CAVENDISH MEDICAL

TAPERED ANNUAL ALLOWANCE

THE CAVENDISH MEDICAL GUIDE

More senior doctors are triggering harsh tax bills because of pensions tax. However, rash decisions are unwise. Here we present some of the myths surrounding the tapered annual allowance.

Since the so-called ‘pension simplification’ in 2006, total annual allowance tax charges have netted HMRC over £1,200m and lifetime allowance breaches have generated a revenue of £335m.

The yearly restriction on the amount you can contribute to your pension free-of-tax is known as the ‘annual allowance’. New rules decrease the standard annual allowance of £40,000 to as low as £10,000 per year for doctors with a ‘threshold income’ of more than £110,000 – this is known as a ‘tapered annual allowance’. Excess pensions savings above the allowance will generate a tax bill charged at your marginal rate of income tax.

As the tax-relievable pensions savings limits are now much lower, the net is catching more and more doctors who are tied into making contributions into the NHS pension scheme. Workers with private pensions, on the other hand, can simply adjust their pension contributions to fall below the cap – albeit with a smaller pension as a result.

According to a recent FT investigation, the tapered annual allowance is ‘fuelling an NHS staffing crisis as large number of senior staff are routinely turning down extra shifts through fear of being landed with punitive bills’.

Earlier this year, the government ruled out changing pensions tax legislation following an official parliamentary review raised by MP Paul Masterson. He shared concerns about the impact the taper was having on consultants and doctors with many choosing to reduce their hours or retire early. However, in recent months, ministers have agreed to consult on providing flexible pension options for doctors.

This culmination of factors has led many consultants to question whether they should be changing their work patterns, taking early retirement or quitting the NHS pension scheme altogether. With this in mind, we believe it is useful to clarify some important facts about the taper and to dispel a few myths:

Myth: Senior doctors should quit the NHS pension scheme

More medics are opting out of the NHS pension scheme according to official figures. A total of 245,561 people opted out of the NHS pension scheme between 2015 and 2017, with 102,755 opting out in 2016 alone (the year in which the taper was introduced), a 78 per cent increase from the previous year. The age group with the highest number of NHS pension scheme leavers in that time were 46-55 year olds, with a 94 per cent increase in 2016.

However, despite the challenges with the NHS scheme, for the vast majority of members, there are too many advantages to ignore. The pension is government backed and index-linked in retirement and also provides benefits for a surviving spouse. If you opt out you will also lose other benefits such as death in service and may also face reduced ill-health retirement options.

In truth, opting out of the NHS scheme is a financially sound move for a limited number of individuals. Before making any decision to leave, we would adviser looking at detailed financial modelling which could help to pinpoint whether it is the best move for you, and if so, the optimal time to leave.

Myth: I should retire from the NHS rather than face tax bills

Many doctors are having to deal with complex pension tax positions which is factoring in to their retirement decisions. We have found that few clients wish to stop clinical work altogether with many preferring to continue in their careers in some capacity – if the opportunities exist for them to do so.

Often it is possible to navigate a path between remaining in practice and the tax challenges this may cause.

One often overlooked point is that by paying some annual allowance tax charges, however undesired at the time, the scheme member will reduce their eventual total pensions savings and be less likely to breach the lifetime allowance later on.

Myth: The NHS pension scheme is no longer worth paying into

New clients will often ask their Cavendish adviser if the NHS pension scheme still represents good value for money. It looks very different to ten years ago and in ten or twenty years' time (when current 2015 scheme members are retiring) it will most likely look very different again. Nonetheless, the value of the scheme largely depends on how long you live.

If you retire at 60 and live for another three decades than the scheme has been worthwhile. If you pass away the day after you retire, you will not have reaped the same rewards although your spouse may continue to enjoy the benefits. Of course, the future is unknown and statistically, you will live to enjoy a long retirement.

The NHS scheme still represents the best value pension you can buy and a private equivalent simply does not exist.

Myth: Opting for the pension scheme to pay my annual allowance tax charge is the best choice for me

There are multiple options for paying an annual allowance tax charge – via self-assessment, through the NHS Scheme Pays option or utilising your personal pension pot. With NHS scheme pays, the pension scheme pays the tax charge on your behalf in return for reduced pension benefits in the future and will charge interest each year until retirement.

There can be tax advantages with this option but you should be mindful that the interest payments can escalate quickly and the future inflation rate is unknown. However you should have some idea of the reduction to the benefits to enable you to make the right decision. You will also need all the necessary information to hand before the application deadline which is normally 31 July each year.

You could also use a personal pension to pay the tax charge – this is typically the best option of the three – however it is essential you receive the right advice in this area.

Myth: I can probably go-it-alone

The calculations required for the tapered annual allowance are extremely complicated, even for financial planners not used to dealing with the nuances of the NHS remuneration and pension package. Every year we conduct 'rescue missions' of new clients who had chosen not to seek advice initially or who had been poorly advised because the professional who helped them did not fully understand the complex income streams of their medical client.

One major issue that we are seeing time and again are incorrect pay levels for NHS staff. When we scrutinise pay slips we often discover that a consultant has not been paid the correct pay level (sometimes for several years) and therefore not only are they owed substantial back pay but their tax position has been incorrect causing significant problems.

Act now

There are many important factors to consider when looking at your financial situation in relation to the tapered annual allowance. Please do not underestimate how complex the issue is but remember that all problems are surmountable with careful analysis and planning. Ensure you have all the financial facts to hand and spend some time talking to people with experience in this area so that you are able to make well-considered decisions.

Cavendish Medical Ltd helps over 450 medical families to achieve their aspirations for later life. For more information or to speak to one of our team, please telephone 020 7636 7006.

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