

## **The Local Government Pension Scheme (England and Wales)**

**Guidance Effective from 1 April 2008**

**Benefits in Excess of the Lifetime Allowance  
Members with Primary Protection**

**Determination of Tax Charge and Resultant Reduced  
Benefits**

**DRAFT**

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## **1 Introduction**

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- 1.1 Under Regulation 22 of the Local Government Pension Scheme Regulations (Benefits, Membership and contributions) 2007 (“the Benefits Regulations”) (SI No. 1166 of 2007), effective from 1 April 2007, the Government Actuary’s Department (GAD) is required to issue guidance to determine the capital value of a member’s benefits.
- 1.2 This note has been prepared by GAD for the Department for Communities and Local Government (DCLG). The main purpose of this note is to issue it to DCLG for onward transmission to administering authorities in order to provide the guidance required by Regulation 22(3) in cases where the value of the member’s benefits including those associated with a previous and simultaneous Benefit Crystallisation Event (BCE) whether from LGPS or another registered pension scheme – exceeds the Lifetime Allowance (LTA). The GAD note on Regulation 21 sets out how to test whether the LTA is exceeded for most members.
- 1.3 This note sets out the treatment for members with Primary Protection. Cases where a member does not have protection and the capital value of accrued benefits do not exceed the LTA are covered by the GAD note on Regulation 21. Other cases are covered by the appropriate GAD guidance note on Regulation 22, depending on the protection status of the member. If a member has both Primary and Enhanced Protection, then Enhanced Protection takes precedence.
- 1.4 This note does not cover the determination of any member’s protected LTA based on their status at 5 April 2006. The guidance assumes such calculations have been carried out and the necessary registration process has been complied with.
- 1.5 This note does not cover a member who has successfully applied for protection under Regulation 48 of the Local Government Pension Scheme (Amendment) Regulations 2006.
- 1.6 A member who is registered for Primary Protection is responsible for providing the LGPS with the unique reference number from the relevant HMRC certificate with details of their protection. The member should also provide the LGPS with the relevant form giving them authorisation to view the HMRC certificate.
- 1.7 DCLG has informed GAD that a member who has reached his/her personal LTA will be able to take benefits in excess of his/her available LTA in the form of a pension or lump sum.
- 1.8 This guidance is based on GAD’s understanding of the Finance Act 2004. Any prevailing HMRC restrictions will take precedence over this guidance.

## 2 General Principles

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- 2.1 Each member will have a lifetime allowance (LTA) setting a ceiling on the pension savings that can benefit from tax relief.
- 2.2 The standard LTA (SLTA) is fixed for each financial year. The SLTA in 2006/07 is set at £1,500,000 and this is intended to increase each year.
- 2.3 A member will have a personal LTA (PLTA), which will be higher than the SLTA if s/he has successfully registered for Primary Protection.
- 2.4 Part of a member's PLTA will be used up at each BCE, whenever pension benefits are crystallised. Such a BCE will reduce the PLTA available at subsequent or simultaneous BCEs. Each member is responsible for providing to the LGPS details of the amount of his/her PLTA used up by previous BCEs as well as the dates and amounts of lump sum taken at the previous BCE's. Once the amount of previous BCEs is deducted from the PLTA, the remaining amount is the member's available LTA (ALTA).
- 2.5 For the purposes of calculating the lump sum payment, the reference is to the SLTA, not the PLTA. However, a different procedure applies for members who had lump sum rights over £375,000 on 5 April 2006.
- 2.6 If a member has any BCE's, including the crystallisation of money-purchase type Additional Voluntary Contributions (AVCs), occurring simultaneously with the crystallisation of his/her LGPS benefits then s/he should inform LGPS of the order in which the BCE's should be deemed to occur. In the calculation of the payment of benefits from the LGPS, the ALTA should only be reduced by the amount used up by previous BCE's and simultaneous BCE's that are deemed by the member to occur *before* the crystallisation of his/her LGPS benefits.
- 2.7 Lump sum benefits are assumed to be crystallised before pension benefits.
- 2.8 Initial capital value of a member's LGPS benefits is then:

$$\text{Initial capital value of LGPS benefits (CV}_0\text{)} = 20 \times P + \text{RG} + \text{AVCs}$$

where:

P = annual scheme pension before commutation

RG = retirement grant

AVCs = value of money-purchase additional voluntary contributions drawn at the same time as the main LGPS benefits

If  $\text{CV}_0 \leq \text{ALTA}$  the member will be able to avoid a LTAC.

If  $\text{CV}_0 > \text{ALTA}$  then a LTAC is likely to have to be paid, but may be avoided or reduced by commuting some pension into a lump sum.

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- 2.9 The member should decide the extent to which s/he wishes to commute pension. The actual capital value of a member's LGPS benefits is then:

$$\text{Actual capital value of LGPS benefits (CV}_1\text{)} = 20 \times \text{RP} + \text{LS} + \text{AVCs-AC}$$

where:

RP = reduced scheme pension (payable annually) after commutation

LS = lump sum after commutation, including AVC lump sum

AC = the amount of AVCs that the member chooses to take as a lump sum

AVCs = as above

If  $\text{CV}_1 \leq \text{ALTA}$  the member will be able to avoid a LTAC

If  $\text{CV}_1 > \text{ALTA}$  then a LTAC will have to be paid.

- 2.10 The lump sum selected will have to be checked to ensure that it is within the relevant limits, as in the section 'Calculation: Total Lump Sum'.

### 3 Calculations:

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#### Tax-free lump sum

- 3.1 The amount of tax-free benefits that a member is entitled to will depend on their ALTA and protection status.
- 3.2 Maximum tax-free lump sum (member with Primary Protection but no protected lump sum).

The amount of the lump sum which can be taken tax-free (TFLS)  
=  $\text{Max} [0, 0.25 \times \text{min}(\text{SLTA less current value of all previously crystallised benefits}, \text{CV}_1)]$

Current value of previously crystallised benefits  
=  $\frac{\text{Capital value of the previously crystallised benefits} \times \text{Current SLTA}}{\text{SLTA when benefits were crystallised}}$

This second calculation should be carried out for each BCE prior to this one. The total is then used in the first calculation above.

- 3.3 Maximum tax-free lump sum (member with Primary Protection and a protected lump sum over £375,000 at 5 April 2006).
- 3.4 A member registered for Primary Protection with lump sum rights as at 5 April 2006 greater than £375,000, will have a different maximum tax-free lump sum, based on their protected lump sum (PLS).

PLS at this BCE =  $\frac{\text{Lump sum entitlement at 5/4/06} \times \text{Current SLTA}}{\text{SLTA at 5/4/06}}$

Current value of previously received lump sums

=  $\frac{\text{Lump sum taken} \times \text{Current SLTA}}{\text{SLTA when lump sum was taken}}$

This second calculation should be carried out separately for each lump sum previously received.

The amount of the lump sum which can be taken tax-free (TFLS)  
=  $\text{Min}(\text{ALTA}, \text{PLS at this BCE} - \text{current value of previously received lump sums})$

#### Total lump sum

- 3.5 A member is entitled to take a lump sum higher than his/her RG by using some or all of the AVC fund and commuting part of his/her pension for additional lump sum. Any residual AVCs will be used to secure additional pension.
- 3.6 However, once the maximum tax-free lump sum has been crystallised, further scope within the ALTA can only be used up in the form of pension benefits. Once the ALTA reaches a balance of zero, the excess benefits can be taken in form of a pension or a lump sum. This is to ensure that no unauthorised payment is made to the member. There are two cases depending on the value of  $\text{CV}_1$ .

**I: If  $CV_1 > ALTA$**

If MAC is the maximum amount of AVCs that may be taken as cash, then the maximum lump sum that the member may take (MLS) is:

$$MLS = \text{Max}[TFLS, 12 \times P + RG + \frac{(2 \times MAC + 3 \times AVC + 3 \times TFLS - 3 \times ALTA)}{5}]$$

If  $MLS = TFLS$ , then the member is likely to be able to avoid the LTAC by commuting additional pension.

**II: If  $CV_1 \leq ALTA$**

$$MLS = \text{min}(TFLS, 25\% \times CV_1)$$

- 3.7 A member may elect for any lump sum (LS) between RG and MLS. Lump sum in excess of TFLS is a Lifetime Allowance Excess Lump Sum and will be subject to the LTAC as shown below.

**Determination of LTAC and reduced benefits**

- 3.8 A tax charge of 55% applies to the value of any lump sum in excess of the tax free amount. A LTAC of 25% applies to the value of any pension in excess of the available LTA. It is necessary to determine separately the amounts by which pension and lump sum exceed the tax allowable limits.
- 3.9 LTA lump sum tax charge and reduced lump sum.

$$\text{Amount of lump sum in excess of TFLS, (XLS)} \\ = \text{Max}[0, (LS - TFLS)]$$

where LS is the lump sum selected, between RG and MLS.

$$\text{LTAC on lump sum (LTAC}_{LS}) = 0.55 \times XLS$$

$$\text{Reduced lump sum} = LS - \text{LTAC}_{LS}$$

If the member is taking a lump sum from his/her AVC fund, as well as a scheme lump sum, then the tax-free part is allocated to the components (AVC or main scheme lump sum) in the order in which they are crystallised. This does not affect the level of the LTAC, but may affect the source of the LTAC payment.

The ALTA is reduced by  $\text{Min}(LS, TFLS)$  where LS is the lump sum, between the RG and MLS, that the member chooses to take.

- 3.10 If the member decides to crystallise an AVC and scheme pension at the same time, then they must decide the order in which this occurs. The following two calculations should be carried out in the order that the member chooses to crystallise the scheme and AVC benefits. So, if scheme benefits are crystallised before AVCs, then carry out paragraph 3.12 first, then paragraph 3.13. However, if the member chooses to crystallise AVCs first, then carry out paragraph 3.13 before paragraph 3.12.
- 3.11 If a member has opted to convert his/her AVCs to a scheme pension, then the procedure for a scheme pension (paragraph 3.12) is carried out twice, for both the main scheme pension and the converted AVC scheme pension.

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3.12 LTA pension tax charge and reduced pension (scheme pension).

Pension in excess of tax allowable amount (XSP)

$$= [P - (LS - RG - AC) / 20] - ALTA/20$$

$$= RP - ALTA/20$$

where:

RP is the reduced scheme pension (pension following deductions for commutation of pension for lump sum chosen by member)

AC is the amount of AVCs that the member chooses to take as a lump sum, and

ALTA is that following the crystallisation of the lump sum and any pension other than this BCE.

If XSP is negative the ALTA has not yet been reached. The entire scheme pension will not be subject to a LTAC. The ALTA is reduced by 20 x RP.

If XSP is equal to zero, then the ALTA is now zero and no LTAC on the scheme pension is payable.

If XSP is positive then the ALTA is now zero but there is a LTAC to pay.

$$\text{LTAC on scheme pension (LTAC}_{\text{scheme pen}}) = 0.25 \times 20 \times \max(\text{XSP}, 0)$$

$$\text{Pension payable (after commutation and tax charge)} = RP - \text{LTAC}_{\text{scheme pen}} / 20$$

A deduction is also made to a widow(er) or civil partner's pension payable after the death of the member. The deduction is 50% of the deduction to the member's pension (i.e.

$$\text{LTAC}_{\text{scheme pen}} / 40)$$

3.13 LTA pension tax charge and reduced pension (AVC pension).

Value in excess of tax allowable amount (XAVC)

$$= (\text{AVCs} - \text{AC}) - \text{ALTA}$$

where:

(AVCs-AC) is the balance remaining in the AVC fund that is to be converted into an annuity, and

ALTA is that following crystallisation of the lump sum and any pension other than from this BCE.

If XAVC is negative the ALTA has not yet been reached. The resulting AVC pension will not be subject to a LTAC. The ALTA is reduced by the value of the AVC fund converted into an annuity.

If XAVC is equal to zero, then the ALTA is now zero and no LTAC on the AVC pension is payable.

If XAVC is positive then the ALTA is now zero and there is a LTAC to pay.

$$\text{LTAC on AVC pension (LTAC}_{\text{AVC pen}}) = 0.25 \times \max(\text{XAVC}, 0)$$

$$\text{Net AVC fund available to convert to annuity} = (\text{AVCs} - \text{AC}) - \text{LTAC}_{\text{AVC pen}}$$

3.14 Total LTAC.

$$\text{Total LTAC} = \text{LTAC}_{\text{LS}} + \text{LTAC}_{\text{scheme pen}} + \text{LTAC}_{\text{AVC pen}}$$

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- 3.15 If at the end of the process, ALTA has not been extinguished, the scheme should ensure that the lump sum paid does not exceed MLS. If it does, then part of the lump sum would be an unauthorised payment, subject to additional tax payable by the scheme. In this situation, the member should be asked to reduce the proposed lump sum by commuting less pension.



## **Annex – Example – Primary Protection**

Consider a member registered for Primary Protection.

### **Her LGPS benefits at retirement in 2007-08 are**

Annual scheme pension (P) = £85,000  
 Retirement grant (RG) = £255,000  
 AVC fund value (AVC) = £45,000  
 Widower's pension = £42,500

### **Lifetime Allowance Limits**

#### **Standard Lifetime Allowance (SLTA)**

SLTA in 2006-08: £1,500,000  
 SLTA in 2007-08: £1,600,000

#### **Personal Lifetime Allowance (PLTA)**

PLTA in 2006-07 = £1,800,000  
 PLTA in 2007-08 = £1,800,000 x (£1,600,000 / £1,500,000) = £1,920,000

#### **Previous Benefit Crystallisation Events (BCEs)**

The member has taken benefits from a previous BCE in 2006-07, with a capital value of £180,000. The value of this benefit in 2007-08 is £192,000, in line with the increase in the SLTA.

#### **Available Lifetime Allowance (ALTA)**

ALTA in 2007-08  
 = PLTA in 2007-08 – current value of previously received BCEs  
 = £1,920,000 - £192,000  
 = £1,728,000

#### **Initial Calculations**

Initial Capital Value of LGPS benefits (CV<sub>0</sub>)  
 = 20 x P + RG + AVC  
 = 20 x £85,000 + £255,000 + £45,000  
 = £2,000,000

This is higher than the ALTA of £1,728,000 so a Lifetime Allowance Charge (LTAC) will be required. However, it may be able to reduce the LTAC by changing the balance of benefits.

**Member's Benefits**

The member would like to take a total lump sum of £450,000 (LS), composed of £255,000 from the RG, £45,000 from the AVC fund (AC) and the remaining £150,000 from commutation of scheme pension.

The reduced scheme pension, following commutation, (RP) would therefore be:

$$\begin{aligned}
 &= P - (LS - RG - AC)/12 \\
 &= £85,000 - (£450,000 - £255,000 - £45,000) / 12 \\
 &= £72,500
 \end{aligned}$$

The AVC fund balance would then stand at zero.

The member's benefits before the payment of a LTAC are:

Total Lump Sum = £450,000  
 Scheme Pension = £72,500  
 Annuitised AVC fund = £0

$$\begin{aligned}
 &\text{Revised capital value (CV}_1\text{)} \\
 &= 20 \times RP + LS + AVC - AC \\
 &= 20 \times £72,500 + £450,000 + £45,000 - £45,000 \\
 &= £1,900,000
 \end{aligned}$$

Since  $CV_1 > ALTA$ , a LTAC will need to be paid.

**Tax-Free Lump Sum (TFLS)**

$$\begin{aligned}
 &= \text{Max}[0, 0.25 \times \text{min}(\text{Current SLTA} - \text{benefits already taken}, CV_1)] \\
 &= \text{Max}[0, 0.25 \times \text{min}(\pounds1,600,000 - \pounds192,000, \pounds1,900,000)] \\
 &= \pounds352,000
 \end{aligned}$$

We need to check that LS is not more than the Maximum Lump Sum (MLS) allowed:

$$\begin{aligned}
 &\text{MLS} \\
 &= \text{Max}[\text{TFLS}, 12 \times P + RG + (2 \times \text{MAC} + 3 \times \text{AVC} + 3 \times \text{TFLS} - 3 \times \text{ALTA}) / 5] \\
 &= \text{Max}[\pounds352,000, 12 \times \pounds85,000 + \pounds255,000 + (2 \times \pounds45,000 + 3 \times \pounds45,000 + 3 \times \pounds352,000 - 3 \times \pounds1,728,000) / 5] \\
 &= \pounds494,400
 \end{aligned}$$

Since the MLS is not lower than the lump sum chosen of £450,000 chosen by the member, the member is able to receive this lump sum.

### Lifetime Allowance Charge Calculations

#### Lump Sum

Since the LS that the member has chosen to take is over the TFLS, she is required to pay the LTAC on the excess lump sum of £98,000 (£450,000 – £352,000).

$$\begin{aligned} \text{LTAC on the lump sum (LTAC}_{\text{LS}}) &= 55\% \times £98,000 \\ &= £53,900 \end{aligned}$$

$$\begin{aligned} \text{The member will receive a net lump sum} &= \text{LS} - \text{LTAC}_{\text{LS}} \\ &= £450,000 - £53,900 \\ &= £396,100 \end{aligned}$$

$$\begin{aligned} \text{The revised ALTA, following crystallisation of the LS} &= £1,728,000 - \min(\text{TFLS}, \text{LS}) \\ &= £1,728,000 - \min(£352,000, £450,000) \\ &= £1,376,000 \end{aligned}$$

#### Scheme Pension

The revised ALTA will allow the member to take an annual pension of £68,800 (£1,376,000 / 20).

$$\begin{aligned} \text{The pension in excess of that permitted by the revised ALTA (XSP)} &= £72,500 - £68,800 \\ &= £3,700 \end{aligned}$$

The member will need to pay a LTAC on the XSP.

$$\begin{aligned} \text{LTAC on the scheme pension (LTAC}_{\text{scheme pension}}) &= 25\% \times 20 \times \text{XSP} \\ &= 25\% \times 20 \times £3,700 \\ &= £18,500 \end{aligned}$$

$$\begin{aligned} \text{The member's annual scheme pension after payment of a LTAC} &= \text{RP} - (\text{LTAC}_{\text{scheme pension}} / 20) \\ &= £71,575 \end{aligned}$$

$$\begin{aligned} \text{The widower's pension is reduced by 50\% of the deduction to the member's pension} & \\ \text{Deduction} &= £18,500 / 40 = £462.50 \text{ pa} \\ \text{Reduced widower's pension} &= £42,500 - £462.50 = £42,037.50 \end{aligned}$$

The member's and widower's annual scheme pensions after payment of a LTAC will be increased in accordance with the Pension Increase Act and will be subject to income tax.

#### AVC fund pension

The member has no AVC funds remaining since the whole of the fund was crystallised in the form of a lump sum.

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**SUMMARY**

**Total LTAC paid = £53,900 + £18,500 =£72,400**

**The member's benefits at retirement are now therefore:**

**Annual scheme pension payable to member = £71,575**

**Lump sum payable to member = £396,100**

**Contingent widower's pension = £42,037.50**