

# TECHNICAL BULLETIN

NO.6

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## **TO ALL EMPLOYERS WITH MEMBERS IN THE LOCAL GOVERNMENT PENSION SCHEME. PLEASE ENSURE COPIES ARE PASSED TO RELEVANT STAFF.**

In the Chancellor's recent statement he highlighted his intention to simplify the Inland Revenue rules on taxation of pensions. This bulletin is intended to keep Chief Executives and other senior staff whose pension 'pot' may potentially reach the Government's intended limit of £1.4 million up to date with Inland Revenue proposals. Our understanding of the current situation is outlined below.

### **The Current Position**

Pension benefits are calculated by reference to salary and service and currently the Inland Revenue restricts the amount of service and salary which can be counted for pension in a tax-approved scheme such as the LGPS (e.g. 40 years service at age 60 or 65, depending on IR Class) and the 'earnings cap', currently £99,000 per annum, for those who joined the LGPS on or after 17<sup>th</sup> March 1987.

The Government now proposes to replace these existing arrangements from 6<sup>th</sup> April 2005 (known as A-day) with a lifetime limit on the total amount of pension savings that can benefit from tax relief.

### **The £1.4 Million Lifetime Limit**

It is proposed that, on retirement, the pension 'pot' of the individual is valued and if it exceeds £1.4 million then the excess will be subject to tax, possibly 33% or 25%, plus the usual level of income tax (up to 40%) on pension thereafter.

The Inland Revenue has prescribed a conversion factor of 20:1 to give a cash value of the pension, therefore, the cash value would be (Pension x 20) + lump sum = Cash value.

#### EXAMPLE 1

A Chief Executive retires at age 60 with 35 years service on a salary of £130,000. His pension would be, 35/80ths of £130,000 = £56,875 p.a. with a lump sum of 3 times that amount, i.e.£170,625.

The value of the benefits would be; £56,875 x 20	=	£1,137,500
Plus the lump sum		£ 170,625
<b>TOTAL</b>		<b>£1,308,125</b>

#### EXAMPLE 2

A Chief Executive retires at age 60 with 40 years service on a salary of £130,000. His pension would be, 40/80ths of £130,000 = £65,000 p.a. with a lump sum of 3 times that amount, i.e.£195,000.

The value of the benefits would be; £65,000 x 20	=	£1,300,000
Plus the lump sum		£ 195,000
<b>TOTAL</b>		<b>£1,495,000</b>

In example 2 the lifetime limit is exceeded by £95,000 and possibly 33% tax, amounting to £31,350, would be levied on this sum. The pension and lump sum would then require to be adjusted to take account of the £31,350 reduction in the fund, but it is not yet clear how this would be achieved.

Any other pension savings coming into payment at the same time will also have to be taken into account, e.g. any Additional Voluntary Contribution (AVC) funds, or benefits accrued in another scheme. Other benefits coming into payment later will be assessed at that time.

There is potential (especially on an ongoing basis as it is proposed the £1.4 million is increased in future by RPI and not increases in earnings), for the cash value of a pension in the LGPS for Chief Executives with long service to exceed the £1.4 million limit.

**It is expected the Chancellor will make s further announcement in his Spring 2004 budget speech, and the new lifetime limit will take effect from 6<sup>th</sup> April 2005. Any further information becoming available which will clarify the position will be notified to employers via further Bulletins.**