

Annual Allowance and Ill Health Retirement

If you retire on Ill Health terms, you may receive an enhancement to your pension benefits. One of the consequences of an enhancement to your pension benefits is that you could potentially incur an Annual Allowance tax charge.

What is Annual Allowance?

The Annual Allowance is set by HM Revenue and Customs (HMRC) as the maximum amount of pension savings individuals can make across all registered pension arrangements, in any one year, that benefits from tax relief. The Annual Allowance limit is currently £60,000. If your pension savings in a year are more than the Annual Allowance limit for that year, you may be liable to pay tax on the amount over the Annual Allowance. HMRC rules relating to Annual Allowance apply to all individuals with savings in registered pension schemes, such as the Civil Service Pension Scheme.

HMRC provide guidance on their website that you may find useful: www.gov.uk/tax-on-your-private-pension

Pension savings include actual employer and employee contributions to Defined Contribution schemes (such as an Additional Voluntary Contribution scheme or the partnership pension scheme). The growth of pension savings is known as the Pension Input Amount and the period over which these savings are measured is known as the Pension Input Period.

For Defined Benefit schemes, the Pension Input Amount is worked out as 16 times the increase in the value of your pension during the year, plus the increase in value of any automatic lump sum (classic/classic plus only). A measure for inflation is included in the calculation.

Please be aware that this doesn't just affect high earners. Any of the following could have an impact on the amount of Annual Allowance you use:

- Buying added pension (especially lump sum purchases)
- Contributing towards other pensions savings such as Additional Voluntary Contributions
- Getting a significant pay rise
- Leaving on ill health retirement with an enhancement to your service
- Transferring in service from another pension scheme under the preferential Club Transfer terms
- Aggregating or linking a previous period of employment from the Civil Service.

The calculation of a Pension Input Amount can be broken down into several steps:

Step 1 – determine the amount of accrued benefits at the end of the previous Pension Input Period and multiply by 16

Step 2 – add any automatic lump sum to the amount from Step 1

Step 3 – uplift the amount from Step 2 in line with inflation

Step 4 – determine the amount of accrued benefits at the end of the current Pension Input Period and multiply the value by 16

Step 5 – add any automatic lump sum to the amount from Step 4

Step 6 – deduct the value from Step 3 from the value in Step 5

The result from Step 6 is the Pension Input Amount.

If you breach the Annual Allowance and fail to meet HMRC severe ill health criteria, you will need to check whether you have any tax to pay. Even if your Pension Input Amount is over the Annual Allowance for the latest Pension Input Period, you still may not have tax to pay. This is because you can use any unused Annual Allowance from up to 3 years prior to the current tax year to offset against the taxable amount. This is called 'carry forward' and more information on this is available at: www.hmrc.gov.uk/pensionschemes/calc-aa.htm

The Pension Input Amount information provided in your Ill Health Retirement quotation is in respect of your Civil Service Pension Scheme benefits only, and includes any added pension or added years. It does not include any Civil Service Additional Voluntary Contributions, partnership benefits or any other pension arrangements you may have outside the Civil Service pension arrangements. You will, however, need to take account of any other pension arrangements when calculating if there is any Annual Allowance tax charge to pay. Information can be obtained from the provider of these benefits.

For more details regarding Annual Allowance, calculating and paying any tax charge, including examples, a calculator and Frequently Asked Questions, please see the below HMRC websites:

www.hmrc.gov.uk/pensionschemes/calc-aa.htm

www.hmrc.gov.uk/tools/pension-allowance/calculator.htm

HMRC severe Ill Health

HMRC has issued guidance that gives exemption from the Annual Allowance tax charge to individuals who meet the HMRC's 'severe Ill Health' criteria.

HMRC's criteria for severe Ill Health is an individual who is suffering from ill health which makes the individual unlikely to be able (other than to an insignificant extent) to undertake gainful work in any capacity up to at least State Pension Age.

However HMRC's severe Ill Health criteria does not match the Civil Service pension arrangements criteria for Ill Health retirement, and so for individuals to gain the exemption status they will need an additional assessment.

Speak to your employer if you require more information about the procedures you may need to follow.

Nothing on this page should be taken as financial advice. You should consider matters carefully before making any decisions and may wish to consult an independent financial adviser for advice.