Lifetime allowance pension trap for NHS Dentists

Jon Drysdale explains the latest in pension regulations

Dentists hoping to benefit from career-long contributions to the NHS pension could end up with severe penalties on their pension benefits from April 2014. The £1bn raid on pensions announced in The Chancellor’s Autumn Statement is set to catch out those dentists with NHS Pension income at retirement in excess of £54,000 pa.

Lifetime Allowance
What has changed? The potential problem has arisen because the previous ‘Lifetime Allowance’ (LTA) of £1.5m will reduce to £1.25m from April 2014. Although the NHS pension scheme does not have a fund value as such, HMRC use a special formula to give a deemed value to the pension benefits of retiring dentists. Those who have worked within the NHS throughout their career may well be subject to an additional 25 per cent charge on top of the usual income tax deductions and/or a 55 per cent charge on lump sum benefits deemed to be in excess of the LTA.

When does the charge apply? Although the rules are effective from the start of the 2014/15 tax year they only apply at the point which benefits are taken. Therefore those taking benefits before 6th April 2014 will be assessed against the current limit of £1.5m. However it is worth bearing in mind that the NHS pension scheme advises that dentists give four months notice in advance of taking their pension. In that case the decision to draw benefits before the new rules apply will need to be made by December 2013.

Deemed value
How is my NHS pension valued? The final pension income is multiplied by 20 in order to arrive at a ‘deemed value’. For example gross pension income of £62,500 equates to a value of £1.25m. However as most dentists recently opted to remain on the ‘1095 NHS pension scheme’ the automatic tax free cash of three times the pension income must also be accounted for. In this example an additional £187,500 has to be added to the valuation (5 x £62,500) in respect of tax free cash, giving a total value of £1,437,500.

What are the penalties for exceeding the LTA? For the above example the excess charge is calculated as follows:

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\text{Excess} = \text{Pension capital value} - \text{LTA from 2014/15} = £1,437,500 - £1,250,000 = £187,500
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The LTA charge payable to HMRC is 25 per cent of £187,500 = £46,875. This is recovered by reducing the annual pension amount by the charge, divided by a standard factor of 20. In this case the reduction is £2,344 pa. Income tax applies to the full pension in the normal way.

Pension capital value: £62,500 x 20 = £1,250,000
Tax free lump sum: £187,500
Total capital value: £1,437,500
LTA (from 2014/15): £1,250,000
Excess: £187,500

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Careful planning is required here especially if personal pension funds are involved.

For some it may be advantageous to remain within the pension scheme and suffer the charge. It will be important to assess your individual circumstances before taking this decision.

Short answer
How do I know what my full NHS pension value will be? The short answer is - you won’t know that figure until you opt to take benefits. However a dentally aware financial adviser will be able to help you with that assessment and all issues relating to the LTA charge, annual allowance calculations and general retirement planning.

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Watch out for the April 2014 deadline. This is in line with the transitional arrangements for previous changes to the LTA. However, to be effective it is likely the member will have to stop contributions to the pension scheme and forgo further benefit accrual. Those who previously applied for HMRC ‘protection’ may have already lost this, especially if they continued to make pension contributions.

For those who are under the current £1.5m limit but are likely to breach the new £1.25m limit, it may be advisable to start taking all pension benefits by April 2014. However, careful planning is required here especially if personal pension funds are involved.

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About the author

Jon Drysdale is a director of PFM Dental and an independent financial adviser. PFM Dental has offered specialist financial planning advice to dental practitioners since 1980 and use experts on the NHS pension as well as providing a specialist accounting service for dentists. Visit www.pfmdental.co.uk for further information.