# PENSIONS FOR PROFESSIONALS

A submission on behalf of

BALPA

BDA British Dental Association

BMA

CPOSA Ltd

fda

mip managers in partnership

NAHT FOR LEADERS, FOR LEARNERS

HCSA Hospital Consultants and Specialists Association

# Pensions for Professionals

A submission on behalf of the **Association of Principal Fire Officers,** the **Association of Scottish Police Superintendents**, the **British Airline Pilots' Association,** the **British Dental Association**, the **British Medical Association**, the **Chief Police Officers' Staff Associatio**n, the **FDA,** the **Hospital Consultants and Specialists Association**, **Managers in Partnership**, the **National Association of Head Teachers**, the **Police Superintendents' Association of England and Wales**, **and** the **Police Superintendents' Association of Northern Ireland**

# Response to Green Paper

## "Strengthening the incentive to save: a consultation on pensions tax relief"

This response has been prepared jointly by the British Medical Association (BMA), the Hospital Consultants and Specialists Association (HCSA), the British Dental Association (BDA), the FDA (the trade union for senior managers and professionals in public service), the British Airline Pilots' Association (BALPA), the Chief Police Officers' Staff Association (CPOSA), the Police Superintendents' Association of England and Wales (PSAEW), the Association of Scottish Police Superintendents (ASPS), the Police Superintendents' Association of Northern Ireland (SANI), the National Association of Head Teachers (NAHT), Managers in Partnership (MiP) and the Association of Principal Fire Officers (APFO). Between us we represent over 230,000 professional people. Although some of our Associations operate as trade unions, many of our members join together in Associations primarily for professional and personal reasons. Doctors, dentists, healthcare managers, senior civil servants, airline pilots, head teachers and senior police and fire officers would place themselves in the 'moderate middle', quietly improving themselves for the benefit of their families and society. Strengthening the incentive to save in good occupational pension schemes is a very high priority for our members.

## Restoring stability and rebuilding confidence in the existing pensions system

Although our Associations welcome this opportunity to respond to the important issues outlined in the Green Paper, we believe the Treasury and the DWP should undertake a more detailed analysis of the current pensions tax relief system before making any final policy decisions. This analysis should, in our view, focus on restoring stability and rebuilding confidence in the existing pensions system. It should also examine both the economic and behavioural impact of any potential changes. To this end, we would propose the establishment of a retirement savings commission – including representatives from employers, professional associations and trade unions, pension funds, insurers/pension providers and economists – to advise Government on any future changes to pensions tax relief and address the specific issues outlined in the Green Paper.

## Maintain current system of pensions tax relief but improve it

Our Associations believe we should maintain the current system of pensions tax relief as it is, in our view, the most effective method of achieving the legitimate aims of government – to foster a culture of saving and provide all working people with a satisfactory standard of living in retirement.

In contrast to the general findings of the OFT study quoted in the Green Paper, our members are very engaged with their pensions and do understand them. In a recent survey of our members, an overwhelming majority (80%) stated that they are aware of the advantages of the current system of upfront tax relief ("Exempt-Exempt-Taxed", EET) and indicated that this provides them with a strong incentive to save. In contrast, a clear majority (71%) agreed that the removal of upfront tax relief (e.g. move from EET to "Taxed-Exempt-Exempt"(TEE)) would

make them likely to save less. Similarly, 64% of members indicated they would be less likely to save if higher-rate tax relief was reduced to 30%. (The results of our recent membership survey on pensions tax relief is attached as Appendix 1.)

The key problem is therefore not lack of understanding – it is the confusion created by multiple and continuous changes to the current system of tax relief including changes to the Annual Allowance (AA) and Lifetime Allowance (LTA) and the introduction of AA tapering for those with adjusted earnings over £150,000.

Any move from an EET to a TEE system would introduce even more complexity, confusion and uncertainty into an already confusing, complex and uncertain pensions system. It would also disproportionately penalise younger savers – in effect, bringing forward their pensions tax bill by a generation.

However, if changes were made to the existing system of tax relief – e.g. move from EET to TEE – we believe defined benefit (DB) schemes would need to be exempted. Failure to do so would, in our view, sound the death knell for DB pensions as the removal of upfront tax relief would substantially increase the cost and complexity of running final salary and career average schemes. Although it would be complicated to administer, it would also be necessary to fully protect all DB and DC pensions built up under the existing EET system at the point of change. It would also undermine the commitment made by the government when the public sector pension changes agreed in 2011 were described by the Chief Secretary to the Treasury in a statement in November 2011 as “a sustainable deal that will endure for at least 25 years”.

To ensure the current system of pensions tax relief meets government aims, we propose the following changes are introduced:

### Removal of the Annual Allowance for DB pension schemes

The AA was originally intended to be part of “a light touch compliance regime”. It was first set at £200,000 (using a flat factor for DB accrual of 10:1) and was designed “not to constrain most pension savers. Its prime purpose will be to limit the leakage of tax relief which could occur if a determined opportunist tried to wash contributions through a pension fund quickly, planning to extract the proceeds improperly” (House of Commons briefing paper, *Restricting pension tax relief*, 10 July 2015). As such, the AA was expected to “be quite academic for most people”. In fact, the AA is very far from being “academic” and now affects a significant and growing number of our DB members, resulting in disproportionate and, in our view, unfair tax charges (see Appendix 2 for worked examples).

Given the nature of DB schemes, the current AA is also increasingly seen as an artificial and arbitrary method of calculating tax (now using a flat DB accrual factor of 16:1) which does not necessarily reflect the actual contributions being made by employers and employees or the long-term value of DB accrual spread over, say, a 40 year professional career. Moreover, it adds significant cost and complexity to the running of DB schemes.

Subjecting DB pensions to the AA is also potentially unfair in some professions in which individuals are likely to only receive one or two promotions during their careers. For example, the promotion of an airline pilot from First Officer to Captain (the only promotion he/she is every likely to get) often results in an individual exceeding the AA and receiving a substantial tax charge (see Appendix 2 for two worked examples). This is perceived as unfair – a tax on hard earned professional career progression. In the case of Assistant Chief Constables, simply progressing through the regulated three pay band structure results in disproportionate AA tax charges (see Appendix 2). The AA in DB schemes can also disadvantage some individuals who qualify for enhanced early retirement – for example, those who are unable to follow their own profession due to illness or injury but are potentially capable of undertaking alternative but typically lower-paid employment.

The current operation of the annual allowance also disadvantages career average schemes, like those in the public sector, where the accrual rate, designed to provide a reasonable pension for the whole workforce, means that some individuals will breach the AA every year, even without a promotion.

### "Negative" Annual Allowance for DB members affected by PPF compensation cap

We believe a mechanism should be introduced whereby any reduction in DB benefits resulting from PPF entry is properly reflected as a negative figure when applying the AA. Under current arrangements any loss of pension due to PPF entry (which in some cases can be more than 50% of the member's anticipated pension) is classified as "zero" in relation to the AA rather than a negative figure. A member who has lost significant accrued benefits and is seeking to rebuild his/her pension is therefore unfairly restricted by the current AA.

### Remove or increase LTA for DC pension schemes

Subjecting DC pensions to the LTA is confusing and unfair. In a DB scheme it is relatively easy to determine whether you are likely to exceed the LTA. However, in the DC world it is much more difficult due to uncertain investment returns. This causes confusion, makes financial planning difficult and sometimes leads to irrational behaviour, with individuals reluctant to save in DC schemes in the often misguided belief that they will be worse off due to the LTA. The LTA is also seen as unfair because DC savers are, in effect, being penalised for good investment returns which are essential in order to build up a decent sized pension pot. The introduction of 'Freedom and Choice' changes has also confused the landscape around the taxation of DC pensions which now seems to make the LTA look out of sync with HM Treasury's pension policy intentions.

### Provide a more stable framework for future pension savings

We believe that the values of the AA and LTA need to be reset at a level that makes pension saving viable and attractive. The current rates are too low and are increasing the number of professionals looking to move out of pension saving. If the allowances are to be retained, once reset we would urge government to apply a "triple lock" indexation formula (as used in relation to the state pension) to the AA, the LTA and the adjusted earnings threshold for tapered reduction in tax relief – that is, the greater of CPI, average earnings or 2.5%. The decision to apply a CPI link to the LTA from April 2018 is a useful signal that government recognises some indexation is appropriate.

In a survey, 51% of members indicated that they would be more likely to save if the AA and LTA were stabilised and subject to the "triple lock" indexation formula. At the same time, a strong majority (78%) said they would be deterred from future pension saving if stability is not restored to the existing system of pensions tax relief.

### Protect the ability to take 25% tax free cash

Any change to this facility would, in our view, have damaging consequences – especially for the substantial number of savers who are relying on their tax free lump sum to pay off mortgages and other debts in the run up to retirement.

### Salary sacrifice

If the existing salary sacrifice arrangements for DB and DC schemes are retained, employers should be required to use their NICs savings to improve pensions rather than "pocket" the savings. We believe the current treatment of employer National Insurance contributions should be maintained.

### Continue to address the issue of unreasonable management charges in DC schemes

We welcome the introduction of 0.75% charge cap for DC default funds from April 2015 as a good first step but much tighter regulation is required to make this cap a genuine route to lower cost pension saving.

### Better promotion in the workplace of benefits of existing EET tax relief system

Our Associations believe the incentive to save could be strengthened through better workplace promotion of the benefits of the existing EET tax relief system. For example, BALPA has launched an initiative showing DC pension scheme members their projected pension income under current contribution rates and their projected pension income from increasing contributions. This was then followed up by individual advice from our IFA firm, BALPA Financial Solutions. Simple initiatives like this highlight the benefit of pensions saving and encourage employees to save more. Feedback from our DC members indicates that one of the strongest incentives to save is to be presented with regular information showing the potential value of their pension as a percentage of their projected final salary.

### Members in the private sector committed to improving DC pension provision

Pension provision in many of the sectors represented by our Associations is above average. This is due to the high profile of pensions amongst members and a strong, co-operative tradition of collective bargaining and consultation over pensions.

However, in the private sector DC pension schemes are still not likely to deliver satisfactory retirement incomes. For example, in commercial aviation pilots could, at best, expect to retire at age 65 on c25% of final salary after a typical 30 flying career (not including state pension) - see Appendix 3. We believe we need to maintain and improve current DC pension provision. The widespread view amongst our members is that to maintain their standard of living during retirement they will need to make significant contributions during their careers – significantly higher than the 14% "high earner" contribution rate quoted in the Green Paper. Based on BALPA's own analysis of aviation DC schemes, we believe the target contribution rate should be closer to 25% (10% employee, 15% employer). Any detrimental changes to pension tax relief would make this more difficult and could even result in inferior pension provision.

## Questioning the justification for change

One of the key arguments being used by Government to justify changes to pensions tax relief is that higher rate tax payers get an unfair advantage – with this group getting over 2/3rd of all tax relief but only contributing c50% of all pension savings.

We question this justification on the following grounds:

- HMRC estimates of the annual cost of tax relief have been shown by the Institute of Fiscal Studies (IFS) to overstate the cost of this relief because they compare (i) the cost of giving tax relief to today's working population *in a particular year* and (ii) the revenue raised from taxing the pensions of today's retirees *in the same year,* rather

than using the more accurate method of looking at pension savings over individuals' lifetimes (see IFS, Carl Emmerson, 2014, *Taxation of private pensions*, for a detailed explanation). We are therefore concerned that important decisions about higher-rate tax relief could be based on inflated and therefore misleading data. Notwithstanding this, it is not surprising that HMRC estimates suggest higher rate taxpayers receive over 2/3rds of all tax relief: "*the fact that a large slice of up-front relief goes to high-income individuals purely reflects the fact that they make a large proportion of pension contributions and pay a large share of income tax revenues*" (IFS, 2014);

- As indicated above, the current method of estimating the value of tax relief "makes no allowance for the amount of tax that will eventually be paid on the pension income" (IFS, 2014) and does not therefore properly reflect the situation whereby higher rate tax payers in employment will almost certainly end up paying the largest slice of income tax on pensions in payment. In other words, we believe higher rate tax payers are already more than "paying their way";

- A lot has already been done to change the tax relief system - including the introduction and gradual reduction of the AA and the LTA, and the forthcoming introduction of AA tapering for people with adjusted earnings over £150k. This has already raised an additional £6 billion per year largely from higher earning professional individuals. The introduction of AA tapering will raise even more revenue by introducing onerous effective tax rates of 67.5% (for members who are additional rate taxpayers) and 60% (for those who pay tax at the higher rate). For additional rate taxpayers, this equates to an additional annual tax bill of £13,500 for many (see Appendix 4 for some worked examples). We are concerned that any further changes would be expensive to administer and are likely to have unintended, detrimental consequences, deterring high rate tax payers from saving in pension schemes and encouraging this group to invest in riskier savings vehicles such as buy-to-let property (which has further consequences for the housing market and creates other negative effects). If tax relief for higher-rate taxpayers were to be reduced to, say, 30%, 64% of our members say they would start pulling out of pensions and look at other investment vehicles such as buy-to-let properties, whilst 43% would start switching to regular ISAs;

- The reduction or abolition of higher rate tax relief would, in our view, start to create a polarised and socially divisive system which is "tax advantageous" for most basic rate taxpayers but "tax dis-advantageous" for most higher rate tax payers. This in turn is likely to signal the end of the road for both DB and DC professional and executive pensions. This would potentially turn the remaining pension schemes into inferior savings vehicles for basic rate taxpayers and, in relation to DC pensions, lead to significantly higher management charges.

- We subscribe to the received wisdom that the best way to maintain and improve a good pension scheme is to ensure that it covers all categories of staff from trainees through to professional employees and senior executives.

- As indicated above, pension provision in the sectors covered by our Associations is generally above average. This is due, at least in part, to the historic efforts of well organised professional staff - doctors, dentists, healthcare managers, senior civil servants, head teachers, airline pilots and senior police and fire officers - to improve pensions through collective bargaining and consultation. This, in turn, has tended to lift pension provision for all staff groups. The removal of this positive effect would be detrimental for junior / non-professional staff groups.

- In some areas, particularly in the public sector, the pension provision has been perceived as a compensation for lower basic salary. The impact of changes to tax relief

remove this perception as increasing numbers of public sector professionals cannot get the same value from their pension saving as was originally the case.

Our Associations would welcome the opportunity to meet with Treasury and DWP officials to discuss these matters further.

# Answers to questions in Green Paper

1. *To what extent does the complexity of the current system undermine the incentive for individuals to save into a pension?*

The basic structure of the current EET system is not seen as complex. Our members see it as a fair, effective and well-established bargain: in return for saving hard for your retirement (often with significant personal contributions) it is reasonable for government to provide full and proper tax relief on the basis that pensions in payment are taxed as normal income. Members clearly understand the need to save for their retirement and attach huge value to having a good occupational pension. It is particularly important that some professionals build up a good occupational pension because they are prevented by licensing or occupational rules from working beyond a certain age (for example, 65 in the case of airline pilots; 60 in the case of senior police officers).

The incentive to save is however being undermined by constant changes to the current system of tax relief – changes to the AA and the LTA, a substantial reduction in tax relief for those with "adjusted" earnings over £150,000 and a general perception that pensions are a honeypot which can be dipped into by government in times of need to raise tax revenues. This is the major deterrent to making investment decisions into pensions.

2. *Do respondents believe that a simpler system is likely to result in greater engagement with pension saving? If so, how could the system be simplified to strengthen the incentive for individuals to save into a pension?*

As indicated above, our Associations believe the basic structure of the existing system is already relatively simple and easy to understand. Rather than radically changing the system – e.g. a moving from EET to a TEE system – we believe the benefits of the existing system should be more widely promoted in the workplace.

We believe that any move from EET to TEE system is likely act as a disincentive to save, certainly for the professional people we represent. There is a danger that it would simply be seen as a removal of upfront tax relief today based on the hope that this will be offset by tax benefits tomorrow / during retirement. Our members struggle to trust that such future promises would be upheld, and the fact that this consultation is being considered four years after public sector schemes were reformed, allegedly for twenty five years demonstrates this point.

As outlined above, we believe the system of tax relief could be simplified, by:

- Removing the LTA for DC pensions but keeping the AA;
- Removing the AA for DB pensions but keeping the LTA;

3. *Would an alternative system allow individuals to take greater personal responsibility for saving an adequate amount for retirement, particularly in the context of the shift to defined contribution pensions?*

No, we do not believe so. We believe the focus should be on (i) maintaining and improving existing DC pension provision under the current system of tax relief and (ii) working towards significantly higher contribution rates than the 14% "high earner" rate quoted in the Green Paper. Any detrimental changes to pension tax relief would, in our view, undermine rather than strengthen professional DC pension provision.

4. *Would an alternative system allow individuals to plan better for how they use their savings in retirement?*

No, for the reasons set out above. In order to plan, individuals need certainty about the system. That is in short supply given the regularity of changes in recent years, this is one of the reasons we believe an Independent Commission should be tasked with considering changes to pension policy.

5. *Should the government consider differential treatment for defined benefit and defined contribution pensions? If so, how should each be treated?*

As indicated above, DC pension provision is inadequate and needs to be improved. Subjecting DC pensions to the LTA is confusing and potentially unfair as it more difficult to assess projected DC pots against the LTA. The LTA is also unfair as DC savers are, in effect, being penalised for good investment returns which are essential in order to build up a decent sized pension pot. We therefore advocate removing the LTA for DC schemes.

For the reasons outlined above, we believe the application of the AA to DB schemes is inappropriate and unfair. We therefore advocate removing the AA for DB.

6. *What administrative barriers exist to reforming the system of pensions tax, particularly in the context of automatic enrolment? How could these best be overcome?*

We have not identified any significant administrative barriers to the reforms of the current system of tax relief we have proposed above. We strongly support the ongoing auto-enrolment programme.

However, we believe any radical changes to the system of tax relief – for example, move from EET to TEE – would lead to huge administrative problems such as (i) potentially protecting / "red-circling" DB schemes (which in our view can only operate effectively under the existing EET system) and (ii) differentiating between "old" DB and DC pensions built up under the existing EET system and new savings built up under a TEE system.

7. *How should employer pension contributions be treated under any reform of pensions tax relief?*

Strong employer support is essential for good occupational pension provision. Given the increased cost of supporting DB schemes (for example, as result of low gilt yields caused in part by the necessary Government response to the post-2008 financial crisis), we believe the existing treatment of employer pension contributions should be maintained.

8. *How can the government make sure that any reform of pensions tax relief is sustainable for the future?*

As outlined above, our Associations support the establishment of an independent commission to conduct a careful and considered review of retirement savings and encourage pension policy designed for the long-term.

We also believe the existing system of tax relief could be made more stable and sustainable by restoring the AA and LTA to a viable level and applying the "triple lock" indexation formula to the AA, the LTA and the £150k adjusted earnings threshold for tapered reduction in tax relief – that is, the greater of CPI, average earnings or 2.5%.

# Appendix 1

## Pensions for professionals - Survey results

| What kind of pension scheme are you currently enrolled in? | | |
|---|---|---|
| **Answer Options** | **Response Percent** | **Response Count** |
| Defined Benefit/DB (eg final salary or career average salary) | 53.5% | 1742 |
| Defined Contribution (DC) | 32.1% | 1046 |
| Don't know | 14.5% | 471 |
| | *answered question* | 3259 |
| | *skipped question* | 20 |

| Age | | |
|---|---|---|
| **Answer Options** | **Response Percent** | **Response Count** |
| 18 - 29 | 5.0% | 163 |
| 30 - 44 | 32.8% | 1074 |
| 45 - 59 | 55.3% | 1809 |
| 60+ | 7.0% | 228 |
| | *answered question* | 3274 |
| | *skipped question* | 5 |

| How aware are you about the advantages of the current system of tax relief on your pension? | | | | | | | |
|---|---|---|---|---|---|---|---|
| Answer Options | Very aware | Somewhat aware | Neither aware or unaware | Somewhat unaware | Very unaware | Rating Average | Response Count |
| | 1218 | 970 | 150 | 238 | 151 | 4.05 | 2727 |
| | | | | | | *answered question* | 2727 |
| | | | | | | *skipped question* | 552 |

| For each of the following scenarios say how it would affect your likelihood to save for your retirement | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Answer Options | Would be very likely to save more | Would be somewhat likely to save more | Would have no effect | Would be somewhat likely to save less | Would be very likely to save less | Don't know | Rating Average | Response Count |
| Replacement of the current system with "workplace ISAs" (i.e. no upfront tax relief, but tax free when you retire) | 95 | 210 | 390 | 599 | 1080 | 361 | 3.47 | 2735 |
| Retention of the current pensions system but tax relief at 30% | 82 | 224 | 543 | 940 | 597 | 360 | 3.24 | 2746 |
| Retention of the current pensions but with indexed linked Annual Allowance and Lifetime Allowance using the "triple lock" (CPI, average earnings or 2.5%, whichever is higher) | 372 | 657 | 603 | 221 | 170 | 708 | 1.91 | 2731 |
| Continued uncertainty about the future of tax relief with possible future changes to the Annual Allowance and Lifetime Allowance likely | 49 | 84 | 362 | 586 | 1187 | 457 | 3.52 | 2725 |
| | | | | | | | *answered question* | 2753 |
| | | | | | | | *skipped question* | 526 |

| If there were a significant reduction in tax relief (to, say, 30%) how likely is it you would take any of the following actions | | | | | | | |
|---|---|---|---|---|---|---|---|
| Answer Options | Very likely | Somewhat likely | Somewhat unlikely | Very unlikely | Don't know | Rating Average | Response Count |
| Stop saving for retirement completely | 246 | 513 | 814 | 992 | 148 | 3.50 | 2713 |
| Pull out of your pensions scheme and save using regular ISAs instead | 269 | 784 | 797 | 608 | 260 | 2.97 | 2718 |
| Pull out of your pensions and look at other investment vehicles such as buy-to-let properties | 619 | 1011 | 483 | 431 | 200 | 2.45 | 2744 |
| | | | | | | *answered question* | 2754 |
| | | | | | | *skipped question* | 525 |

# Appendix 2

## Impact of Annual Allowance on DB scheme members (pre-April 2016)

### 2.1 Airline pilots

Given the complexity of Annual Allowance calculations, the following two examples are illustrative but based on actual information provided by two BALPA members employed by British Airways who were recently promoted. *All tax charge figures will obviously increase significantly as a result of the introduction of AA tapering for those with adjusted incomes of over £150,000 from April 2016.*

**Example 1 - Promotion from Senior First Officer to Captain after 22 years' service**
Before promotion: Pilot accrues 1/75$^{th}$ of pensionable salary each year – nominal pensionable salary is £111,601;
After promotion: Pilots accrues 1/75$^{th}$ of pensionable salary each year – nominal pensionable salary is £148,784

**First year of impact**

| | Start of PIP | End of PIP |
|---|---|---|
| Effective pensionable salary* | £101,457 | £121,457 |
| Length of service | 22 | 23 |
| Years' service/75 x effective pensionable salary | £29,761 | £37,247 |
| Multiplier | 16 | 16 |
| | £476,169 | £595,947 |
| **Value of increase in pension fund during PIP** | | **£119,777** |

Assuming the pilot made no Additional Voluntary Contributions during the previous three years, we calculate that he/she would carry forward an AA credit of approximately £15,000. The tax charge due to the AA would therefore be (£119,777 - £40,000 - £15,000) * 45% = **£29,150**

### Second year of impact

| | Start of PIP | End of PIP |
|---|---|---|
| Effective pensionable salary* | £121,457 | £141,927 |
| Length of service | 23 | 24 |
| Years' service/75 x effective pensionable salary | £37,247 | £45,416 |
| Multiplier | 16 | 16 |
| | £595,947 | £726,664 |
| **Value of increase in pension fund during PIP** | | **£130,717** |

The tax charge due to the AA would therefore be (£130,717 - £40,000) * 45% = **£40,823**

*Best two years in the last five – minus 1.5 x Lower Earnings Limit

**Example 2 - Promotion from Captain to Training Captain after 24 years' service**
Before promotion: Pilot accrues 1/60$^{th}$ of pensionable salary each year – nominal pensionable salary is £156,297;
After promotion: Pilots accrues 1/60$^{th}$ of pensionable salary each year – nominal pensionable salary is £185,212

### First year of impact

| | Start of PIP | End of PIP |
|---|---|---|
| Effective pensionable salary* | £145,683 | £162,019 |
| Length of service | 24 | 25 |
| Years' service/60 x pensionable salary | £58,273 | £67,508 |
| Multiplier | 16 | 16 |
| | £932,371 | £1,080,123 |
| **Value of increase in pension fund during PIP** | | **£147,752** |

We calculate that the pilot is not likely to carry forward any AA credit from previous years. The tax charge due to the AA would therefore be (£147,752 - £40,000) * 45% = **£48,488**

### Second year of impact

| | Start of PIP | End of PIP |
|---|---|---|
| Effective pensionable salary* | £162,019 | £176,476 |
| Length of service | 25 | 26 |
| Years' service/60 x pensionable salary | £67,508 | £76,473 |
| Multiplier | 16 | 16 |
| | £1,080,123 | £1,223,567 |
| **Value of increase in pension fund during PIP** | | **£143,444** |

The tax charge due to the AA would therefore be (£143,444 - £40,000) * 45% = **£46,549**

*Best two years in the last five – minus 1.5 x Lower Earnings Limit

## 2.2 Chief Police Officers

| | | Service | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | **20** | **21** | **22** | **23** | **24** | **25** | **26** | **27** | **28** | **29** |
| **pay bands** | | | | | | | | | | | |
| 1 | £95,640 | *£73,531* | *£79,783* | *£86,035* | *£92,287* | *£98,540* | *£104,792* | *£111,044* | *£117,297* | *£123,549* | *£129,801* |
| 2 | £101,805 | *£36,974* | *£39,242* | *£41,510* | *£43,778* | *£46,046* | *£48,314* | *£50,581* | *£52,849* | *£55,117* | *£57,385* |
| 3 | £107,976 | *£39,640* | *£41,845* | *£44,051* | *£46,256* | *£48,461* | *£50,666* | *£52,872* | *£55,077* | *£57,282* | *£59,488* |
| | **Total AA Excess** | ***£156,823*** | ***£167,549*** | ***£178,274*** | ***£189,000*** | ***£199,725*** | ***£210,450*** | ***£221,176*** | ***£231,901*** | ***£240,421*** | ***£246,674*** |

The tables calculate the AA excess (in italics) assuming there is no unused allowance to carry forward. In practice there will be very little or no unused allowances to carry forward into the future.

(CPI =2%)

# Appendix 3

## DC pension schemes – Airline pilots

| 30 year career | % final salary |
|---|---|
| **DHL** | 15% |
| **easyJet** | 16% |
| **Jet2** | 15% |
| **Flybe** | 17% |
| **bmi Regional** | 15% |
| **Bristow Helicopters** | 16% |
| **CHC Helicopters** | 20% |
| **Thomas Cook** | 22% |
| **British Airways** | 17% |
| **Thomson Airways** | 20% |
| **Loganair** | 23% |
| **Virgin** | 21% |
| **BA CityFlyer** | 20% |
| **KLC** | 21% |
| **Cobham Helicopter Services** | 11% |

**Assumptions**

- Minimum or typical employer / employee contribution rates;
- No salary sacrifice arrangements;
- Annual investment return of 5% over 30 years (with an annual management charge of 0.5%);
- Pilot retires at age 65;
- Annual pension includes (i) 5 year guarantee, (ii) 2/3rds dependant's pensions and (iii) RPI indexation;
- In addition to promotion to Captain, salary increases each year include incremental progression and RPI increase.

# Appendix 4

## Impact of tapered reduction of AA from April 2016 – introduction of effective 67.5% and 60% tax rates

For employees who are **additional** rate taxpayers before the tapering of the annual allowance the effective tax rate is 67.5%:

- For every £1,000 of adjusted income an additional rate taxpayer earns in excess of £150,000, they will pay tax at 45% on that income (£450).
- For every £1,000 of adjusted income an additional rate taxpayer earns in excess of £150,000, they will also lose £500 of their Annual Allowance (subject to a restriction of £30,000). An additional rate taxpayer will suffer a 45% tax charge on the lost Annual Allowance (£225).
- The total tax charge on every additional £1,000 of adjusted income an additional rate taxpayer earns in excess of £150,000 is therefore £675 – 67.5% of £1,000.

For employees who are **higher** rate taxpayers before the tapering of the annual allowance the effective tax rate is 60%:

- For every £1,000 of adjusted income a higher rate taxpayer earns in excess of £150,000, they will pay tax at 40% on that income (£400).
- For every £1,000 of adjusted income a higher rate taxpayer earns in excess of £150,000, they will also lose £500 of their Annual Allowance (subject to a restriction of £30,000). An additional rate taxpayer will suffer a 40% tax charge on the lost Annual Allowance (£200).
- The total tax charge on every additional £1,000 of adjusted income a higher rate taxpayer earns in excess of £150,000 is therefore £600 – 60% of £1,000.

## 4.1 Airline Pilots

British Airways DB Scheme - Example 1 - Pilot - Longhaul pay point 24 - Captain - 24 years' service

| 1. Adjusted Income Calculation for annual allowance taper | |
|---|---|
| | £ |
| Basic salary | £161,151 |
| Flying pay | £7,722 |
| Time away from base allowance | £1,800 |
| **Total Taxable Income** | **£170,673** |
| Add back value of increase in pension | £71,042 |
| **Total Adjusted Income** | **£241,715** |
| **Marginal tax rate** | **45%** |

| 2. Impact of pension tax relief restriction on the annual allowance (AA) | |
|---|---|
| | £ |
| Unrestricted AA | £40,000 |
| Adjusted Income | £241,715 |
| Excess over £150,000 | £91,715 |
| Lost AA (lost AA restricted to max £30,000) | £30,000 |
| Balance of AA remaining | £10,000 |
| **Tax cost of lost AA at marginal rate** | **£13,500** |

| 3. Value of increase in pension DB 60ths Scheme | Start of PIP | End of PIP |
|---|---|---|
| | £ | £ |
| Pensionable salary (assumed 2% annual increase) | £145,683 | £150,512 |
| Length of service | 24 | 25 |
| yrs service/60 x pensionable salary | £58,273 | £62,713 |
| multiplier | 16 | 16 |
| Deemed fund value | £932,371 | £1,003,413 |
| Less CPI uplift estimated at 0% in 2015 | £0 | £0 |
| **Value of increase in pension fund during PIP** | | **£71,042** |

| 4. Impact of lost personal allowance (PA) for incomes in excess of £100,000 | |
|---|---|
| **Calculation of Adjusted Net Income (ANI)** | |
| | £ |
| Total taxable income | £170,673 |
| less employee gross pension contribution at 8.5% of pensionable salary at end of PIP | -£12,794 |
| Total ANI | £157,879 |
| Excess over £100,000 PA | £57,879 |
| Lost PA | £10,600 |
| **Tax cost of lost PA at marginal rate** | **£4,770** |

| Tax Rate Bands | | |
|---|---|---|
| Basic Rate Tax | £0 | £31,785 |
| Higher Rate Tax | £31,786 | £150,000 |
| Additional Rate Tax | £150,001 | plus |

| 5. Marginal tax rate calculation | |
|---|---|
| | £ |
| Total taxable income | £170,673 |
| Add value of increase in pension | £71,042 |
| Less AA remaining | -£10,000 |
| **Grand total** | **£231,715** |
| **Marginal tax rate** | **45%** |

| 6. Effective tax rate calculation | |
|---|---|
| | £ |
| Tax due on every £1,000 earned on adjusted income in excess of £150,000 at marginal rate | £450 |
| Tax on Lost AA of £500 at marginal rate | £225 |
| Total Tax Charge | £675 |
| **Effective tax rate on every additional £1,000** | **67.5%** |

## Example 2 - Pilot - Longhaul pay point 16 - Captain - 16 years' service

### 1. Adjusted Income Calculation for annual allowance taper

| | £ |
|---|---|
| Basic salary | £130,174 |
| Flying pay | £7,722 |
| Time away from base allowance | £1,800 |
| **Total Taxable Income** | **£139,696** |
| Add back value of increase in pension | £58,685 |
| **Total Adjusted Income** | **£198,381** |
| **Marginal tax rate** | **45%** |

### 2. Impact of pension tax relief restriction on the annual allowance (AA)

| | £ |
|---|---|
| Unrestricted AA | £40,000 |
| Adjusted Income | £198,381 |
| Excess over £150,000 | £48,381 |
| Lost AA (lost AA restricted to max £30,000) | £24,191 |
| Balance of AA remaining | £15,809 |
| **Tax cost of lost AA at marginal rate** | **£10,886** |

### 3. Value of increase in pension DB 60ths Scheme

| | Start of PIP £ | End of PIP £ |
|---|---|---|
| Pensionable salary (assumed 2% annual increase) | £115,638 | £121,781 |
| Length of service | 16 | 17 |
| yrs service/60 x pensionable salary | £30,837 | £34,505 |
| multiplier | 16 | 16 |
| Deemed fund value | £493,389 | £552,074 |
| Less CPI uplift estimated at 0% in 2015 | £0 | £0 |
| **Value of increase in pension fund during PIP** | | **£58,685** |

### 4. Impact of lost personal allowance (PA) for incomes in excess of £100,000

**Calculation of Adjusted Net Income (ANI)**

| | £ |
|---|---|
| Total taxable income | £139,696 |
| less employee gross pension contribution at 8.5% of pensionable salary at end of PIP | -£10,351 |
| Total ANI | £129,345 |
| Excess over £100,000 PA | £29,345 |
| Lost PA | £10,600 |
| **Tax cost of lost PA at marginal rate** | **£4,770** |

### Tax Rate Bands

| | | |
|---|---|---|
| Basic Rate Tax | £0 | £31,785 |
| Higher Rate Tax | £31,786 | £150,000 |
| Additional Rate Tax | £150,001 | plus |

### 5. Marginal tax rate calculation

| | £ |
|---|---|
| Total taxable income | £139,696 |
| Add value of increase in pension | £58,685 |
| Less AA remaining | -£15,809 |
| **Grand total** | **£182,572** |
| **Marginal tax rate** | **45%** |

### 6. Effective tax rate calculation

| | £ |
|---|---|
| Tax due on every £1,000 earned on adjusted income in excess of £150,000 at marginal rate | £450 |
| Tax on Lost AA of £500 at marginal rate | £225 |
| **Total Tax Charge** | **£675** |
| **Effective tax rate on every additional £1,000** | **67.5%** |

£

Virgin Atlantic DC Scheme

Example - Pilot – Pay point 14 - Captain

| 1. Adjusted Income Calculation for annual allowance taper | |
|---|---|
| | £ |
| Basic salary (Pensionable) | £120,058 |
| Flying pay | £23,882 |
| **Total Taxable Income** | **£143,940** |
| Add back value of increase in pension | £27,013 |
| **Total Adjusted Income** | **£170,953** |
| **Marginal tax rate** | **40%** |

| 2. Impact of pension tax relief restriction on the annual allowance (AA) | |
|---|---|
| | £ |
| Unrestricted AA | £40,000 |
| Adjusted Income | £170,953 |
| Excess over £150,000 | £20,953 |
| Lost AA (lost AA restricted to max £30,000) | £10,477 |
| Balance of AA remaining | £29,523 |
| **Tax cost of lost AA at marginal rate** | **£4,191** |

| 3. Value of increase in pension DC Scheme | | |
|---|---|---|
| | £ | |
| Employer Pension Contribution | £18,009 | 15% |
| Employee Pension Contribution | £7,203 | 6% |
| Relief given under net pay at BR | £1,801 | |
| **Value of increase in pension fund** | **£27,013** | |

| 4. Impact of lost personal allowance (PA) for incomes in excess of £100,000 | |
|---|---|
| **Calculation of Adjusted Net Income (ANI)** | |
| | £ |
| Total taxable income | £143,940 |
| less gross employee pension contribution | -£9,004 |
| Total ANI | £134,936 |
| Excess over £100,000 PA | £34,936 |
| Lost PA | £10,600 |
| **Tax cost of lost PA at marginal rate** | **£4,240** |

| Tax Rate Bands | | |
|---|---|---|
| Basic Rate Tax | £0 | £31,785 |
| Higher Rate Tax | £31,786 | £150,000 |
| Additional Rate Tax | £150,001 | plus |

| 5. Marginal tax rate calculation | |
|---|---|
| | £ |
| Total taxable income | £143,940 |
| Add value of increase in pension | £27,013 |
| Less AA remaining | -£29,523 |
| **Grand total** | **£141,430** |
| **Marginal tax rate** | **40%** |

| 6. Effective tax rate calculation | |
|---|---|
| | £ |
| Tax due on every £1,000 earned on adjusted income in excess of £150,000 at marginal rate | £400 |
| Tax on Lost AA of £500 at marginal rate | £200 |
| **Total Tax Charge** | **£600** |
| **Effective tax rate on every additional £1,000 is therefore** | **60%** |

Thompson Airways DC Scheme

Example - Pilot - PP24 - Captain

### 1. Adjusted Income Calculation for annual allowance taper

| | £ |
|---|---|
| Basic salary (Pensionable) | £125,690 |
| Duty Rig payments | £12,511 |
| Flight Duty Allowance | £4,145 |
| **Total Taxable Income** | **£142,346** |
| Add back value of increase in pension | £24,352 |
| **Total Adjusted Income** | **£166,698** |
| **Marginal tax rate** | **40%** |

### 2. Impact of pension tax relief restriction on the annual allowance (AA)

| | £ |
|---|---|
| Unrestricted AA | £40,000 |
| Adjusted Income | £166,698 |
| Excess over £150,000 | £16,698 |
| Lost AA (lost AA restricted to max £30,000) | £8,349 |
| Balance of AA remaining | £31,651 |
| **Tax cost of lost AA at marginal rate** | **£3,340** |

### 3. Value of increase in pension DC Scheme

| | £ | |
|---|---|---|
| Employer Pension Contribution | £18,854 | 15% |
| Employee Pension Contribution | £4,399 | 3.5% |
| Relief given under net pay at BR | £1,100 | |
| **Value of increase in pension fund** | **£24,352** | |

### 4. Impact of lost personal allowance (PA) for incomes in excess of £100,000

**Calculation of Adjusted Net Income (ANI)**

| | £ |
|---|---|
| Total taxable income | £142,346 |
| less gross employee pension contribution | -£5,499 |
| Total ANI | £136,847 |
| Excess over £100,000 PA | £36,847 |
| Lost PA | £10,600 |
| **Tax cost of lost PA at marginal rate** | **£4,240** |

### Tax Rate Bands

| | | |
|---|---|---|
| Basic Rate Tax | £0 | £31,785 |
| Higher Rate Tax | £31,786 | £150,000 |
| Additional Rate Tax | £150,001 | plus |

### 5. Marginal tax rate calculation

| | £ |
|---|---|
| Total taxable income | £142,346 |
| Add value of increase in pension | £24,352 |
| Less AA remaining | -£31,651 |
| **Grand total** | **£135,048** |
| **Marginal tax rate** | **40%** |

### 6. Effective tax rate calculation

| | £ |
|---|---|
| Tax due on every £1,000 earned on adjusted income in excess of £150,000 at marginal rate | £400 |
| Tax on Lost AA of £500 at marginal rate | £200 |
| **Total Tax Charge** | **£600** |
| Effective tax rate on every additional £1,000 is therefore | 60% |

## 4.2 Chief Police Officers and Chief Constables

The taper threshold for chief police officers is pensionable pay of £130k, thus capturing all chief constables and mid-force deputies.

For a medium force chief constable (circa £150k) their AA tax is currently £8.4k for accrual alone (without any pay increase). After tapering it increases to £12.3k, an increase of 46%.