BDA: FAQs on pension tax

July 2019

Despite all of the issues with pensions tax, it is important to remember two fundamental things – that saving into a pension scheme is a positive, and generally tax efficient, way to provide financial security for old age; and that the NHS Pension Schemes remain among the best vehicles around offering guaranteed incomes and generous contributions from Governments.

What is the Lifetime Allowance?

This is a limit on the value of pension savings you are allowed to hold before tax charges apply. Your pension savings are assessed at the point of retirement – if they are valued as being in excess of the Lifetime Allowance, you will be liable for a special tax charge. The higher the level of pension savings you have, the more likely you are to breach this Allowance on retirement.

Further information on this can be seen in BDA's briefing for members on the Lifetime Allowance. [member login required]

For many people, and depending upon the nature of your retirement, the Lifetime Allowance will only apply once.

What about the Annual Allowance?

Unfortunately, the Annual Allowance (AA) is applied each tax year and so must be considered on an ongoing basis. It represents a limit on how much pension growth you are allowed to see each year before you start to lose the tax relief on pension contributions.

Further information about the Annual Allowance can be seen in BDA's briefing for members on Annual Limits. [member login required]

In recent years Government's reduction in the Annual Allowance has been coupled with a "Taper", which means that higher earners can see this Allowance reduced from £40,000 to £10,000.

This means that increases in NHS earnings can serve to both increase the level of NHS pension built up (and therefore result in higher levels of pension growth) and to reduce the Allowance available for tax free growth.

It is also possible that, for a very small minority of members, this "double whammy effect" could see their post-tax pay reduced if they increase their earnings. Higher earning dentists can see five-figure tax charges being levied as a result.

The complexities of this system mean that some professional advisers, such as accountants and IFAs, are not overly familiar with the nuances.

It is important to check with your advisers that they have experience of dealing with the Annual Allowance. BDA members can get preferential rates for financial advice with Lloyd and Whyte, who have experience of dealing with NHS Pension Schemes.

It is also important to ensure you get relevant information about your pension growth. Although NHS Pension Schemes indicate that their intention to write to any members who will affected by Annual Allowance, members are strongly advised to request an "Pensions Savings Statement" each Autumn.

How have dentists responded to these tax charges?

We have spoken to dentists who have elected to opt out of the NHS Pension Schemes so that they don't incur Annual Allowance charges. However, this does mean that they would pay income tax on the earnings that would otherwise have been paid as a pension contribution.

It also means that they lose rights to death in service benefits and potential ill health retirement enhancements.

Some dentists are using the facility that allows AA tax charges to be paid by the NHS Pension Schemes, in exchange for lower pension benefits. This means that an individual does not have to pay the tax charge. However consistent use of this facility could lead to a drastic reduction in NHS Pension.

Some members who are seeing increases in earnings result in high tax charges are taking steps to reduce levels of NHS work, refusing extra work and not seeking higher paid posts.

Dentists approaching retirement who might breach the Lifetime Allowance are realising that early retirement, with a reduced NHS Pension, can mean that they are less exposed to potential charges.

Could the tax system be changed?

Amongst many higher earners, the current system of taxing pension savings is being seen as providing an incentive to do less work, to seek early retirement or to withdraw from saving for retirement.

Whilst there is scope for reform to the tax system there is currently no indication that HM Treasury are minded to improve the position for higher earners or those with high levels of pension savings. Pension tax relief costs tens of billions of pounds each year to the public purse, so any reforms could actually seek to make the position worse in order to save money.

What about changes to the NHS Pension Scheme?

At present the NHS Pension Schemes offer members a range of options to build up more pension than the standard amount, but no facility to build up a lower NHS Pension; other than for people who decide to periodically opt in and out of pension saving.

We have consistently raised the need for the NHS Pension Scheme to offer members a facility to voluntarily build up a lower level of pension in exchange for lower contributions.

We have engaged through the NHS Pension Schemes' Advisory Boards (SAB) which makes recommendations to government on pension changes. Some options being explored include:

- allowing individual members to choose their own level of pensionable pay
- allowing members to pay half of their regular contributions in exchange for half of the regular pension (the 50:50 option)
- allowing members who opt out of pension saving to have access to death and ill health benefits
- allowing members to voluntarily stop accelerated growth in pensions previously built up in the NHS.

In June 2019, the Department of Health and Social Care announced that they intend to consult in bringing in flexibility in the form of the 50:50 option. The announcement indicated that this facility would be available to high earning senior clinicians.

Whilst Government acceptance that flexibility is needed is welcome, we will continue to argue (in both the SAB and in response to the DHSC consultation) that flexibilities should be available to all scheme members.

It is also felt that a more flexible vehicle than 50:50 could be adopted, such as allowing members to voluntarily choose their own level of pensionable pay. Any flexibility will need the agreement of HM Treasury who will be mindful that such a change could result in lower income to Government, through lower member pension contributions and reduced tax charges.

The consultation on introducing these changes are available on the Government's website.

More information

More information is on our website: www.bda.org/pensions-tax

BDA Extra and Expert members can benefit from one-to-one advice with our Pensions Team, please get in touch if you'd like to discuss this issue or any other aspect of pensions and their taxation, email us or telephone 020 7563 4161/6897