NHS EMPLOYERS
PENSIONS AND TAX

An NHS employers guide to Annual and Lifetime Allowances

Use of this guide is limited – see notice on page 29 for detail
August 2015
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This guide was commissioned by NHS Employers following requests from employers for a comprehensive guide to Annual and Lifetime Allowance issues affecting them and their employees.
INTRODUCTION

NHS employing organisations participate in the NHS Pension Schemes and may also offer an alternative Qualifying Pension Scheme for Auto-enrolment purposes. Tax legislation applies to these Schemes.

Staff members in these pension schemes earn pension benefits according to the regulations or rules of these Schemes and these benefits are covered by over-riding tax legislation that restricts the level of tax-free annual and lifetime pension savings. These restrictions are known as the Annual Allowance and the Lifetime Allowance.

It used to be the case that very few NHS workers were likely to exceed the tax allowance thresholds. This has rapidly changed and the level of the Annual Allowance (at £40,000 for the 2015/16 tax year) and Lifetime Allowance (currently £1.25m for the 2015/16 tax year and reducing to £1m from 6 April 2016) means that many more NHS workers will have pension values that exceed the allowances and need to understand the impact and their options. In the NHS Pension Schemes the tax charges (if not settled directly by the employee) lead to a reduction in retirement benefits, which in turn means that their total reward is affected. This makes it an employer issue. Further changes announced in the Summer budget will impact on “higher earners” and complicate the analysis required to assess the impact.

We suggest that NHS employers consider how they support and help their staff understand how the pension and tax legislation applies to them. This action is considered to be good practice and may provide opportunities to help employers attract, retain and engage their workers. There are potential financial savings for employers who are able to adapt pay and pension policies to support their workers directly through reduced turnover and better engagement.

This guide provides employing organisations with information and examples of the tax legislation applicable to NHS pension savings. It is intended for use by NHS employers to help them understand the impact that these tax rules have on their workforce and to identify actions they may take to analyse the current and future position, control the impact as appropriate and engage effectively with their staff.

NHS organisations have some obligations to collect and pass information to members and to the Scheme Administrators, NHS Pensions, and these are also outlined.

TAX CHARGES

Any NHS worker who has pension benefits above the tax thresholds may be subject to a tax charge. It is considered that many members will wish to manage their pension provision to be within the allowable amounts and to be able to do so requires a clear understanding of their pension arrangements, the tax regime and what actions they may consider. Indeed, when this tax regime was introduced it was expected that pension schemes would be adapted by sponsoring employers and pension scheme managers to provide benefits within the regime, or that pension scheme members would adapt their pension saving to be within the thresholds. However, the NHS Pension Schemes have no flexibility in the regulations for directly managing pension growth. So if members wish to reduce or manage their pension growth they may instead seek to leave the pension scheme, control their pensionable remuneration, reduce their working hours or even leave the NHS. This introduces risk to employers of staff seeking alternative reward if they opt out, or, if they leave the NHS altogether, additional costs of recruitment to replace key (often senior) staff.

ANALYSE

It used to be the case that very few NHS workers were likely to exceed the tax allowance thresholds. This has rapidly changed and the level of the Annual Allowance (at £40,000 for the 2015/16 tax year) and Lifetime Allowance (currently £1.25m for the 2015/16 tax year and reducing to £1m from 6 April 2016) means that many more NHS workers will have pension values that exceed the allowances and need to understand the impact and their options. In the NHS Pension Schemes the tax charges (if not settled directly by the employee) lead to a reduction in retirement benefits, which in turn means that their total reward is affected. This makes it an employer issue. Further changes announced in the Summer budget will impact on “higher earners” and complicate the analysis required to assess the impact.

CONTROL

The growth of pension value impacts on different people at different times in their NHS careers and requires different steps to be taken. NHS workers need access to information and support at relevant times, not just as they approach retirement. The information should be forward looking rather than a response to the allowances being exceeded. Employers have a clear role to support staff who are seeking help in managing their pensions.

ENGAGE

We suggest that NHS employers consider how they support and help their staff understand how the pension and tax legislation applies to them. This action is considered to be good practice and may provide opportunities to help employers attract, retain and engage their workers. There are potential financial savings for employers who are able to adapt pay and pension policies to support their workers directly through reduced turnover and better engagement.

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Limitations as to use.

This guide does not provide legal, accounting, tax or financial advice to any party. The regulations of the NHS Pension Scheme determine pension benefits and tax legislation is in the Finance Act 2004. For further details of limitations please see page 29.
Why NHS employers should consider pension and tax issues

The total reward you provide to your employees includes access to the NHS Pension Scheme (or other pension arrangements for auto-enrolment purposes). The application of the tax regime to these pension arrangements may reduce the retirement benefits your workers receive, which in turn reduces their total reward. The reducing allowances will capture many more NHS workers and so pensions tax requires careful consideration.

Helping your workforce understand their pension and the tax issues may provide them with the information they need to take action to retain and manage the value of their overall reward package.

NHS employers can analyse, control and engage with their staff to manage the impact of pensions tax on their organisations.

This may help to reduce risk and improve engagement. It may also serve to assist with recruitment and retention, and lower costs.

Taking these actions will allow you and your workers to control the impact of pensions tax and help your workforce appreciate and maintain their reward value.

- **Analyse – Know who is or could be affected – and how**
- **Control – Understand actions you and your staff can take to maintain reward value**
- **Engage – Inform and educate your workforce – in advance**
BACKGROUND TO CURRENT PENSION TAXATION

Tax relief on pensions has a long history as far back as the 1921 Finance Act, which introduced tax relief to pension schemes satisfying certain conditions.

There followed numerous tax changes over the years, culminating in the current pensions tax regime which was introduced on 6 April 2006 by the Government and was aimed at rationalising the various pension tax rules and the simplification of pensions policy.

The new rules introduced a lifetime cap on the value of pension savings an individual could build up (with the benefit of tax reliefs) over his or her lifetime and this was further controlled by a limit on the value which could be built up each year.

These limits are known as the Lifetime Allowance and the Annual Allowance.

This guide is designed to focus specifically on the Lifetime Allowance and Annual Allowance and the application of these on the NHS Pension Schemes.

THE LIFETIME ALLOWANCE (LTA)
- Introduced with effect from 6 April 2006 (known as ‘A Day’) and is the maximum amount an individual can build up in all of their registered pension schemes, occupational and private without incurring an additional tax charge.
- Originally set at £1.5m it was gradually increased each tax year until reaching £1.8m from 6 April 2011. The Government then began a process of reduction to £1.5m from 6 April 2012, £1.25m from 6 April 2014 and will reduce it again to £1m on 6 April 2016.
- A test against the LTA is normally made at the time when a member of a pension scheme first draws benefits from that scheme.
- Pension savings which exceed the LTA are subject to a one off tax charge.
- The NHS Pension Schemes provide for the benefits above the LTA to be paid either as a pension, or as a lump sum payment at retirement.
- Pensions above the LTA incur a tax charge of 25% and are then taxed at the members marginal rate.
- Benefits above the LTA taken as a lump sum incur a tax charge at 55%.
- The LTA limits for tax years from 2006/07 are shown in Appendix 1.

THE ANNUAL ALLOWANCE (AA)
- The Annual Allowance was introduced with effect from 6 April 2006 and is the maximum amount an individual can contribute, or accrue in any 12 month period without incurring a tax charge.
- Unused AAs from the preceding three tax years can be carried forward, and these can reduce, or in some cases eliminate, an AA charge which would otherwise apply.
- Pension savings which exceed the AA are taxable at the individual’s marginal tax rate. The member may choose to settle any AA charge directly or, if the amount is over £2,000, they may ask the NHS Pension Scheme to settle their tax bill in which case the “debt” is held on their pension account and is recovered at retirement, including any interest accrued.
- For a defined benefit pension arrangement the calculation to determine the AA considers pension growth in a defined period formally known as the “Pension Input Period”, or PIP. In the NHS Pension Schemes the PIP was 1 April to 31 March but this will change to match the tax year from 6 April 2016.
- Pension growth is formally known as the “Pension Input Amount” and this measures the pension at the end of the PIP against the value at the start of the PIP plus inflation.
- The annual allowance limits for tax years from 2006/07 are shown in Appendix 1.
LIFETIME AND ANNUAL ALLOWANCES

Lifetime Allowance since 2006

- 2006/07: £1.5m
- 2011/12: £1.8m
- 2012/13: £1.5m
- 2014/15: £1.25m
- 2016/17*: £1.0m

Annual Allowance since 2006

- 2006/07: £215k
- 2010/11: £255k
- 2011/12: £50k
- 2014/15: £40k
- 2016/17*: £10k

* subject to legislation
IMPACT ON EMPLOYERS
AND POSSIBLE ACTIONS

Why employers are impacted and what they are obliged to do, can do and cannot do

• Traditionally taxation of personal income and wealth has been considered to be a matter between the individual and Her Majesty’s Revenue and Customs (HMRC). NHS employers are bound to apply the taxation codes provided by HMRC, but have generally not felt compelled to assist their employees on tax matters. But these pension tax allowances are different in that the Government expected employers and individuals to respond to them.

• The desire of employees for better communications and information on pensions is both obvious and unsurprising, but the incentive for employers to take a greater role is perhaps less clear. The most obvious reason for greater employer involvement in pensions tax matters is simple; because employees will increasingly demand and then expect such action from ‘good’ employers. The provision of such a service will doubtless be well received, but the benefits are much greater.

• The provision of such a service will support the recruitment process, particularly for direct entrants at the more senior grades. And at the other end of the spectrum it will help with the retention of senior (and increasingly more junior) staff whose replacement will be expensive and far exceed the costs of providing a better pensions taxation service (not to be confused with the provision of independent financial advice). There is evidence that supports the principle that it is significantly cheaper to retain staff than recruit replacements.

• Employers are required to provide data to NHS Pensions to allow NHS Pensions to provide pensions savings statements to members. This provides a retrospective look at what pension has been accrued.

• A proactive employer may wish to provide additional information for their staff that helps the employee understand where they may incur a pensions tax charge unless action is taken.

• Managing pension growth that may affect the Annual Allowance and Lifetime Allowance thresholds may require different actions. But understanding the issues, what actions are possible and and helping your workers understand these is good operational risk management.

• Employers must not directly provide financial advice to employees on what course of action they should take.

The actions employers can take and the risks to employers of taking action, and of not taking action

• It is fair to assume that most employees will have little knowledge of occupational pensions and arguably even less of the associated taxation policies. The key to successfully assisting such employees with pensions taxation issues is the provision of information and this can be delivered in a number of ways. Employers can be proactive and arrange pension tax seminars for their staff; provide written material explaining the tax rules illustrated with relevant examples; they can ‘signpost’ further information through links on the employer’s website; and they can provide on-line pension tax calculators.

• NHS employers should be able to identify “at risk” members of their scheme and provide support and access to help or education materials as required. Pensions tax charges often come as a surprise and there is an increasing risk that this is the case. At least some of the risk can be managed by giving employees advanced warning.

• A clear remuneration strategy and appropriate policies are recommended to ensure that NHS employers are able to respond to requests from affected workers and understand what options are available to them to control remuneration that may be an effective management of pensions tax. The timing of pay awards or promotion, changes in working patterns or the access to salary sacrifice arrangements are all areas where remuneration committees should have input and understanding.

• If employers do not analyse their workers, do not help control and manage risk and do not engage with their staff it is likely that those affected will be disengaged by discovering that they could have taken actions to manage their pension tax.

• NHS employers should consider the risk of being seen to focus effort on the higher paid, and must not incentivise staff to leave the NHS Pension Scheme.
EMPLOYEE ACTIONS AND OPTIONS

ANNUAL AND LIFETIME ALLOWANCES

• Different options apply for employees who may wish to manage their Annual or Lifetime Allowance tax charges.

ANNUAL ALLOWANCE

• The current Annual Allowance is £40,000. Members may exceed this value but may face a tax charge if they do. For the NHS Pension Schemes, this involves comparing the pension value at the beginning and end of each Pension Input Period; for a defined contribution arrangement (like an Additional Voluntary Contribution (AVC) or a private pension) it is the total of the employer and employee contributions in the relevant Pension Input Period. The value is tested across all pension arrangements which the individual is a member of. Should the individual become aware that they are likely to breach their AA, they have a number of choices available to them:
  – pay the tax and carry on as before;
  – have the tax charge paid by the scheme (Scheme Pays) with a compensating reduction in their final pension,
  – opt out of the scheme or reduce AVC contributions;
  – vary their contract with a view to reducing their pensionable earnings and thus exposure to taxation e.g. change to part-time employment;
  – use a salary sacrifice mechanism (if available) to manage pension growth;
  – or leave their employment and thus membership of the pension scheme.

• There are consequences to whatever action is taken and it is very important that employees and employers understand these. For example; the use of salary sacrifice can assist with staying within the Annual Allowance limit in the short term but could mean that limits are exceeded in future years when sacrificing ceases and pensions can be lower.

• Members may also have unused Annual Allowance from previous PIPs. They are able to “carry forward” unused AA to help reduce or remove tax charges.

FUTURE CHANGES

Changes to annual allowance thresholds for higher earners have been announced in the 8th July 2015 budget and these are examined below.
**LIFETIME ALLOWANCE**

- The current Lifetime Allowance (LTA) is £1.25m (but will reduce to £1m from 6 April 2016 – see below).

- Faced with a potential breach of their LTA an individual faces a number of choices: they can do nothing and bear the tax on excess benefits above the Lifetime Allowance or seek to manage potential tax charges (which may also require them to opt out of membership).

- Or they may be able to apply for protection against pensions taxation if available – see Appendix 2. This may require them to ‘freeze’ their pension growth and add no more value before they draw their pension upon retirement. Usually this will involve leaving the pension scheme as an active member, something individuals need to consider carefully as there are implications for drawing their pension early and for ill-health and life insurance benefits. Some protection options allow for further pension to be earned but this additional pension is not protected from tax charges.

- It should be remembered that if an individual breaches, or is likely to breach their LTA, it does not automatically follow that they will have breached their AA. They may breach either or both.

The actions employees can take and the risks to them of taking action or not

- It is very important that NHS scheme members understand their options before making any decision that will potentially affect both their pension and/or their employment.

- Members may wish to vary working hours, defer promotions, or vary their remuneration (e.g. through salary sacrifice) but they will need to consider the loss of value associated with these sorts of actions on their pay and on their pension. Often the member will be better off paying a tax charge. The analysis required can be complex.

- Those who are affected need to appreciate the options they have to settle tax charges and whether they are likely to be affected in future years and what they may do to reduce the risk of this happening.

- If they use the facility where the Scheme settles their tax charge (Scheme Pays) this will be a direct reduction to their pension at retirement which may then reduce or remove a Lifetime Allowance tax charge.

- Not taking any action may increase the amount or frequency of tax charges. Independent Financial Advice should be sought before making any decisions.
The effect of NHS pay changes, including salary sacrifice changes, timings and impact

The main focus of issues that may create an Annual Allowance tax charge are rises in pensionable pay, through promotion or recruitment (from another NHS provider) or through a pensionable award such as a Clinical Excellence Award or pensionable bonus combined with further pension accrual.

Employers may be faced with requests from staff who may be affected to consider how and when pay increases are structured to assist with potential AA tax charges.

**ANNUAL ALLOWANCE**

- Annual Allowance tests consider the pension growth in a Pension Input Period (PIP) which in the NHS has been from 1 April to 31 March. This has changed as a result of the 8th July 2015 budget and will be aligned with tax years from 6 April 2016 onwards (with a transitional period applying during 2015/16). Exceeding the threshold in one PIP may create a tax charge if the member does not have any or sufficient ‘carry forward’ allowance to cover the excess growth above the Annual Allowance for the relevant PIP.

- The current Annual Allowance threshold of £40,000 (correct for NHS PIPs ending on 31 March 2015) may seem a high-bar, yet an increase in pensionable pay of £5,000 per year may be sufficient to create this level of ‘pension growth’ when combined with sufficient length of pensionable service. Any increase in pensionable pay above inflation along with the extra pension earned from being in the Scheme serves to increase pension value and the way that HMRC require the growth in defined benefit to be calculated using a multiple of 16 means that net pension growth of £2,500 in a Pension Input Period is enough to create £40,000 in pension value for AA purposes. This applies at any level of pensionable pay, but growth of this level may be considered more likely at salary levels above £50,000.

- As an example, a member who has an Agenda for Change increment on 1 April of £2,000 and at the same time finished a salary sacrifice arrangement for £3,000 may see enough increase in pensionable pay to create an issue. Any further increase in pay (either through national awards or enhanced increments for example) would see higher possibilities of breaching the threshold.

- Mid year changes in pay, or salary sacrifice, may help to manage pensionable pay growth when tested against the Annual Allowance threshold.

- The ‘carry forward’ rules may allow sufficient unused pension growth from previous Pension Input Periods to prevent a one-off increase in pay creating a tax charge.
LIFETIME ALLOWANCE

- Lifetime Allowance thresholds will vary according to what is in place when the member actually takes some or all of their benefits and whether they have any form of HMRC ‘protection’ in place. In the Final Salary NHS Pension Scheme sections it is the pay at or near retirement that is of most relevance, so mid-career changes have less direct impact on this allowance although they will contribute to overall pension value.

- Members of your staff who are sacrificing salary may cease this election near retirement to restore their pensionable pay to a higher level for calculating NHS Pension.

- Equally, remaining in a salary sacrifice arrangement through to leaving or retiring will reduce the overall pensionable pay and correspondingly reduce NHS Pension. This is a member decision and needs careful consideration.

- To gain the full benefit of ceasing to sacrifice salary a 1995 section member will need to have ceased sacrificing pay for at least 12 months before leaving. A 2008 section member will need to have stopped sacrificing salary for at least three years due to the longer reference period for calculating reckonable pay in this section.

- Managing pensionable pay through salary sacrifice is complex and requires a clear understanding of the impact on both pay and pension.

- The current threshold of £1.25 million (for tax years 2014/15 and 2015/16) requires NHS pension values of between £54,347 and £62,500 depending on the arrangement your staff are in. So pensionable pay of around £109,000 in the 1995 Section is needed or £93,750 in the 2008 section, combined with at least 40 years of pensionable service, to create a pension of this level.

- In the 2015 NHS CARE scheme, average revalued earnings of £84,375 over a career of 40 years may breach the LTA.

- Of course, your staff may have additional pension saving through AVCs, Added Pension or other pension arrangements outside of the NHS, all of which are considered when testing against the lifetime allowance when they take their NHS pension. Some of these are within the NHS Scheme and will be considered by NHS Pensions but AVCs and personal pensions (or other occupational pensions) may not be visible to you or NHS Pensions and need to be collated separately by the individual.

- The timing of pay changes throughout a career and close to retirement is still important and varies depending on the Scheme or section of Scheme that the member is in.

- Understanding the impact is considered to be important to allow for timely planning to occur.
**KEY DATES FOR ANNUAL ALLOWANCE**

Post- Summer Budget 2015

The key dates that are relevant for Annual Allowance issues are:

- **6 April each year** – Start of Pension Input Period (PIP).
- **6 July each year** – Deadline for Employers to submit member details to NHS Pensions (from previous PIP).
- **31 July each year** – Date by which members must tell NHS Pensions of decision to use Scheme Pays’ facility.
- **6 October each year** – Date by which NHS Pensions will tell members they have exceeded Annual Allowance (in the NHS Pension Scheme ONLY). If staff have other pension arrangements, including NHS AVCs, they will need to gather information from each of these and collate the growth themselves. This may mean that they do not breach the threshold in any single pension arrangement, and as such may not get a Pension Savings Statement automatically from any of their pension arrangements.
- **31 January each year** – Latest date for submission of Self Assessment tax return (on-line). The Government has announced the introduction of digital tax returns from 2016 to replace paper returns.
- **5 April each year** – End of Pension Input Period.

During 2015/16 a transitional arrangement is in place with pension accrual proportioned between two periods - one from 1 April 2015 to 8 July 2015 and one from 9 July 2015 to 5 April 2016.
PENSION ACCRUAL

The different effects of final salary, career average re-valued earnings and defined contribution pension accrual, including additional NHS pension options

**ANNUAL ALLOWANCE**

- Defined benefit pension growth for the Annual Allowance test is determined by the change in value at the end of the Pension Input Period (PIP) against the value at the start of the PIP (after allowing for inflation). This figure is then multiplied by a factor of 16 and any automatic lump sum is added.
- Defined contribution Annual Allowance is tested by the actual amount of contributions paid in during a PIP.
- Members with both types of accrual will need to add these together.
- Employers are probably familiar with the way that the NHS Final Salary pension scheme sections calculate pension benefits and how these subsequently impact on pension, and thus on pension growth. Any increase in pensionable pay applies to all Final Salary pensionable service. In this way, an increase in pensionable pay for these member types has the most impact on pension value tested against the Annual Allowance.
- With the 2015 NHS Pension Scheme, from 1 April 2015 many members will have their pension for service after this date calculated on a Career Average Revalued Earnings (CARE) basis, which only considers earnings and membership in the Pension Scheme year.
- An increase in pensionable pay for members in the 2015 Scheme has no effect on past CARE service.
- Many members will also have pre 2015 service, so the calculation of pension growth needs to consider both the Final Salary method and the CARE method, and add them together to give an overall NHS Pension growth value.
- “Added Years” and “Added Pension” elements are considered to be part of the main Scheme that the member is in so these are included in Pension Saving Statements if relevant. Both of these types of additional saving entitle the member to defined benefit type pension growth and are valued in the same way as main scheme benefits.
- It remains to be determined how NHS Pensions will collate this information and whether members will receive one NHS Pensions Saving Statement covering both pre and post April 2015 Schemes, or two separate ones (possibly only on request).
- AVCs are outside of the main NHS Pension Schemes and as such will be excluded from Pension Savings Statements issued by NHS Pensions. The provider who administers these arrangements will provide a statement (automatically if the threshold is breached in this arrangement, or on request if not) to show the amount of contributions paid into these arrangements during the relevant Pension Input Period.

**LIFETIME ALLOWANCE**

- Defined benefit pension is tested against the lifetime allowance using the amount of pension (and lump sum if relevant). Defined benefit pensions are multiplied by a factor of 20 and any retirement lump sum is added to the result. When considering pension value for a defined benefit pension the method of earning pension (CARE or Final Salary, or other) is not relevant. It is the calculated value at the date benefits are taken that is used.
- Defined contribution pensions use the value of the pension fund.
- Both types are assessed at the date that any part of the benefits are taken. This is known as a Benefit Crystallisation Event (BCE).
- Members who can elect to take retirement lump sums (or higher retirement lump sums) may be able to manage their pension value for lifetime allowance purposes by doing so.
- Reductions or increases in pension value through early or late retirement all contribute towards the lifetime allowance calculation.
Future changes and an outline of the potential impact (as known at time of writing)

**Lifetime Allowance**
- The Chancellor of the Exchequer confirmed in the July 2015 Budget that the Lifetime Allowance would reduce to £1m on 6 April 2016.
- This further reduction in lifetime pension savings will mean that many more NHS workers are likely to exceed the threshold and face tax charges. There will be a further set of ‘protection’ options available for affected members to consider and, if they wish, to apply for to allow them to have a personal LTA threshold between £1m and £1.25m. More details about the protection options are included in appendix 2.

- Pension amounts of £43,479 (plus 3 x this amount as a lump sum) from the NHS Pension Scheme 1995 section, or £50,000 from the 2008 section and 2015 NHS Pension Scheme (without further lump sums being taken) are enough to create a tax charge for members when set against this lower LTA. Potentially this affects members with NHS earnings of £77,300 and above with 45 years’ pensionable service in the 1995 section, and earnings of £66,667 in the 2008 section, again with 45 years’ pensionable service. In the 2015 Scheme the pension value is determined by the accrual rate and the CPI rate so an earnings level that affects members is less easy to predict yet in theory average Re-valued Career Earnings of £60,000 at retirement could be considered likely to breach a £1m LTA with 45 years’ pensionable service due to the higher accrual rate that this Scheme provides.

**Annual Allowance**
- There are currently proposed changes to the Annual Allowance for Higher Earners passing through the parliamentary process.
- These changes (if implemented without change) will introduce a lower Annual Allowance for those with earnings above £150,000 with a tapered reduction to their Annual Allowance depending on the size of their income.
- For those whose income exceeds £150,000 their Annual Allowance will reduce by £1 for every £2 income above £150,000, down to a minimum Annual Allowance of £10,000 for those with income of £210,000 and above.

**Other pension tax issues**
- There has been continued discussion around the suitability of the LTA and AA and how defined benefit pension schemes are tested against these thresholds.
- Pension Industry commentators have called for a (further) review, albeit a considered approach after suitable consultation.
- While pre-announced changes are still to be legislated for during 2015/16 the Government is also consulting on how tax relief for pensions is made. We may yet see further change to pension taxation in future years.

### TABLE 1. Example NHS pay and pension amounts to achieve £1m Lifetime Allowance Threshold

<table>
<thead>
<tr>
<th>NHS Pension Scheme (section)</th>
<th>Pensionable Pay</th>
<th>Pensionable Service</th>
<th>Pension amount</th>
<th>Tax free retirement lump sum</th>
<th>Lifetime Allowance “amount”</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>£77,295</td>
<td>45</td>
<td>£43,479</td>
<td>£130,437</td>
<td>£1,000,017</td>
</tr>
<tr>
<td>2008</td>
<td>£66,667</td>
<td>45</td>
<td>£50,000</td>
<td>Nil</td>
<td>£1,000,005</td>
</tr>
<tr>
<td>2015 (Average)</td>
<td>£60,000</td>
<td>45</td>
<td>£50,000</td>
<td>Nil</td>
<td>£1,000,000</td>
</tr>
</tbody>
</table>
FUTURE CHANGES

Annual Allowance changes from 6th April 2016

Annual Allowance

• Set out below is a summary of the changes to the annual allowance announced in the Budget on 8 July 2015. It is based on guidance issued by HMRC, and draft legislation and therefore is subject to change. This document will be updated and expanded as and when any uncertainties and implications become clearer.

The changes in a nutshell

• Annual allowance for those earning above £150,000 is to be reduced on a tapering basis so that it reduces to £10,000 for those earning above £210,000. For every £2 of income above £150,000, an individual’s annual allowance will reduce by £1. This will take effect for the 2016/17 tax year onwards.

• All arrangements in all schemes will have their pension input period aligned with the tax year. Transitional arrangements will apply for the 2015/16 tax year.

Who is affected

• The taper applies to someone if “threshold income” is above £110,000 and “adjusted income” is above £150,000. So if threshold income is £110,000 or lower, there is no change to an individual’s annual allowance.

Threshold income

Threshold income is made up of the following elements

1. The income figure found by completing steps 1 and 2 of s23 Income Tax Act 2007*; plus
2. earnings/employment income given up for salary sacrifice or flexible remuneration arrangements made after 8 July 2015; less
3. any contributions paid under the “relief at source” arrangements – ie, contributions to contract-based pension schemes; less
4. the amount of any lump sum death benefit received which is subject to income tax under the new flexibility rules.

*This is basically all earned and unearned income on which income tax is charged, so would include for example:
• Income from employment, including benefits in kind
• Income from self-employment
• Partnership income
• Property income (eg rental income)
• Certain foreign income
• Income from trusts
• Income from investments (eg, interest, dividends)

Certain allowable reliefs are deducted from this. There are lots of these, but none are likely to affect the vast majority of employees, being things like trade loss relief, share loss relief, etc. The personal allowance is not deducted. Also, note that contributions to the NHS pension schemes, which are deducted from gross pay before tax is charged, will automatically be outside of threshold income.

If threshold income is no more than £110,000 there is no need to go any further.

If threshold income is more than £110,000 it will then be necessary to calculate “adjusted income” – see below.

These items would be entered on your self-assessment tax return when you complete it – if you have them.
FUTURE CHANGES

Annual Allowance

Adjusted Income

Adjusted income is made up of the following elements:

1. Threshold Income; plus

2. The contributions made to occupational pension schemes, ie deducted from gross pay before tax was deducted; plus

3. any employer contributions to defined contribution pension arrangements; plus

4. the employer value of accrual in defined benefit or cash balance pension arrangements.

The employer value of accrual in a defined benefit or cash balance arrangement is the pension input amount figure (worked out in the usual way) minus any member contributions.

If adjusted income is greater than £150,000 the taper will apply.

So, in summary, if threshold income is:

• £110,000 or lower, annual allowance remains unchanged and there is no need to calculate adjusted income.

• greater than £110,000 but adjusted income is £150,000 or lower, annual allowance remains unchanged.

• greater than £110,000 and adjusted income is more than £150,000, annual allowance is determined by the taper.

Note that if an individual has flexibly accessed any benefits in a defined contribution arrangement, the reduced money purchase annual allowance of £10,000 will also apply.

Working out whether the taper applies

Individuals will need information from their employer and pension scheme and none of this information will likely be available before the end of the tax year.

This means it will not be possible to know for sure whether the taper applies, and hence what the annual allowance is, before the end of the tax year.

Calculating the value of accrual in defined benefit pension arrangements

There is no change to how accrual in defined benefit pension arrangements is measured for annual allowance purposes – it is still 16 x pension accrued (with an allowance for CPI inflation). To work out the employer’s share of this value to include in adjusted income, any employee contributions are deducted.

Pension scheme information requirements

As yet, there has been no mention of any changes to the information that pension schemes must provide, but information regulations setting out new requirements are expected in Autumn 2015. Currently pension schemes are required to inform individuals of their pension input amount no later than 6 months after the end of the tax year to which it relates, but this requirement is only automatic if the individual has exceeded the annual allowance in the scheme.

From April 2016 it is difficult to see how this requirement can remain unchanged, because schemes will not know what the annual allowance is for some individuals.
**Annual Allowance**

**Alignment of the Pension Input Period**

To help those affected by the new restriction the government proposes to align pension input periods (PIPs) under all arrangements in registered pension schemes with the tax year, starting from April 2016. This means that for tax year 2016/17 the PIP for all arrangements will be 6 April to 5 April, but for tax year 2015/16 there is a need for transitional arrangements.

**How will the transitional arrangements work?**

Tax year 2015/16 will be split into two “mini” tax years for the purposes of the annual allowance. The “pre-alignment tax year” will run from 6 April 2015 to 8 July 2015. Any open PIPs will be treated as having ended on 8 July 2015. Any pension savings made in PIPs that ended in the pre-alignment tax year will be tested against an annual allowance of £80,000 (plus any available carry forward from 2012/13, 2013/14, and 2014/15).

The period from 9 July 2015 to 5 April 2016 is the “post-alignment tax year”. The annual allowance for savings made in the post-alignment tax year is nil. But if any of the £80,000 annual allowance in the pre-alignment tax year has not been used, this can be carried forward subject to a maximum of £40,000. Any carry forward from 2012/13, 2013/14, and 2014/15 can also be used.

**Calculating pension input amount for 2015/16**

**Defined contribution arrangements**

The pension input amount for the pre-alignment tax year is the total contributions paid to the arrangement in PIPs ending in the pre-alignment tax year. The pension input amount for the post-alignment tax year is the total contributions paid between 9 July 2015 and 5 April 2016.

**Defined benefit arrangements**

Special rules apply for defined benefit arrangements to save scheme administrators having to value pension savings on 8 July or other dates. There will be a single PIP (the combined period) for 2015/16, starting from the date the original 2015/16 PIP started and ending on 5 April 2016.

The pension input amount for the pre- and post-alignment tax years will then be calculated as follows:

The pension input amount for the post-alignment tax year will be PIACP x 272/D, where:

- PIACP is the pension input amount for the combined period;
- 272 days is the number of days from 9 July 2015 to 5 April 2016; and
- D is the number of days in the combined period.

A one-off inflation figure of 2.5% is proposed to apply to the opening balance for the transitional period.
EXAMPLES
HOW THE ANNUAL ALLOWANCE AND LIFETIME ALLOWANCE ARE CALCULATED
John had 20 years pensionable service at the start of the PIP and has had a £10,000 increase in pensionable pay which, combined with an extra year's pensionable service has increased his pension value for AA purposes by £59,375. Without any “carry forward” from previous PIPs he faces a tax charge at his marginal tax rate of the excess amount of £19,375. Assuming he is a higher rate tax payer at 40% this would be £7,750.
Julie has 2008 section pension benefits and 2015 Scheme CARE pension benefits. The affect of her pensionable pay increase of £20,000 applies to her final salary pension and she earns 1/54th of her pensionable pay in the 2015 scheme. She also has revaluation on her previous CARE benefits. The combined effect of this pension growth for AA purposes means that she breaches the AA threshold and without any "carry forward" she faces a tax charge on the excess at her marginal rate. Assuming she is a higher rate tax payer at 40% this would be £4,294.
LIFETIME ALLOWANCE CASE STUDY

Roger is age 57.

Roger has a 1995 section pension of £60,000 and an automatic lump sum of £180,000. His pension is multiplied by 20 to "test" against the LTA and the lump sum is added which means that he has a pension value for LTA purposes of £1,380,000 and is liable for a tax charge on the excess over the £1,250,000 LTA. If he takes the excess as an additional lump sum he would have a tax charge on this amount at 55%, £71,500.

He could elect for a larger tax free retirement lump sum which would reduce his annual pension by £1 for every £12 extra lump sum he chooses. If he elected to take £300,000 tax free retirement lump sum in total his annual pension would be reduced by £10,000 to £50,000 and his LTA value would be £1,300,000. This would reduce the amount liable to tax to £50,000. Taking this £50,000 excess amount as a further taxable additional lump sum would incur a tax charge of 55%, £27,500.

If Roger doesn’t take his pension before 5th April 2016 the Lifetime Allowance reduces to £1,000,000 and without Fixed or Individual Protection he faces higher tax charges.
Ken’s salary is £90,000 but he has other income from his employment and other investments which take his “threshold income” above £110,000 so he has to add the value of his pension input amount. This takes his “adjusted income” over £150,000 and reduces his Annual Allowance to £18,777. Although he was already above the standard lifetime allowance figure of £40,000 this makes more of his pension growth subject to a tax charge and assuming he doesn’t have any carry forward he will pay tax at 40% on £40,598, which is £16,239. This is £8,489 higher than if the change had not occurred.
ALIGNING THE PENSION INPUT PERIOD
TRANSITIONAL RULES

JOHN’S PENSION SAVINGS OVER THE PIP ROM 1 APRIL 2015 TO 5 APRIL 2016 ARE £56,225

THESE ARE APPORTIONED BETWEEN THE PRE-ALIGNMENT TAX YEAR AND THE POST-ALIGNMENT TAX YEAR

PRE BUDGET SAVINGS - £15,000
CARRY FORWARD £65,000
CAPPED TO £40,000

POST BUDGET SAVINGS - £41,225
CARRY FORWARD £40,000
ALL USED UP

2016/17 PIP
AA – £40,000
(reducing for people earning over £150,000)

Pre-alignment tax year
AA – £80,000
Plus
carry forward from 2012/13, 2013/14, 2014/15

Post-alignment tax year
AA – nil
Plus
pre-alignment tax year unused allowance (Max £40,000)
and
carry forward from 2012/13, 2013/14, 2014/15

Tax year PIP
FURTHER SOURCES OF INFORMATION AND SUPPORT

HMRC Technical pages Registered Pension Scheme Manual
http://www.hmrc.gov.uk/manuals/psmmanual/RPSM00100000.htm

NHS Employers website
http://www.nhsemployers.org/pensions

NHS Pensions website – tax information
http://www.nhsbsa.nhs.uk/Pensions/4103.aspx

Options for additional support and information
KPMG provide services to help NHS organisations understand, analyse, manage and communicate pensions and taxation regulations and legislation.

Main KPMG Website

Or contact;

Mark Belchamber
Head of Health Pensions – Public Sector
KPMG LLP
15 Canada Square
London E14 5 GL
Tel: +44 (0) 20 7311 4979
Mobile +44 (0) 7920 503677
Mark.Belchamber@kpmg.co.uk
APPENDIX 1:
ANNUAL ALLOWANCE AND LIFETIME ALLOWANCE LIMITS

The annual allowance was significantly reduced with effect from 6 April 2011 from £255,000 to £50,000 and further reduced from 6 April 2014 to £40,000. From 6 April 2016, higher earners will have their annual allowance further reduced.

The lifetime allowance was reduced from 6 April 2012 from £1,800,000 to £1,500,000 and again from 6 April 2014 from £1,500,000 to £1,250,000.

In the March 2015 Budget the Chancellor has announced a further cut from 6 April 2016 from £1,250,000 to £1,000,000 until 6 April 2018 when it is expected that this threshold will be increased by reference to CPI.

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<td>£40,000</td>
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<tr>
<td>2016/17</td>
<td>£40,000 tapering to £10000*</td>
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<td>2016/17</td>
<td>£1,000,000*</td>
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* Subject to legislation
APPENDIX 2:
HISTORY AND TYPES OF PROTECTION AVAILABLE TO MEMBERS

With the introduction in 2006 of LTA and AA, the Government introduced a variety of protections against liability for pension tax breaches, essentially a way of protecting an individual’s pension savings value at a level at or above the new allowance and thus avoiding or reducing tax charges.

Normally the individual who takes advantage of protection cannot add any more value to their pension from the date of protection or protection may be lost. Some protection types allow for further pension savings within strict limits and some only protect pension savings already accrued. Financial advice should be sought to fully understand the implications of protection and whether further pension accrual may occur.

There are several types of ‘protection’:

- **Primary Protection** – created on 6 April 2006 (A Day) and gave those with pension rights of more than £1.5m their own, higher personal lifetime allowance, expressed through an enhancement factor, e.g. + 1.5 of the standard, statutory allowance (i.e. 1 + 1.5 x £1.5m = £3.75m). The closing date for applications was 5 April 2009.

- **Enhanced Protection** – allows the individual to retain all accrued rights as at A Day, regardless of the Lifetime Allowance – but with the proviso that the member can have no further benefit accrual (other than some allowance for indexation of defined benefits). The closing date for applications was 5 April 2009.

- **Fixed Protection 2012** – introduced when LTA reduced from £1.8m to £1.5m in April 2012. Allowed individuals to retain the £1.8m allowance – but the individual can build up no further benefits (apart from some limited indexation of defined benefits). Closed to registration on 6 April 2012.

- **Fixed Protection 2014** – introduced when LTA reduced from £1.5m to £1.25m in April 2014. Allowed individuals to retain the £1.5m allowance – but the individual can build up no further benefits (apart from some limited indexation of defined benefits). Closed to registration on 6 April 2014.

- **Individual Protection 2014** – introduced when LTA reduced from £1.5m to £1.25m in April 2014. For members with pension savings of £1.25m or more on 5 April 2014, this protection gives them a personalised lifetime allowance of the value of their pension savings on 5 April 2014 subject to a limit of £1.5m. People can apply for Individual Protection 2014 until 5 April 2017.

- **Fixed Protection 2016 and Individual Protection 2016** - members will be able to apply for Individual Protection 2016 (IP16) and Fixed Protection 2016 (FP16). Unlike previous LTA changes, there will be no application deadline for the new protections. However individuals will need to apply for protection before they take their benefits, as they will need an HMRC reference number if they want to rely on the protection. This means that those wanting to rely on IP16 or FP16 should apply before they take any benefits on or after 6 April 2016. (Those wanting FP16 will likely have to cease contributions/accrual before 6 April 2016.)

- Application will be online and available only from July 2016.

Members will no longer receive a lifetime allowance protection certificate; instead, once they have successfully applied for protection, the online service will provide them with a reference number which they will need to keep. There will also be an online service for scheme administrators to check the protection status of their scheme members. HMRC will provide more information on this in due course.

In the period between April and July 2016, an interim applications process will apply for members who want to take benefits before the new online service becomes available. These members will be able to write to HMRC between April and July; HMRC will check the details of their protection and respond to the member in writing. This can then be presented to the scheme administrator in advance of the full application being made after July 2016.

**Auto-enrolment and/or re-enrolment.**

Another aspect of many of the above ‘protection’ options that restrict further pension growth to be borne in mind is if the employer automatically enrols a new employee (or re-enrols someone who has previously opted out), the employee may have to avoid enrolment altogether or opt out of membership within the first month depending on how the enrolment is classified) or they may lose their protection.
### APPENDIX 3: ANNUAL ALLOWANCE THRESHOLD BREACH EXAMPLES

Indicative pay and service that may create Annual Allowance charges NHS Pension Scheme 1995 section

| Salary Increase of 4% | | | | | |
|---|---|---|---|---|
| 1995 Section | 1995 Section inc MHO |
| Salary Increase | 1.04 | 1.04 |
| Accrual Rate | 1/80th | 1/80th |
| Cash rate | 3/80th | 3/80th |
| Inflation | 1.025 | 1.025 |
| AA Pension factor | 16 | 16 |

| Salary Increase of 10% | | | | | |
|---|---|---|---|---|
| | | | | |

<table>
<thead>
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<th>Pensionable service at start of year (years)</th>
<th>Pensionable service at start of year (years)</th>
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<td>15,877</td>
<td>17,311</td>
<td>18,744</td>
<td>20,177</td>
<td>21,609</td>
<td>23,042</td>
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<td>62,474</td>
<td>64,207</td>
<td>65,940</td>
<td>67,673</td>
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| Salary Increase of 4% | | | | | |
|---|---|---|---|---|
| 30,000 | 10,509 | 13,181 | 15,853 | 18,525 | 21,197 | 23,869 | 26,541 | 29,213 |
| 50,000 | 17,061 | 21,696 | 26,222 | 30,747 | 35,272 | 39,797 | 44,324 | 48,850 |
| 70,000 | 23,613 | 29,256 | 34,891 | 40,525 | 46,159 | 51,793 | 57,427 | 63,060 |
| 90,000 | 30,165 | 36,808 | 43,452 | 50,091 | 56,734 | 63,379 | 69,023 | 74,666 |
| 110,000 | 36,717 | 43,360 | 50,004 | 56,648 | 63,291 | 69,936 | 76,580 | 83,223 |
| 130,000 | 43,269 | 49,912 | 56,555 | 63,198 | 69,841 | 76,486 | 83,130 | 89,773 |
| 150,000 | 49,821 | 56,464 | 63,107 | 69,750 | 76,393 | 83,038 | 89,682 | 96,325 |
| 170,000 | 56,373 | 63,016 | 69,659 | 76,302 | 82,945 | 89,589 | 96,233 | 102,876 |

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<tr>
<th>1995 section inc MHO</th>
<th>1995 section inc MHO</th>
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<tr>
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APPENDIX 3: ANNUAL ALLOWANCE THRESHOLD BREACH EXAMPLES CONT.

Indicative pay and service that may create Annual Allowance charges NHS Pension Scheme 2008 section and 2015 NHS Pension Scheme (CARE only) benefits

### 2008 Section

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<th>Salary Increase</th>
<th>Accrual Rate</th>
<th>Cash rate</th>
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### CARE only

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<th>CARE Accrual Rate</th>
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<td></td>
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<td>1/54th</td>
<td>0</td>
<td>1.025</td>
<td>16</td>
<td>0.015</td>
<td>50%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Pensionable salary at start of year, increasing at 10% over the year (£)</th>
</tr>
</thead>
<tbody>
<tr>
<td>30,000</td>
</tr>
<tr>
<td>50,000</td>
</tr>
<tr>
<td>70,000</td>
</tr>
<tr>
<td>90,000</td>
</tr>
<tr>
<td>110,000</td>
</tr>
<tr>
<td>130,000</td>
</tr>
<tr>
<td>150,000</td>
</tr>
<tr>
<td>170,000</td>
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