free lump sum and buy a smaller annuity. This will provide you with a regular income for the rest of your life.

You can decide on the annuity basis and how it should be paid. You can choose:

- ▶ to have your annuity stay the same or increase automatically each year by a fixed percentage

- ▶ how often it's paid
- ▶ whether you want your annuity to be guaranteed to be paid for a fixed period of up to 10 years, even if you die in that period
- ▶ to have an annuity paid to your spouse or civil partner if you die before them.

However, once the annuity has been bought, you can't cash it in, transfer it or change these options.

If you have a medical condition that reduces your life expectancy, you may be able to buy an impaired life annuity, which will use a higher annuity rate and therefore provide you with a higher income.

Capped Drawdown

Capped Drawdown applies to products that offer drawdown (such as SIPP). The income depends on tables provided by the Government Actuary's Department (GAD) and you can choose what level of income you wish up to a maximum.

Income review up to age 75	Every 3 years
Income review past age 75	Yearly*

*This now starts on the first income anniversary after your 75th birthday rather than on your 75th birthday.

If you were in capped drawdown before 6 April 2015, you can continue to have an Annual Allowance of £40,000, so long as the income you take is within GAD maximum. You can, though, convert to flexi-access drawdown.

If you had a pre-retirement pot and put more of that into drawdown this will normally trigger a review of your income level for your whole arrangement.

At your next review date your income levels will be calculated based on 150% of GAD tables.

New capped drawdown arrangements are unavailable after 5 April 2015, when all new drawdown arrangements are on a flexi-access basis.

Flexi-Access Drawdown and UFPLS

From 6 April 2015, there are two main ways of accessing your money purchase funds flexibly – flexi-access drawdown and uncrystallised funds pension lump sum (UFPLS).

If you take a flexible income, you will have a Money Purchase Annual Allowance of £10,000 and you won't be able to use carry forward. If you are a member of a defined benefit scheme, your overall Annual Allowance stays at £40,000 and you can still use carry forward in that scheme.

Flexi-access drawdown

This type of income drawdown allows you to draw any amount from your money purchase pension fund, whenever you want provided, of course, that the scheme allows it. And, unlike the old rules under flexible drawdown, you don't need to have a minimum level of secure income. Any arrangements going into drawdown for the first time after 5 April 2015 will do so via flexi-access drawdown. Also, existing flexible drawdown arrangements were automatically converted to flexi-access drawdown on 6 April 2015.

Generally, you can take 25% of any benefits you crystallise as a tax free lump sum. However, unlike UFPLS, tax free cash is not limited to 25%. So, for example, individuals with scheme specific lump sum protection will still be able to take the protected tax free cash above the standard 25%. The fund, less any tax free lump sum taken, remains invested in a tax advantaged environment and you can simply draw an income directly from it, if and when they want. Any amount drawn from the fund is taxed as income.

UFPLS

Using UFPLS, you can take a single or series of lump sums from your uncrystallised funds, without actually having to designate them for drawdown first.

25% of the UFPLS is paid tax free, with the balance taxable as pension income.

But there are conditions that you must meet:

- ▶ It must be payable from uncrystallised rights held under a money purchase arrangement;
- ▶ If under 75, you must have enough lifetime allowance available to cover the full amount of the UFPLS;
- ▶ If over 75, you only need to have some lifetime allowance left when you want to take the UFPLS. But if the UFPLS is more than your available lifetime allowance, the tax free element is limited to 25% of your remaining lifetime allowance. The rest of the lump sum is taxable as pension income; and
- ▶ You must be at least age 55 or meet the ill-health conditions.

And, you can't take such a lump sum if you have:

- ▶ primary or enhanced protection with protected tax free cash rights; or
- ▶ a lifetime allowance enhancement factor, but your lump sum allowance is less than 25% (such as from receiving a pension credit on divorce from a pension already in payment).

You can find out more about the Lifetime Allowance on Page 14.

If you have scheme specific lump sum protection, allowing tax free cash of more than 25% of the fund, you can't take an UFPLS from that scheme - unless you give up your right to the higher tax free cash.

Triggering the £10,000 Money Purchase Annual Allowance (MPAA)

There are a number of triggers for the £10,000 money purchase annual allowance (MPAA)

- ▶ Taking an UFPLS;
- ▶ Taking income from a flexi-access drawdown fund (including payments from a short-term annuity provided from a flex-access drawdown fund);

- ▶ Buying a flexible annuity;
- ▶ Drawing a DC scheme pension (unless the scheme pays them to 12+ members);
- ▶ Taking a 100% 'stand-alone' TFC using primary protection

What happens if I die before I take my pension benefits?

Death benefits, like retirement benefits, now offer a lot of flexibility. As ever, lump sums can be paid to any individual or trust that you nominate. But the rules from April 2015 no longer restrict the beneficiary of an income on your death to a dependant. This means that your pension savings can now be passed to anyone you nominate to draw an income from, while remaining in a tax privileged pension wrapper via an inherited drawdown fund. Once a drawdown fund has been created for your nominated beneficiary, they can access the pot at any age, drawing as much or as little as they choose. And they can nominate their own beneficiaries to inherit the pension pot on their death. This allows pension wealth to be cascaded down the generations, with fully flexible access, and without ever forming part of an estate until it is paid out.

The following table shows how any benefits paid on your death are taxed:

Age at death	Benefits taken before death	Taxation of death benefits	
		Lump sum	Income
Under 75	None	0%*	0%*
	Drawdown/annuity	0%*	0%
75 and over	None	Marginal rate	Marginal rate
	Drawdown/annuity	Marginal rate	Marginal rate

* If these are not paid as a lump sum, or set up as drawdown or an annuity, within two years of us being notified of death, they will be taxed in the same way as death from age 75 but the funds won't be tested against the Lifetime Allowance.

Lifetime Allowance

The lifetime allowance is currently £1million. From 6 April 2018, this allowance will be linked to the Consumer Prices Index (CPI) so may increase in the future if this index increases.



If you have built up tax free lump sum rights of more than 25% before 6 April 2006 you have a special calculation which includes using the current Lifetime Allowance. For this calculation only, the Lifetime Allowance remains at £1.8 million even when the calculation is carried out after 5 April 2014, the date at which the Lifetime Allowance started to decrease.

Transitional Protection

Enhanced and Primary Protection

Between April 2006 and April 2009 it was possible for you to apply for transitional protection, either Enhanced Protection or Primary Protection. These reduced or removed the tax charge if you exceeded the Lifetime Allowance. Your financial adviser will be able to confirm if this applies to you.

If you applied for Primary Protection, you will continue to have your protection calculated using £1.8 million.

If you applied for Enhanced Protection, that protection can continue.

Fixed Protection 2012

When the Lifetime Allowance reduced to £1.5 million in April 2012, Fixed Protection 2012 was introduced to protect pension funds up to £1.8 million and had to be applied for by 5 April 2012. Pension contributions had to stop after that date though otherwise the protection would be lost.

Fixed and Individual Protection 2014

With the further reduction of the Lifetime Allowance to £1.25 million from 6 April 2014, the government recognised that people may have built up pension funds of between £1.25 million and £1.5 million based on the rules that applied before then. In this case, you had the opportunity to apply for either or both Fixed Protection 2014 and Individual Protection 2014. Fixed Protection 2014 gave a personal Lifetime Allowance of £1.5 million. Pension contributions had to stop after that date though otherwise the protection would be lost.

To be eligible for Individual Protection 2014, your pension must be valued at more than £1.25 million at 5 April 2014 and you don't have Primary Protection. You can apply even if you have Enhanced Protection or either of Fixed Protection 2012

or Fixed Protection 2014. The value of your fund at 5 April 2014 will be protected and you'll still be able to have pension contributions paid without losing that protection. You have until 5 April 2017 to apply.

Fixed and Individual Protection 2016

Two new forms of protection (Fixed Protection 2016 and Individual Protection 2016) will be created for those caught by the reduction in Lifetime Allowance in April 2016. These will mirror existing 2014 protections.

Fixed protection 2016 will allow a personal LTA of £1.25million Lifetime Allowance beyond 2016. Pension contributions will have to stop after that date though otherwise the protection will be lost. To be eligible for Individual protection 2016 your pension must be valued at more than £1 million at 5 April 2016 and you don't have Primary Protection. The value of your fund at 5 April 2016 (up to a maximum of £1.25 million) will be protected and you'll still be able to have pension contributions paid without losing that protection.

The online process for the 2016 protections will be available from late summer 2016. Between 6 April 2016 and end July 2016,

there is an interim certificate process if you or your personal representatives need to claim benefits which exceed £1 million. Further information on this can be found on [.gov.uk](http://gov.uk). Please note you must also apply for the full protection once it becomes available, otherwise a lifetime allowance charge will apply.

Auto-enrolment

From 1 April 2015, if you have any of the above forms of transitional protection, and you let your employer know, they can choose whether or not to automatically enrol you into their pension scheme. But do note that if you have Enhanced Protection, or any version of Fixed Protection and you are automatically enrolled, you must opt-out of the scheme within one month or you will lose your protection.

Smaller funds

There are rules which allow small 'stranded pots' of £10,000 or less in a single pension scheme to be paid as a lump sum in certain situations. You can take up to 3 'stranded pots' from personal pensions. There is no limit on the number of small 'stranded pots' that can be taken from occupational schemes.

'Stranded pots' are not tested against the Lifetime Allowance.

How will these changes affect me?

Example 1

Jeremy has built up a pension fund over the last 25 years and it has now reached £1.1 million. He decides to retire in October 2016. He hasn't applied for any kind of protection so he has the standard Lifetime Allowance of £1 million.

The excess £100,000 will be taxed in one of two ways:

- ▶ If Jeremy takes it as a lump sum, it will be taxed at 55% before payment so he will receive the net payment of £45,000 from that part of the fund.
- ▶ If he takes it as an income, it will be taxed at 25% however, he will also be paying income tax on that income as he receives it.

Had Jeremy applied for fixed protection 2016 he would not have been liable for this extra tax.

Example 2

Sylvia has also built up a considerable pension fund of £1.95 million. She, however, had applied for Fixed Protection 2012 so had a personal Lifetime Allowance of £1.8 million rather than £1.5 million. When she retires in December 2016 she will have a tax charge to pay but it won't be as much.

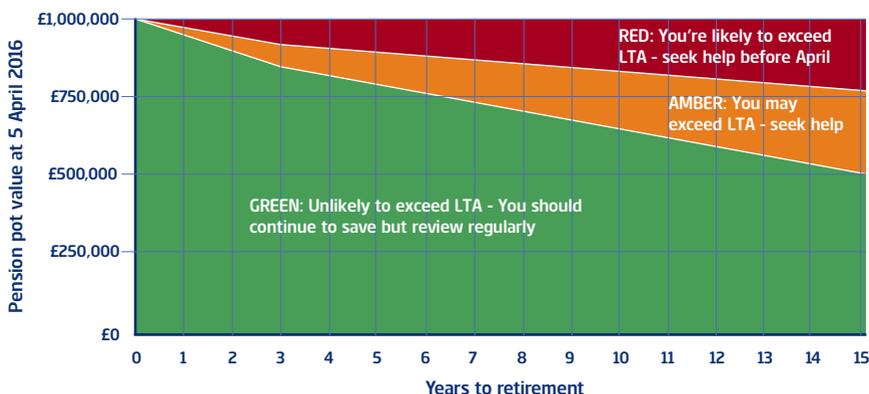
- ▶ *With* Fixed Protection 2012, the charge is either 55% or 25% (depending on which benefit option she chooses) of the excess:

**£1.95 million - £1.8 million =
£150,000 excess**

- ▶ *Without* Fixed Protection 2012, the charge would have been either 55% or 25% of the excess:

**£1.95 million - £1 million =
£950,000 excess**

If you think you will be affected by any of the information given above, please speak to your financial adviser or a tax specialist. We recommend taking advice from a financial adviser before buying a product.



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