New arrangements for pensions contributions tax relief

Assessing the risk: resources for employers in the NHS

September 2011
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Introduction

The Finance Act 2011 confirms the revised arrangements in respect of pension contribution tax relief. As such, with effect from April 2011, the annual allowance (AA) has been reduced from £255,000 to £50,000 and from April 2012 the lifetime allowance (LTA) will be reduced from £1.8m to £1.5m.

These changes may give rise to individual tax liabilities for members of the NHS Pension Scheme. Examples illustrating this impact can be found on the pension pages of our website.

Whilst annual and lifetime allowance assessment is a matter for individuals and the HMRC rather than for employers, it is recommended that employers carry out a risk assessment of the potential impact to help inform their approach to reward and to mitigate against changes in retirement planning.

To help employers in assessing the risk, the NHS Employers organisation has commissioned a series of illustrative graphs which cover:

- (Graph A) Breaching the annual allowance with no carry forward of unallocated annual allowance
- (Graph B) Breaching the annual allowance with full carry forward of unallocated annual allowance
- (Graph C) Exercising choice and switching from the 1995 section to the 2008 section of the NHS Pension Scheme
- (Graph D) Breaching the lifetime allowance.

These graphs provide a ‘ready reckoner’ for employers to assess:

- whether increases in pensionable pay will impact on the annual or lifetime allowances. Such increases may arise through promotion, additional allowances or awarding of clinical excellence awards
- the impact of exercising choice and switching from the 1995 section to the 2008 section of the NHS Pension Scheme
- the final salary (at the point of retirement) that may result in a breach of the lifetime allowance.
The graphs are only intended as an approximate guide and so do not take into account the different definitions of pensionable or reckonable pay. They also do not take into account any salary caps that may be in effect. Employers should be aware that all pension arrangements contribute towards the annual allowance and that these graphs only consider benefits built up in the NHS Pension Scheme.

**Important information**

Information contained within this document is provided for broadly indicative purposes only. It cannot be relied upon and should not be used for individual purposes. Independent financial advice should be sought by individuals when determining their own status in respect of tax liability.
Graph A. Breaching the annual allowance with no carry forward of unallocated annual allowance

For members of the 1995 section of the NHS Pension Scheme

For members of the 2008 section of the NHS Pension Scheme
How to use graph A – Breaching the annual allowance with no carry forward of unallocated annual allowance

These graphs show the percentage pay increase that would be needed over the year in order to breach the annual allowance (£50,000) for given levels of service in the Pension Scheme. This is shown for members earning salaries of £70,000, £100,000 and £130,000.

In this case, this is assuming that the member has no previous unused allowance to roll forward. For example, in the 2008 section a member starting the year with 14 years’ service (ending with 15 years’ service) and earning £70,000 a year, would need an approximate pay increase of 10.5 per cent in excess of the Consumer Price Index (CPI) in order to breach the allowance. However, a member starting the year with 39 years’ service (ending with 40 years’ service), would need an approximate pay increase of 4.1 per cent in excess of CPI in order to breach the allowance.

These graphs assume that CPI is zero for the purpose of calculating the increase in benefit value over the year and they assume the member does not have any unused allowances from the previous three years. In order for this to occur, the member would have had to have received significant pay increases in each of the past three years.

The 2008 section graph assumes that the members have only ever been in the 2008 section (i.e. they joined the NHS Pension Scheme on, or after, 1 April 2008).
Graph B. Breaching the annual allowance with full carry forward of unallocated annual allowance

For members of the 1995 section of the NHS Pension Scheme

For members of the 2008 section of the NHS Pension Scheme
How to use these graph B – Breaching the annual allowance with full carry forward of unallocated annual allowance

These graphs show the percentage pay increase that would be needed over the year in order to breach the annual allowance (£50,000) for given levels of service in the Pension Scheme. This is shown for members earning salaries of £70,000, £100,000 and £130,000.

In this case, this is assuming that the member has most of their allowance from the previous three years to roll forward and so has an allowance greater than £50,000 available. For example, in the 2008 section, a member starting the year with 14 years’ service (ending with 15 years’ service) and earning £70,000 a year, would need an approximate pay increase of 42 per cent in excess of CPI in order to breach the allowance. However, a member starting the year with 39 years’ service (ending with 40 years’ service), would need an approximate pay increase of 16.4 per cent in excess of CPI in order to breach the allowance.

These graphs include allowances from the previous three years minus any allowance that was used up by additional pension accrual in each of the years.

They assume that the member has not received any pay increases in the past three years. CPI is assumed to be zero for the purpose of calculating the increase in benefit value over the year and for the roll forward of the unused allowance.
Graph C. Exercising choice and switching from the 1995 section to the 2008 section of the NHS Pension Scheme

1995–2008 switch (not including unused allowances)

1995–2008 switch (including unused allowances)
How to use Graph C – Exercising choice and switching from the 1995 section to the 2008 section of the NHS Pension Scheme

These graphs show the percentage pay increase that would be needed over the year in order to breach the annual allowance (£50,000) for given levels of service in the Pension Scheme, in the same year that a member moves from the 1995 section to the 2008 section through the Choice exercise. This is shown for members earning salaries of £70,000, £100,000 and £130,000.

The first graph assumes that the member has none of their allowance from the previous three years to roll forward, while the second graph assumes the member has most of their allowance from the previous three years available. For example, a member starting the year with 39 years’ service in the 1995 section, ending with 40 years’ service in the 2008 section, earning £70,000 a year and with no unused allowance, would need a pay cut of approximately 6.6 per cent in excess of CPI in order to avoid breaching the allowance. However, a member with most of their allowance from the previous three years available would need an approximate pay increase of 6.5 per cent in excess of CPI in order to breach the allowance.

When a member moves to the 2008 section they are required to commute some of their pension in order to take a minimum lump sum at retirement. The level of minimum lump sum depends on the length of service in the 1995 section. We have assumed that this minimum lump sum is not allowed for in the calculation of the change in benefit value over the year. HM Revenue and Custom (HMRC) has confirmed this approach.

The second graph includes allowances from the previous three years minus any allowance that was used up by additional pension accrual in each of the years. It assumes that the member has not received any pay increases in the past three years.

CPI is assumed to be zero for the purpose of calculating the increase in benefit value over the year and for the roll forward of the unused allowance.
Graph D. Lifetime allowance

For members of the 1995 section of the NHS Pension Scheme

For members of the 2008 section of the NHS Pension Scheme
How to use graph D – Lifetime allowance

These graphs show the salary that would be required at retirement in order to breach the lifetime allowance limit (£1.5 million) for given levels of service in the pension scheme. For example, a member in the 2008 section retiring with 15 years’ service would need a salary of £300,000 in order to breach the allowance, whereas a member with 40 years’ service at retirement would need a salary of £112,500.

These graphs assume that all service has been in the relevant section (i.e. that the member has not switched from the 1995 section to the 2008 section through the Choice exercise).

For a member that moved from the 1995 section to the 2008 section, they would be somewhere between the two graphs. The salaries in the 2008 section graph are effectively set at a lower level, with the salary required to breach the allowance rising with the amount of service that was spent in the 1995 section. This is because the more service the member has in the 1995 section, the higher the minimum lump sum that must be taken (lump sums being valued differently to pension).
NHS Employers

The NHS Employers organisation is the voice of employers in the NHS, supporting them to put patients first. Our vision is to be the authoritative voice of workforce leaders, experts in HR, negotiating fairly to get the best deal for patients.

We manage employer negotiations with the NHS trade unions on pay, pensions and terms and conditions. On behalf of primary care trusts, we lead on specific contract negotiations for GPs and dentists and are involved in contract discussions on community pharmacy.

We work with employers in the NHS to reflect their views and act on their behalf in four priority areas:

1. pay and negotiations
2. recruitment and planning the workforce
3. healthy and productive workplaces
4. employment policy and practice.

The NHS Employers organisation is part of the NHS Confederation.

Contact us

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