

Judicial Pension Scheme

Annual Allowance from 2016/17 - Important Changes

Key Points

- The Judicial Pension Scheme 2015 is a tax registered scheme
- The 1993 Judicial Pension Scheme is **not** registered for tax (the Annual Allowance does not apply)
- All Judicial AVC schemes are registered for tax
- The Annual Allowance restricts the amount of tax relief available for pension savings.
- The Annual Allowance is being reduced for people earning more than £150,000 for the 2016/17 tax year onwards
- There is an exemption for those whose earnings and other income is less than £110,000
- The method of reduction is called Tapered Annual Allowance (TAA) and works by reducing the annual allowance by £1 for every £2 of adjusted income
- The option to have any tax charge paid from pension scheme rights is available
- Unused allowance from three previous tax years can be carried forward. This only applies if a member of a registered scheme)

Introduction

Although there is no limit on the pension savings that may be made in a tax registered pension scheme, the Annual Allowance (AA) effectively limits the amount of tax relief available on contributions to defined contribution (DC) schemes and pension accrual in defined benefit (DB) schemes.

The Chancellor announced in his Summer budget that pension tax relief for high earners and other high-income individuals will be restricted.

The reduced availability of tax relief for those with high earnings or income will take effect for all tax years from 6 April 2016. The method used to reduce pension tax relief is to reduce the annual allowance, i.e. the maximum amount of pension savings in a UK registered pension scheme that will attract marginal rate tax relief.

Pension Input Periods (PIP)

The PIP is the period over which pension savings are measured. Prior to the changes on 8 July 2015, the PIP for the Judicial schemes ran from 1 April to 31 March each year.

From July 2015 all PIPs are aligned with the tax year and end on 5 April. There are transitional arrangements for the 2015/16 tax year, which in the Judicial Scheme involves a pre-alignment PIP from 1 April to 8 July 2015 and a post-alignment PIP from 9 July to 5 April 2016.

Pension Input Amounts (PIA)

To determine if the AA has been exceeded for a particular tax year, it is not simply the amount of contributions made or the accrual in that tax year that is taken into account. Instead, it is the total pension input amount (PIA) made within a pension input period (PIP) ending in the tax year.

In a Defined Benefits arrangement such as the Judicial Pension Scheme 2015, the PIA is calculated as the difference between

the accrued pension at the end of the PIP and the accrued pension at the end of the previous PIP. The previous figure is adjusted for inflation and the difference multiplied by a factor specified by HMRC which is currently 16.

In Defined Contribution arrangements such as the Judicial AVC scheme and the Partnership Pension Account, the PIA is the member and employer contributions paid.

Tapered Annual Allowance (TAA)

The method to reduce the Annual Allowance is the Tapered Annual Allowance (TAA). It works by reducing the normal Annual Allowance (currently £40,000) by £1 for every £2 of adjusted income for earnings over £150,000 up to a maximum reduction of £30,000, leaving a minimum AA of £10,000.

Therefore members with an adjusted income of between £150,000 and £210,000 are affected by the taper from the 2016/17 tax year. Those with an adjusted income of over £210,000 will have an Annual Allowance of £10,000.

The TAA reduction will be subject to an income floor of £110,000, please see example below for details of how the Threshold Income is calculated.

The income definition for the TAA will not be the same as taxable income. It will include all taxable income together with the pension accrual in the tax year, this will be known as adjusted income.

Carry forward

Members may carry forward unused Annual Allowance from up to three previous tax years. However, it is necessary to have been a member of any **registered** pension scheme at some point in the tax year from which unused allowance is to be brought forward. The table below details the tax status of the judicial schemes:

Judicial Pension Scheme 1993	Non-registered
Judicial Pension Scheme 2015	Registered
Partnership Pension Account	Registered
Judicial Additional Voluntary Contributions	Registered
Judicial Added Years Scheme	Registered

Before AA is carried forward from a previous year, the current year's allowance must first be exhausted. Any unused AA must be carried forward from earlier tax years before later years.

Option to Elect for Statutory Scheme Pays

A member has a right to ask the Judicial Pension Scheme to pay the AA charge from their accrued pension benefits under the scheme. If the scheme does pay the tax in any year that it is due, then at retirement the member's pension is reduced by an actuarially calculated factor.

Important Notes

Under current legislation if the AA is exceeded the scheme is obliged to provide information about the AA and the pension input amount (PIA) by the 6 October following the end of the tax year that gave rise to the charge. The member then has an obligation to include the AA information on their annual tax return.

As the legislation has not been finalised to implement the changes to the AA, the information in this note is based on our current understanding of the tax and legal position. This document is for reference purposes only and does not constitute financial advice. If you think that you might be affected by the Annual Allowance, we recommend that you take independent financial advice from a registered individual, who can assess and quantify the extent of any tax liability that is due. You can find a list of independent financial advisers at www.unbiased.co.uk

If you have any questions on the information contained in this note, please contact us by e-mail at judicialpensions@justice.gsi.gov.uk

Example 1

The following example illustrates the impact of the changes for a High Court Judge with a salary of £177,988 who is a member of the Judicial Pension Scheme 2015.

Step 1 – Checking Threshold Income

To check if the Annual Allowance will be tapered the taxable earnings (Threshold Income) are compared against a £110,000 limit:

Pensionable pay		£177,988
Non-pensionable pay	+	£nil
Other taxable income	+	£nil
Pension contributions ¹	-	£ 14,328
Other tax deductible reliefs	-	£nil
<u>Threshold income</u>		<u>£163,660</u>

As the Threshold Income is above the £110,000, the Annual Allowance might be tapered.

Step 2 – Checking Adjusted Income

The next step is to check whether, when added together if the taxable earnings and the increase in the value of the pension over the year (Pension Input Amount) are greater than the £150,000 limit. The increase in the value of pension for 2016/17 was £66,069:

Threshold income		£163,660
Increase in value of pension ²	+	£ 66,069
<u>Adjusted income</u>		<u>£229,729</u>

As the Adjusted Income is over the £150,000 threshold, the Annual Allowance will be tapered.

Step 3 – Tapering the Annual Allowance

The standard Annual Allowance in 2016/17 is £40,000. This is tapered by £1 for every £2 that the Adjusted Income exceeds £150,000. As the Adjusted Income is £79,729 over the limit the Annual Allowance is tapered to £10,000.

Step 4 – Comparing accrued pension against the Annual Allowance

The pension has increased in value by £66,069 during 2016/17, which is greater than the tapered Annual Allowance of £10,000. The £56,069 difference is the amount by which it exceeds the Annual Allowance in 2016/17. This amount is potentially subject to an Annual Allowance charge if the member has no unused allowance from the previous 3 years.

Step 5 – Calculating any Annual Allowance charge

Deducting the Annual Allowance of £10,000 from the pension accrued of £66,069 means that £56,069 will be subject to the Annual Allowance charge at the individual's marginal tax rate (£25,231 for those whose marginal rate of tax is 45%).

The member may choose to pay the tax due themselves or alternatively the scheme can pay the tax due with a reduction to the member's pension at retirement.

¹Contributions are equal to salary received multiplied by the contribution rate, i.e. £177,988 x 8.05%

²£66,069.15 equals the judge's salary, multiplied by 2.32%, multiplied by the HMRC factor of 16

Example 2

The following example illustrates the impact of the changes for a Circuit Judge with a salary of £132,184 who is a member of the Judicial Pension Scheme 2015.

Step 1 – Checking Threshold Income

To check if the Annual Allowance will be tapered the taxable earnings (Threshold Income) are compared against a £110,000 limit:

Pensionable pay		£132,184
Non-pensionable pay	+	£nil
Other taxable income	+	£nil
Pension contributions ¹	-	£ 9,716
Other tax deductible reliefs	-	£nil
<u>Threshold income</u>		<u>£122,468</u>

As the Threshold Income is above the £110,000, the Annual Allowance might be tapered.

Step 2 – Checking Adjusted Income

The next step is to check whether, when added together if the taxable earnings and the increase in the value of the pension over the year (Pension Input Amount) are greater than the £150,000 limit. The increase in the value of pension for 2016/17 was £49,072:

Threshold income		£122,468
Increase in value of pension ²	+	£ 49,072
<u>Adjusted income</u>		<u>£171,540</u>

As the Income is over the £150,000 threshold, the Annual Allowance will be tapered.

Step 3 – Tapering the Annual Allowance

The standard Annual Allowance in 2016/17 is £40,000. This is tapered by £1 for every £2 that the Adjusted Income exceeds £150,000. As the Adjusted Income is £21,540 over the limit the Annual Allowance is tapered to £29,230 (£40,000 – £10,770).

Step 4 – Comparing accrued pension against the Annual Allowance

The pension has increased in value by £49,072 during 2016/17, which is greater than the tapered Annual Allowance of £29,230. The £19,842 difference is the amount by which it exceeds the Annual Allowance in 2016/17. This amount is potentially subject to an Annual Allowance charge if the member has no unused allowance from the previous 3 years.

Step 5 – Calculating any Annual Allowance charge

The difference of £19,842 will be subject to the Annual Allowance charge at the individual's marginal tax rate (£7,937 for those whose marginal rate of tax is 40%)

The member may choose to pay the tax due themselves or alternatively the scheme can pay the tax due with a reduction to the member's pension at retirement.

¹Contributions are equal to salary received multiplied by the contribution rate, i.e. £132,184 x 7.35%

²£49,072 equals the judge's salary, multiplied by 2.32%, multiplied by the HMRC factor of 16

Example 3

The following example illustrates the impact of the changes for a Circuit Judge with a salary of £132,184 who is a member of the Judicial Pension Scheme 2015. They have unused Annual Allowance of £24,000 as they contributed to the AVC scheme in the previous tax year whilst a member of the Judicial Pension Scheme 1993.

Step 1 – Checking Threshold Income

To check if the Annual Allowance will be tapered the taxable earnings (Threshold Income) are compared against a £110,000 limit:

Pensionable pay		£132,184
Non-pensionable pay	+	£nil
Other taxable income	+	£nil
Pension contributions ¹	-	£ 9,716
Other tax deductible reliefs	-	£nil
<u>Threshold income</u>		<u>£122,468</u>

As the Threshold Income is above the £110,000, the Annual Allowance might be tapered.

Step 2 – Checking Adjusted Income

The next step is to check whether, when added together if the taxable earnings and the increase in the value of the pension over the year (Pension Input Amount) are greater than the £150,000 limit. The increase in the value of pension for 2016/17 was £49,072:

Threshold income		£122,468
Increase in value of pension ²	+	£ 49,072
<u>Adjusted income</u>		<u>£171,540</u>

As the Income is over the £150,000 threshold, the Annual Allowance will be tapered.

Step 3 – Tapering the Annual Allowance

The standard Annual Allowance in 2016/17 is £40,000. This is tapered by £1 for every £2 that the Adjusted Income exceeds £150,000. As the Adjusted Income is £21,540 over the limit the Annual Allowance is tapered to £29,230 (£40,000 – £10,770).

Step 4 – Comparing accrued pension against the Annual Allowance

The pension has increased in value by £49,072 during 2016/17, which is greater than the tapered Annual Allowance of £29,230. The £19,842 difference is the amount by which it exceeds the Annual Allowance in 2016/17. As the member has £24,000 unused Annual Allowance they do not exceed the limit.

Step 5 – Calculating any Annual Allowance charge

No charge payable.

¹Contributions are equal to salary received multiplied by the contribution rate, i.e. £132,184 x 7.35%

²£49,072 equals the judge's salary, multiplied by 2.32%, multiplied by the HMRC factor of 16

Example 4

The following example illustrates the impact of the changes for a District Judge with a salary of £107,100 who is a member of the Judicial Pension Scheme 2015.

Step 1 – Checking Threshold Income

To check if the Annual Allowance will be tapered the taxable earnings (Threshold Income) are compared against a £110,000 limit:

Pensionable pay		£106,040
Non-pensionable pay	+	£nil
Other taxable income	+	£nil
Pension contributions ¹	-	£ 7,794
Other tax deductible reliefs	-	£nil
<u>Threshold income</u>		<u>£98,246</u>

As the Threshold Income in respect of the judicial salary is below £110,000, the Annual Allowance is not tapered. However, if the member has other taxable income then the Threshold Income might be exceeded.

Step 2 – Checking Adjusted Income

Not applicable

Step 3 – Tapering the Annual Allowance

Not applicable

Step 4 – Comparing accrued pension against the Annual Allowance

The pension has increased in value by £39,360² during 2016/17, which is less than the Annual Allowance of £40,000.

Step 5 – Calculating any Annual Allowance charge

No charge payable.

¹Contributions are equal to salary received multiplied by the contribution rate, i.e. £106,040 x 7.35%

²£39,360 equals the judge's salary, multiplied by 2.32%, multiplied by the HMRC factor of 16