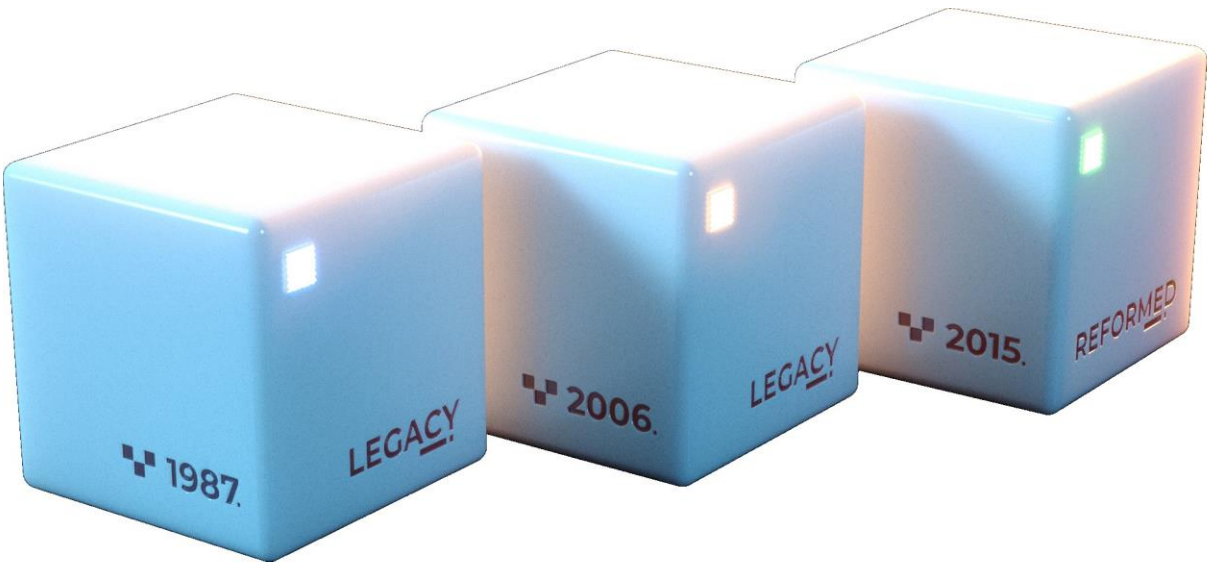
National Police Chiefs' Council

Member tax information
Introduction to pensions tax



Contents

Introduction

1. This document is for members of the police pension scheme to provide an introduction to pensions tax covering all aspects including annual allowance and pensions savings statements. This provides a lot of background information about how the annual allowance and how pension growth is assessed.
2. The information and rates quoted in this document are for the 2024/25 tax year and therefore relevant links have been provided throughout the document to the GOV.UK website so that the most up to date information can be found.
3. In the appendix of the document there are some case studies with example calculations to show the impact of different scenarios on annual allowance.
4. At the end of the document there is also a glossary with some useful terms explained.
5. Due to the complex nature of police pensions, taxation and remedy, the technical content of this document has been specifically commissioned by NPCC and written by specialist tax advisers KPMG.

Understanding the Annual Allowance

What is the annual allowance?

6. The annual allowance is the maximum amount of pension that you can build up each tax year across all pension schemes you are a member of before you have to pay a tax charge.

7. The way in which the annual allowance that applies to you is worked out, depends on a number of factors, including the pension you may have built up in previous years and your total income.

8. The standard annual allowance is £60,000 for tax year 2024/25[1], but carry forward or a tapered annual allowance may alter this.

It is possible to have a higher annual allowance than the standard by ‘carrying forward’ unused allowances from previous years

It is also possible to have a reduced (also known as “tapered”) annual allowance, if you have income above certain thresholds

Money purchase annual allowance

9. If you start to take money from a defined contribution pension pot, for example, if you have a personal pension that you decide to draw income from, your annual allowance in respect of saving into defined contribution pensions may be lower. This is known as the Money Purchase Annual Allowance.

[1] Historical standard annual allowance rates – https://www.gov.uk/government/publications/rates-and-allowances-pension-schemes/pension-schemes-rates

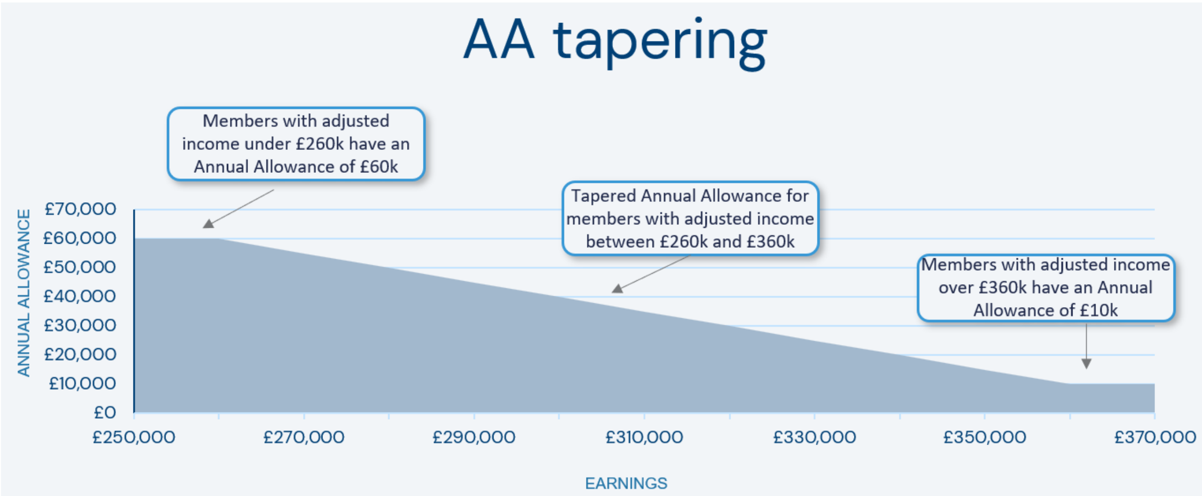
What is the tapered annual allowance?

10. In the tax year 2024/25, if your threshold income is more than £200,000 and your adjusted income is more than £260,000, then your standard annual allowance will be reduced.

11. The standard annual allowance reduces by £1 for every £2 of adjusted income you have over £260,000, down to a minimum annual allowance of £10,000.

12. In the tax year 2024/25, the maximum reduction to your annual allowance will be £50,000, which means that if your income is £360,000 or more your annual allowance will be £10,000.

13. The chart below shows how tapering works: –



What are the income thresholds (adjusted and threshold)?

14. It is possible to have a lower ("tapered") annual allowance, if you have income above certain thresholds. In order to work out if this applies to you, you have to undertake two tests.

Step 1: Threshold income test

If threshold income is greater than £200k, move to next step	If threshold income is less than £200k, you will have no tapering to annual allowance

Step 2: Adjusted income test

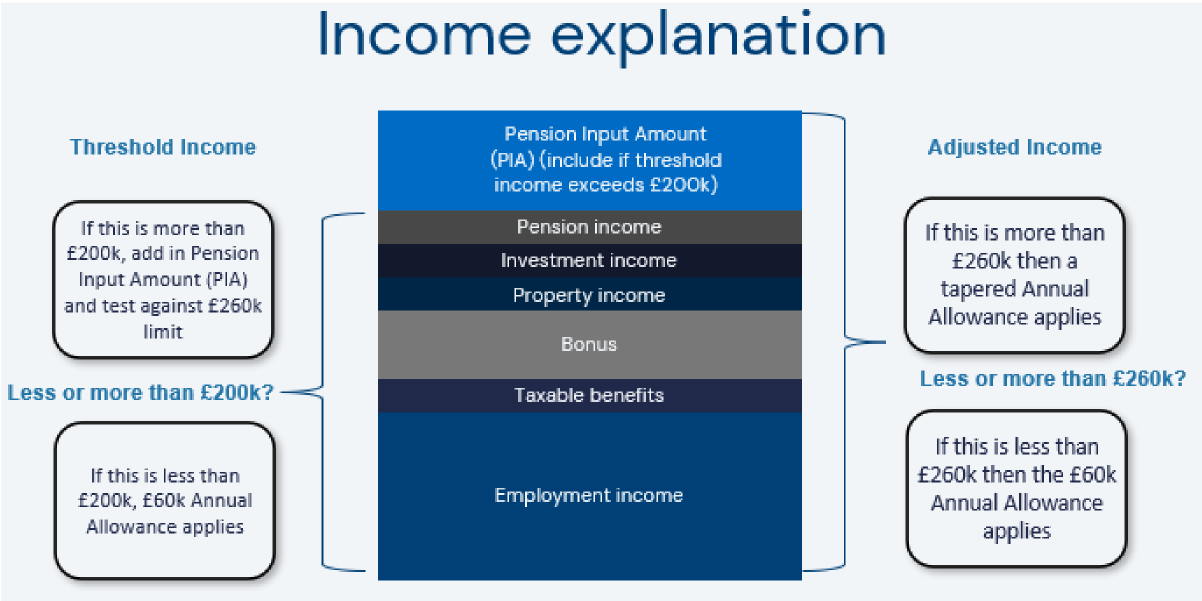
If adjusted income is greater than £260k, you will have a tapered annual allowance

The threshold income test

15. The threshold income is all your net income for the tax year. Broadly speaking this includes all taxable income from all sources but deducting the gross amount of any individual pension contributions you have made; this includes normal member contributions and also any additional voluntary contributions

The adjusted income test

16. You can calculate your adjusted income by adding the value of any pensions you have built up over the year (also known as the "pension input amount") to your threshold income.

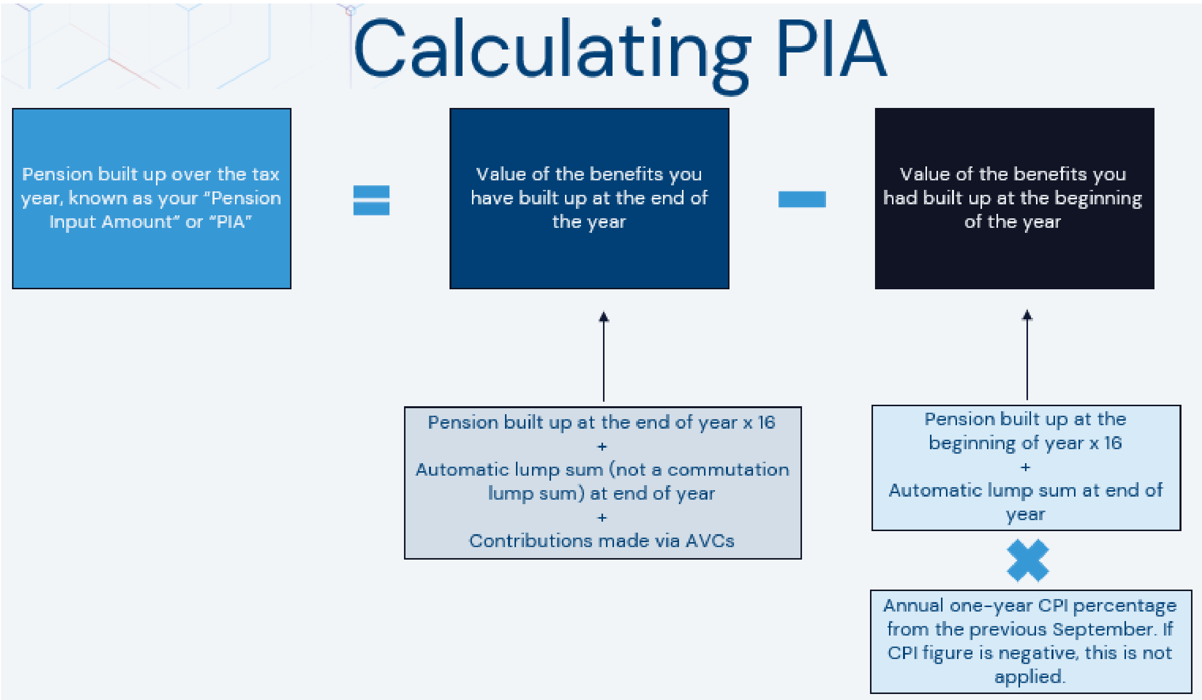


Testing your pensions savings

How are pension savings tested against the annual allowance?

17. To determine the amount of annual allowance used in each tax year, the value of pension built up over that tax year, or the "pension input amount" (PIA), has to be worked out. Exactly how this is done depends on the type of pension scheme.

18. As the police pension scheme is a defined benefit scheme, the PIA is worked out by looking at the value of the benefits which you have built up at the end of the year minus the value of the benefits which you had built up at the start of the year.



Annual allowance example calculation

- Maya has an annual pension at start of 2023/24 of £10,000
- She has an automatic lump sum at start of 2023/24 of £30,000
- Her annual pension at end of 2023/24 is £12,000
- Her automatic lump sum at end of 2023/24 is £36,000
- The annual CPI in September 2022 was 10.1%

19. The value of benefits built up at the start of the year is calculated as:

$$(£10{,}000 \times 16)\ +\ £30{,}000 = £190{,}000$$

$$£190{,}000 \times 10.1\% = £209{,}190$$

20. The value of the benefits built up at the end of year is calculated as:

$$(£12{,}000 \times 16)\ +\ £36{,}000 = £228{,}000$$

21. The total value built up over the year to be tested against the annual allowance i.e. the pension input amount (PIA) is

$$£228{,}000 - £209{,}190 = £18{,}810$$

22. Maya has the standard annual allowance of £60,000 and as the PIA of £18,810 is less than this Maya has not breached the annual allowance, does not need to utilise any carry forward, and has not triggered an annual allowance tax charge.

How does carry forward work?

23. If you do not use all of your annual allowance in a particular tax year, it's not necessarily lost. That unused allowance can be carried forward to a later tax year.

24. You can carry forward any unused annual allowance from the previous three years on a rolling basis. You must use the current year's annual allowance first, and then look back to the earliest of the previous three tax years.

25. To be able to carry forward any unused annual allowance you must:

- Earn at least the amount you wish to contribute in the current tax year (unless the contributions will be employer contributions).
- Have been a member of a UK registered pension scheme in each of the tax years from which you wish to carry forward your unused annual allowance.

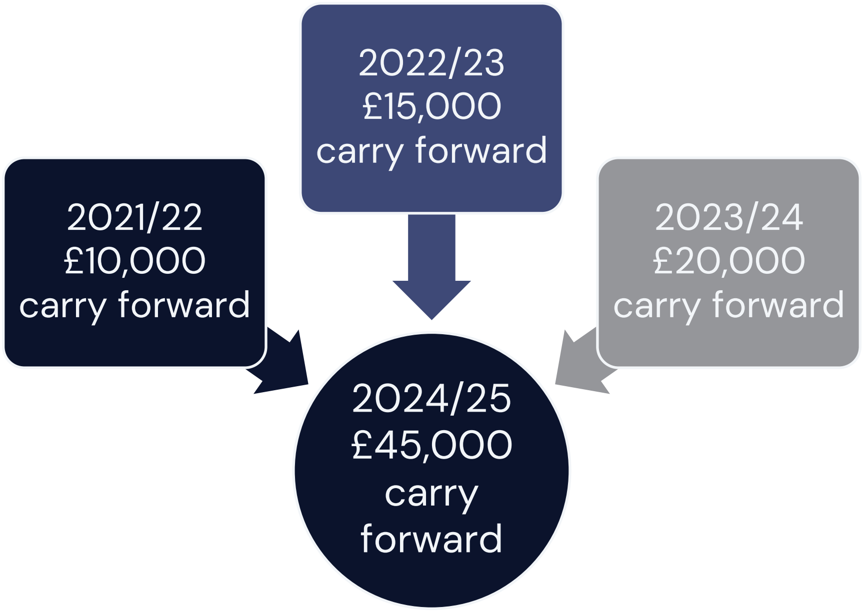
Carry forward example calculation

26. Maya's current and previous three years' pensions savings (Pension Input Amount) looks like this:

Tax year	Standard annual allowance	Pension Input Amount (PIA)	Unused allowance in the tax year
2024/25	£60,000	£80,000	£0
2023/24	£60,000	£40,000	£20,000
2022/23	£40,000	£25,000	£15,000
2021/22	£40,000	£30,000	£10,000

27. This table shows that for 2024/25, Maya has a standard annual allowance of £60,000 and there is available carry forward from the previous three years making her total annual allowance £105,000.

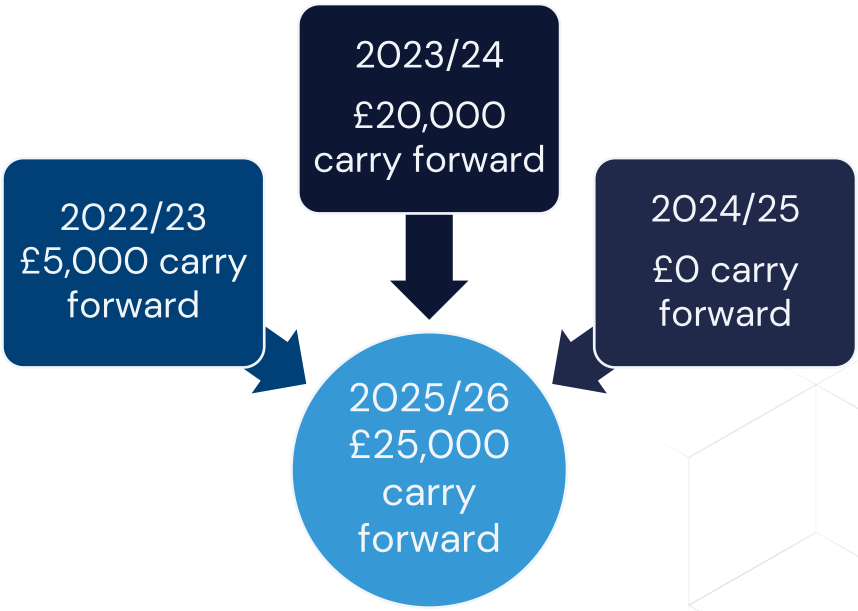
28. The total available annual allowance is calculated as follows: –



$$£60{,}000 + £45{,}000 = £105{,}000\ (\textit{total annual allowance})$$

29. In 2024/25 she builds up £80,000 of pension (i.e. this is her PIA for the year). As this is lower than her annual allowance including carry forward of £105,000 then she is not subject to an annual allowance tax charge.

30. Looking ahead, for the 2025/26 tax year Maya will have her standard annual allowance plus the available carry forward from the previous three years which is:



The Pensions Savings Statement

What is the purpose of a Pensions Savings Statement (PSS)?

31. A PSS provides key details relating to the pension you have built up (the Pension Input Amount (PIA)) over a tax year, which will be helpful in allowing you to calculate any annual allowance tax charge.

32. The Scheme must provide you with a PSS if the amount of pension you have built up is more than the annual allowance by 6 October following the end of a tax year. It must contain: –

The value of the pension you have built up over the last tax year	The value of the pension you have built up for each of the previous three years
Amount of annual allowance in the last tax year	Amount of annual allowance for the previous three tax years

What to do if you have a taxable excess

How do I calculate my annual allowance tax charge?

33. If you have exceeded your annual allowance, then the excess amount above your annual allowance, after taking into account any carry forward, is taxable at your marginal rate of income tax.

34. For example, if you have exceeded your annual allowance by £10,000 and you have a marginal rate of income tax of 20%, then the tax due would be: –

$$£10{,}000 \times 20\% = £2{,}000$$

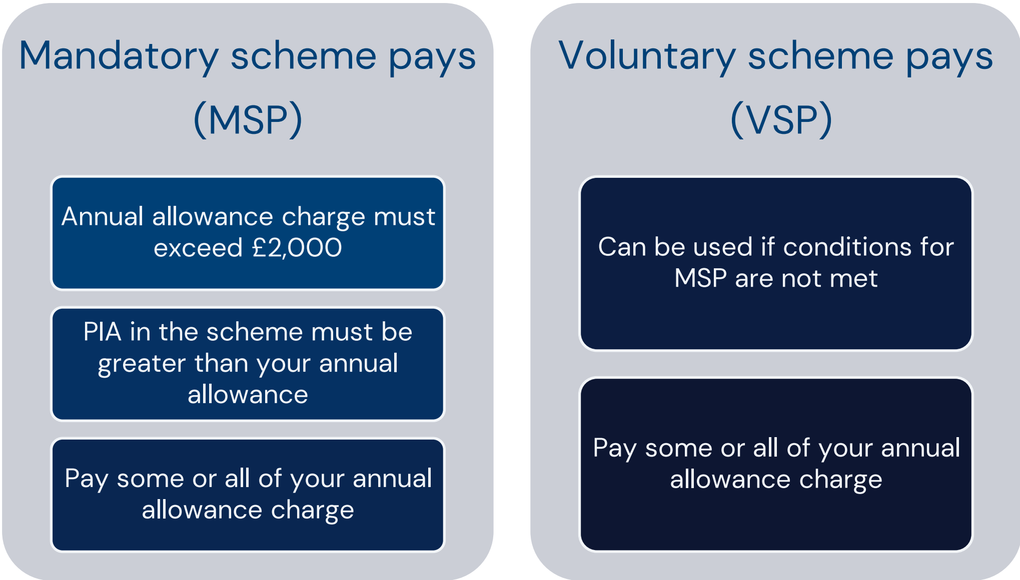
How is the annual allowance tax charge paid?

35. The annual allowance tax charge can be paid through either: –

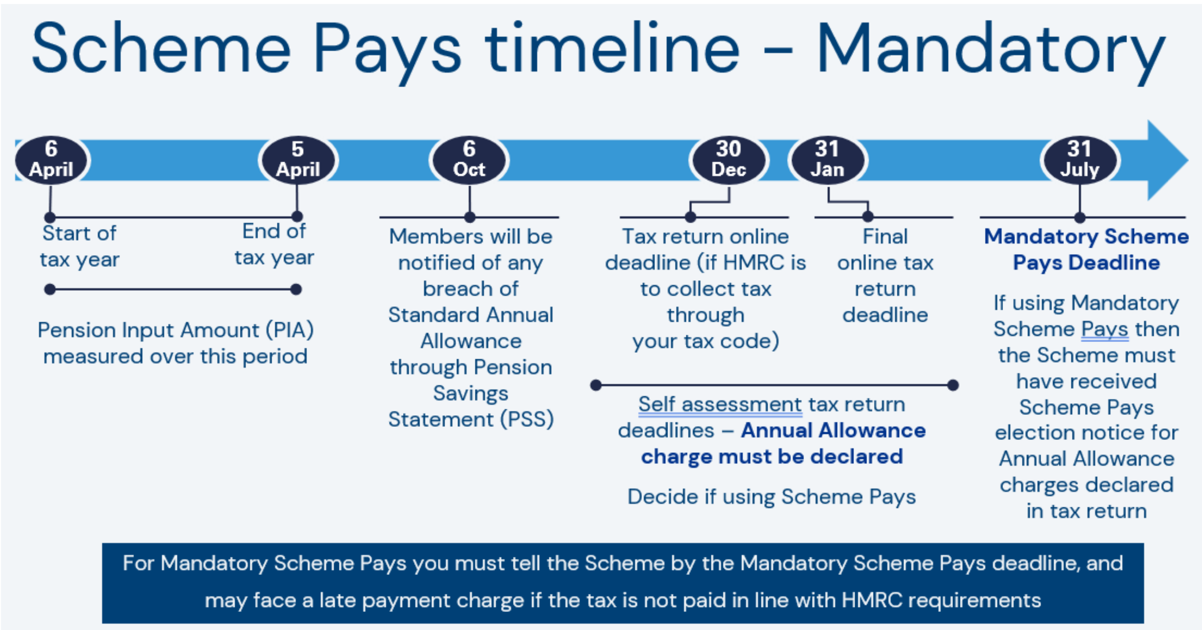
    a. Your self-assessment tax return process, and or

    b. The scheme by using a facility known as “scheme pays”.

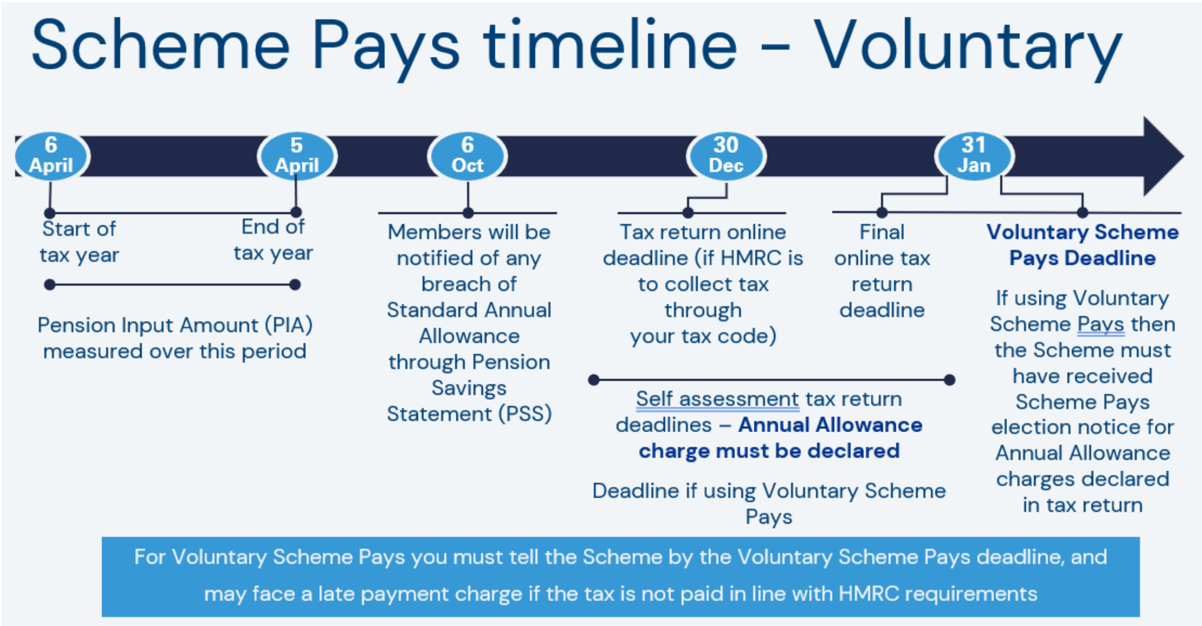
36. There are two types of scheme pays available under the police pension scheme: -



37. The timeline of events from receiving a PSS to electing for mandatory scheme Pays are



38. The timeline of events from receiving a PSS to electing for voluntary scheme Pays are shorter as the final deadline for elections to be received is 31 January.



39. See HMRC tax manual for details about annual allowance tax charge deadlines.

How does Scheme Pays impact pension benefits?

40. If you opt to use the scheme pays facility to pay your annual allowance tax charge, your pension benefits will be permanently reduced. The reduction in pension represents the cost to the scheme for paying your tax charge.

41. The pension reduction is called a scheme pays debit and will be calculated at the point the tax charge is paid specific to your personal circumstances. This reduction will be tracked through to your retirement date, at which point it will be deducted from the benefits you receive.

42. For the police pension scheme, when the scheme pays debit is initially calculated it is based on your normal pension age (age 60). If you retire before this date, the debit will be adjusted and reduced to reflect the fact that the pension will be in payment for a longer period.

43. Depending on when your pension comes into payment, it could mean that you end up paying more in the longer term than the actual tax charge through the scheme pays debit applied to your pension.

How is an annual allowance tax charge reported on a tax return?

44. Reporting an annual allowance tax charge on your self-assessment tax return is your own responsibility, and this needs to be reported even if you elect for scheme pays and the scheme pays the charge on your behalf.

Understanding the lifetime allowance

45. From 6 April 2024, the lifetime allowance (LTA) has been abolished, and replaced by two new allowances: –

    i. The Lump Sum Allowance (LSA) and

    ii. The Lump Sum and Death Benefit Allowance (LSDBA).

46. Lump sum benefits at retirement (for the LSA) or on death (for the LSDBA) that exceed these allowances will be subject to income tax.

47. See GOV.UK for more details about the LSA and the LSDBA.

Lump Sum Allowance (LSA)

48. The LSA restricts the total maximum tax free cash lump sum that you can receive, and in the 2024/25 tax year this is set at £268,275.

49. This is an overall limit and police pension scheme rules may not allow you to take as much lump sum as this. More information about the limits for police pensions can be found on the policepensioninfo website in the member remedy factsheet – unauthorised payments.

50. This applies when you take lump sums under a number of different circumstances which are known as "Relevant Benefit Crystallisation Events" such as taking a cash lump sum at retirement or a stand alone lump sum.

Lump Sum Death Benefit Allowance (LSDBA)

51. The LSDBA limits the total tax free lump sum available to £268,275 and limits tax free lump sum in the case of death under age 75 to £1,073,100 in the 2024/25 tax year.

52. This applies to "relevant lump sums" and "relevant lump sum death benefits" such as taking a cash lump sum at retirement, a serious ill health lump sum, or some other lump sum death benefits.

Appendix

1. A number of example illustrations have been provided in this appendix to show how pensions tax impacts pension benefits.

Case study 1: Impact of promotion on annual allowance calculation

- David is a Chief Inspector with 20 years' pensionable service
- At the beginning of the year, he is promoted to Superintendent with a £4,000 pay rise
- Following promotion, at the end of the year, his pensionable pay will be £72,000
- He is full time and doesn't pay any AVCs
- David has no other income and his income is under the Threshold Income

2. Looking at the pension that David accrues over the 2024/25 year, there are five calculations that are needed to provide the relevant information: –

A: Total value of pension at the start of the year

3. David is in the 2015 police pension scheme (PPS) and as a transitional member, has previous membership of the PPS 1987 scheme, the value of his pension needs to take account of the build up of his whole pension across both schemes.

4. The value calculated as at 6 April 2024 is £21,791.

B: Total value of the pension at the start of the year increased by inflation

5. The amount of pension built up at the beginning of the year, is then increased in line with the annual CPI inflation from the previous September.

6. In this example, CPI as at September 2023 was 6.7%.

$$\pounds 21{,}791 \times 6.7\% = \pounds 23{,}251$$

C: Total value of pension at the end of the year

7. The value of David's pension at the end of the year on 5 April 2025 is £24,302

D: Amount of pension built up over the year allowing for inflation

8. The amount of the pension built up over the year, the Pension Input Amount (PIA), is the difference between C – B.

$$£24{,}302 \; - \; £23{,}251 = £1{,}051$$

E: Capital value of pension build up over the year to test against the annual allowance

9. The amount of pension built up over the year, must then be converted into a capital value. This is done by multiplying the pension built up by 16.

$$£1{,}051 \; \times 16 = £16{,}816$$

10. The calculated amounts are therefore: -

A: £21,791	• Total value of pension at the start of the year
B: £23,251	• Total value of the pension at the start of the year increased by inflation
C: £24,302	• Total value of the pension at the end of the year
D: £1,051	• Amount of pension built up over the year, allowing for inflation
E: £16,816	• Capital value of pension built up over the year to test against the annual allowance

11. The capital value of pension built up is the amount that is used to test against the annual allowance.

12. In this example, the impact of the promotional pay rise does not lead to an Annual Allowance Tax Charge, as there is sufficient headroom versus the £60,000 annual allowance limit.

Case study 2: Impact of weighted accrual on annual allowance calculation

- Sarah is an Assistant Chief Constable with 23 years' pensionable service
- at the beginning of the year, Sarah's salary is £130,000 per year
- during the year she receives a pay rise of 7%, taking her salary to £139,100
- She is full time and doesn't pay any AVCs
- Sarah has no other income and his income is under the Threshold Income

13. Looking at the pension that Sarah accrues over the 2024/25 year, there are five calculations that are needed to provide the relevant information: –

A: Total value of pension at the start of the year

14. Sarah is in the 2015 police pension scheme (PPS) and as a transitional member, has previous membership of the PPS 1987 scheme, the value of her pension needs to take account of the build up of her whole pension across both schemes.

15. The value calculated as at 6 April 2024 is £52,099.

B: Total value of the pension at the start of the year increased by inflation

16. The amount of pension built up at the beginning of the year, is then increased in line with the annual CPI inflation from the previous September.

17. In this example, CPI as at September 2023 was 6.7%.

$$\pounds 52{,}099 \times 6.7\% = \pounds 55{,}590$$

C: Total value of pension at the end of the year

18. The value of Sarah's pension at the end of the year on 5 April 2025 is £59,900

D: Amount of pension built up over the year allowing for inflation

19. The amount of the pension built up over the year, the Pension Input Amount (PIA), is the difference between C – B.

$$\pounds 59{,}900 - \pounds 55{,}590 = \pounds 4{,}310$$

E: Capital value of pension build up over the year to test against the annual allowance

20. The amount of pension built up over the year, must then be converted into a capital value. This is done by multiplying the pension built up by 16.

$$£4{,}310 \times 16 = £68{,}690$$

21. The calculated amounts are therefore: -

- **A: £52,099** – Total value of pension at the start of the year
- **B: £55,590** – Total value of the pension at the start of the year increased by inflation
- **C: £59,900** – Total value of the pension at the end of the year
- **D: £4,310** – Amount of pension built up over the year, allowing for inflation
- **E: £68,960** – Capital value of pension built up over the year to test against the annual allowance

22. The capital value of pension built up is the amount that is used to test against the annual allowance.

23. In this example, the combined impact of the weighted accrual and a significant pay rise leads to pension built up which is greater than the standard annual allowance of £60,000.

24. Sarah has £47,003 available carry forward from the previous three years (2021/22, 2022/23 and 2023/24) which means that there is sufficient carry forward available from previous years leading to no Annual Allowance Tax Charge.

Case study 3: Calculating the maximum tax free cash

- Judy is approaching retirement from the 2015 police pension scheme
- They have 28 years' pensionable service in the PPS 1987 and PPS 2015
- Due to their age, service and rank, their lump sum will be restricted
- Judy does not have any protections
- The Lump Sum Allowance (LSA) for 2024/25 is £268,275

25. Judy will have some retirement options to consider, at their chosen retirement date they will have:

Option one: No commutation	
PPS 1987 annual pension	£66,912
PPS 2015 annual pension	£2,474
Total annual pension	**£69,386**

Or

Option two: Maximum tax free cash		
	Lump sum	**Residual annual pension**
PPS 1987	£150,552	£60,692
PPS 2015	£10,602	£1,590
Total	**£161,155**	**£62,282**

26. In the PPS 1987, as Judy has a restricted commutation, this means that the calculation of the lump sum is:

$$£66{,}912 \times 2.25 = £150{,}552$$

27. In the PPS 2015, the maximum tax free cash available is calculated using a tax free cash formula of: $20fg/(20+3f)$ Where:

- *20 = HMRC revaluation rate*
- *f = commutation factor = 12*
- *g = annual pension = £2,474*

28. So the PPS 2015 lump sum is calculated as:

$$\frac{20 \times 12 \times £2{,}474}{20 + (3 \times 12)} = £10{,}602$$

29. Due to the fact that the lump sum from the PPS 1987 is restricted and the total lump sum is £150,552, as this is less than the LSA, the maximum tax free cash is not restricted further.

Glossary

Term	Description
Adjusted Income	Equal to your net income for the year (known as your Threshold Income) plus the value of any pensions you have built up over the year (known as your Pension Input Amount). Your Adjusted Income is tested against a prescribed limit each tax year to help determine whether you are subject to a Tapered Annual Allowance.
Annual Allowance (AA)	The maximum amount of pension you can build up each year (your Pension Input Amount) which benefits from tax relief.
Annual Allowance Charge	A tax charge on the value of any pension you have built up in excess of the Annual Allowance over the tax year. This is charged at your marginal rate of income tax for the relevant tax year.
Carry Forward	The amount of your unused Annual Allowance remaining from the three previous tax years, which can be used to offset an Annual Allowance Charge in the relevant tax year.
Consumer Prices Index (CPI)	A measure of inflation.
Lifetime Allowance (LTA)	This was the maximum value of total pension savings which you could build up over your lifetime eligible to receive tax relief. The LTA was abolished on 6 April 2024.
Mandatory Scheme Pays (MSP)	A facility by which you may ask the scheme to pay your Annual Allowance Charge. This can only be used if your Annual Allowance Charge exceeds £2,000 and your Pension Input Amount within the scheme is greater than the Standard Annual Allowance. This results in a permanent reduction in benefits.
Money Purchase Annual Allowance (MPAA)	A level of Annual Allowance which is lower than the Standard Annual Allowance, for individuals who have started to take money from a defined contribution pension pot.
Pension Input Amount (PIA)	This is the value of the pension you have built up during the tax year.

Pensions Saving Statement (PSS)	A notification letter provided to you from the scheme because you have built up pension which is greater than the Annual Allowance.
Scheme Pays	Where a member asks the scheme to pay their Annual Allowance charge to HMRC on their behalf by making a deduction from the member's scheme benefits. This will lead to a permanent reduction in benefits from the scheme. There are two types of Scheme Pays, namely Mandatory Scheme Pays and Voluntary Scheme Pays.
Standard Annual Allowance	The term used to describe the normal Annual Allowance available to all individuals.
Tapered Annual Allowance	A level of Annual Allowance which is lower than the Standard Annual Allowance, for individuals where their Threshold Income and the Adjusted Income are higher than the respective prescribed limits.
Threshold Income	Equal to your net income for the tax year, including all taxable income from all sources but deducting the gross amount of any individual pension contributions you have made. Threshold Income is tested against a set limit to help determine whether a member is subject to Tapered Annual Allowance.
Voluntary Scheme Pays (VSP)	A facility by which you may ask the scheme to pay your Annual Allowance Charge if you do not meet the conditions for Mandatory Scheme Pays. This results in a permanent reduction in benefits.