Beware the sting in the pension tail………

Clive Edwards

The NHS has always relied on the goodwill of its staff and associated members to provide the best service it can under extreme conditions. This will include staff agreeing to work additional hours in order to meet the gap in care being demanded and during the current pandemic, and has never been truer or tested as hard. The extra work is usually recognised and rewarded through the pay-packet of the health professional.

However, the extra pay may create an unexpected tax burden on the recipient because the extra pay increases their final pension entitlement.

Any tax due as a result of this is paid via a tax return and becomes payable by the next 31 January after the end of the tax year in which the liability arose.

A tax year runs from 6 April to the following 5 April.

For example; if tax becomes due on work undertaken in May 2020, it will not be payable until 31 January 2022, being the first 31 January following the end of the tax year (6th April 2020 – 5th April 2021).

As the recipient normally meets their tax liabilities each month through the Pay As You Earn system, they may be blissfully ignorant of tax returns because they are not required to file them each year.

Being asked to pay more tax up to 21 months after they provided extra care to their patients can be a shock, both physically and financially.

Why might there be tax to pay on the extra work performed?

The NHS pension scheme is a defined benefit one, which means your actual pension receivable is based on your salary if employed, or on your career earnings if self employed, and not on the actual amount of contribution paid each month.

There are currently two schemes in operation – the 1995/2008 and the 2015 scheme.

The tax legislation allows each person a pension input of £40,000 each year.

If that is exceeded, then tax is due on the amount above that threshold.

The £40,000 is not measured against the contributions you have made, but rather on a multiple of the annual growth in your pension entitlement (your pension at the end of the tax year less your pension at the beginning of the tax year).

That multiple will depend on which pension scheme you are in, ranging from 16 times for the 2015 scheme to 19 times for the older scheme.

Therefore, the extra pension earned from the additional hours, multiplied by 16 or 19 times may push you over the threshold and give you a tax liability.

What can you do about the tax liability?

If a tax liability is created, then you can chose to meet it personally in full, use your pension scheme to meet it in full, or a mixture of the two.

You need to instruct the pension scheme to meet the tax due and then confirm that via a tax return.

There is a time deadline on that request – usually the form needs to be completed and submitted by the 31 July following the end of the filing deadline for the tax year the work was performed in.

If you are unsure or if you don't know what the liability will be, you can submit a claim to the pension scheme for £1 in order to bank the ability to use those funds, and then amend that claim within four years for the actual amount you want the pension fund to pay, once the final outcome is known.

NHS Pensions have a form specifically for scheme pays elections and they provide guidance on their website

If you use your pension funds to meet the tax burden, it will reduce your pension entitlement upon retirement, so you need to think carefully before making the claim.

You should consult with an Independent Financial Advisor should you have any queries on this point.

As a one off, the Government has said that it will effectively meet any tax liability created in the 2019/20 tax year which is paid for out of the pension fund.

If you think this may apply to you, or you have recently received a letter from NHS Pensions Agency (NHSPA), your claim needs to be made by 31 July 2021.

How will you know if there is a tax payment due?

The NHSPA will send out a letter to any member who they believe may have breached the annual threshold. That letter will provide information designed to help you work out if you have a liability to report or not.

The website will provide you with data on your pension.

Although this information is not always up to date, it should give you an idea of how your pension is performing and levels of annual growth.

If you do not use all of your allowance in one year, you can carry forward the surplus for a maximum of 3 years and set against future breaches.

Caveat

As complicated as the above may sound, it is a simplified version of a very complex area.

In summary…

If you find yourself giving more to the NHS and getting paid for it, not only do you take home more pay, but your pension entitlement increases as well. Depending on the levels of skill and time involved, that extra income could create a tax liability for you further down the line. You can use either the Pensions Agency or an IFA to help you on pension growth, and your accountant/tax advisor to help you on the liability that growth may create. Sadly, as it's based on historic actions, the tax cannot be reduced, but you can seek advanced notification on likely amounts to help manage your home budget.

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