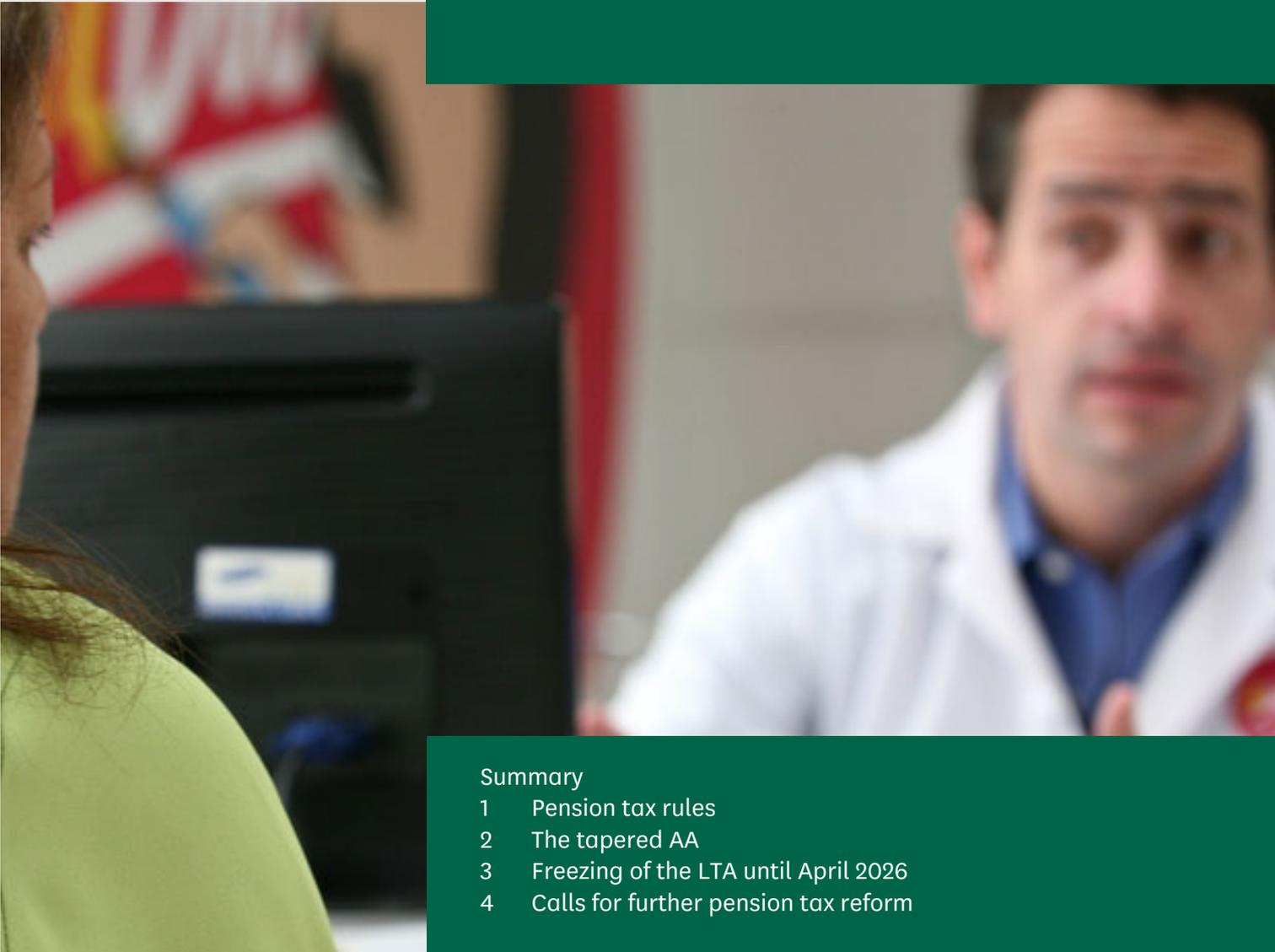


By Djuna Thurley

20 August 2021

## Pension tax rules - impact on NHS consultants and GPs



### Summary

- 1 Pension tax rules
- 2 The tapered AA
- 3 Freezing of the LTA until April 2026
- 4 Calls for further pension tax reform

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## Summary

This note looks at the concerns about the impact of pension tax rules on some senior NHS clinicians and GPs who are members of the NHS Pension Scheme, a [defined benefit](#) (DB) public service pension scheme.

### The annual allowance and lifetime allowance

Pension tax relief works on the principle that contributions to pensions are exempt from tax when they are made, but taxed when they are paid out. The amount of tax-relieved pension saving an individual can build up is limited by the [annual allowance \(AA\)](#) and [lifetime allowance \(LTA\)](#). Both have been reduced in stages since 2010:

- The standard LTA reduced in stages from £1.8 million in 2010 to £1 million in April 2016. It then rose in line with inflation from April 2018 until April 2021. The Government legislated in the [Finance Act 2021](#) (s28) to freeze it at its current level of £1,073,100 until April 2026.
- The standard AA reduced in stages from £255,000 in 2010 to £40,000 in April 2014. From April 2016, There is also a [tapered AA](#), introduced in April 2016, which reduces the AA of higher earners ('adjusted incomes' above £240,000) to a lower level (a minimum of £4,000).

When making these reductions, the Coalition Government put in place measures to mitigate the impact. For example, people at risk of breaching the AA in a particular year can 'carry forward' unused allowances from the previous three years ([FA 04](#), s228A) and in certain circumstances, people could apply for protection against a reduced LTA ([FA 04](#), s218, Sch 36).

For more detail, see [Pension tax relief: the annual and lifetime allowances](#), Commons Library Briefing Paper CBP 5901, March 2021.

### Changes the tapered AA in 2020

The [tapered AA](#), introduced in April 2016, reduces the AA of earners with adjusted incomes above a threshold level to a lower minimum than the standard AA. When these rules were introduced, they applied to people with '[adjusted incomes](#)' (taxable income plus the value of pension growth) above £150,000 and '[threshold income](#)' above £110,000. The taper could reduce the AA to a minimum of £10,000 (HMRC, [Pension scheme rates](#), April 2021).

Although these rules applied across all schemes, the nature of many doctors' work (for example, consultants taking on additional work often at short notice to cover service pressures) meant there was a particular impact on the NHS. This was particularly felt in 2019-20 when the capacity to bring forward

unused AAs from the previous three years was largely exhausted ([DHSC consultation, July 2019](#)).

In the [March 2020 Budget](#), the Government announced increases of £90,000 in the income thresholds for the tapered AA ('adjusted income' increased to £240,000, 'threshold income' to £200,000) and a decrease in the minimum AA to £4,000 (para 2.183-5; [HMRC policy paper](#), March 2020). The [BMA](#) welcomed the announcement – which would mean that the “vast majority of doctors are now removed from the effect of the taper” – but said it was long overdue and that further reform was needed. The changes were legislated for in the [Finance Act 2020](#) (s22).

### **NHS pension scheme flexibility**

Before deciding to change the tapered AA thresholds, the Government considered – but ultimately did not take forward – proposals for more flexibility in pension scheme rules.

The Department of Health and Social Care (DHSC) [consulted](#) in September 2019 on proposals to allow senior medical staff to opt to build up pension benefits at a lower rate to reduce the risk of incurring a tax charge. The BMA described the proposals as a '[sticking plaster](#)' and the pension tax rules needed to change.

In [Budget 2020](#), the Government said the flexibility proposals would not be taken forward (para 2.184). This was confirmed in February 2021, when the DHSC [responded to the consultation](#). It said the majority of respondents had “argued that tax reform would be the simplest way of solving the issue of senior clinicians limiting their NHS work for fear of large unexpected annual allowance charges.” Changes to the tapered annual allowance in *FA 2020* had achieved “the same intended policy aim as the proposed flexibilities but without the additional complexity that the latter would introduce.”

In its 2021 report, the [Review Body on Doctors' and Dentists' Remuneration](#), recommended that employers consider making better advice available and allowing “flexibility for employees to take some of their remuneration as non-pensionable pay, thus reducing their tax liabilities without having to leave their pension scheme” (para 4.86).

### **Calls for further reform of pension tax rules**

In its October 2019 report on [Taxation and Life Events](#), the Office of Tax Simplification said the Lifetime and Annual Allowance charges could present significant complexities for pension savers in different circumstances in either DB or DC schemes. It said that, given the aim of limiting the overall pension tax relief going to any individual, applying both charges might be unnecessary. For DB schemes, – like the NHS Pension Scheme – one option might be to apply the LTA only (para 3.74-5).

In March 2020, [the BMA welcomed](#) the changes to the tapered AA, but said that a pay increase or a promotion could still result in doctors facing

significant tax bills as a result of exceeding the standard AA. [Responding to the decision in Budget 2021](#) to freeze the LTA at its current level until April 2026, it said this was “going to push doctors out of the NHS.” It argued for the option of a tax-unregistered pension scheme for those affected, pointing to planned reforms for the judiciary.

[In a Parliamentary Written Answer on 18 May 2021](#), the Government rejected this approach on grounds that the circumstances of judicial appointments are unique:

The unique circumstances of judiciary appointments mean that it is necessary to reform their pension arrangements. Judges are not able to work in private practice after taking up office, and many judges take a significant pay cut to join the judiciary. The combination of these factors is why the Government is committed to introduce a reformed judicial pension scheme. Such a scheme would not benefit the vast majority of NHS staff, as members would receive no tax relief on their contributions.

The [BMA continues to call](#) for reform to help address doctor shortages, including “removing punitive pension taxation rules so older doctors can remain in work flexibly.”

For more on the reforms to [Judges’ pensions schemes](#), see Commons Library Briefing, CBP 8540, April 2021.

# 1 Pension tax rules

Pension tax relief works on the principle that contributions to pensions are exempt from tax when they are made, but taxed when they are paid out. Pension contributions made by individual employees are usually paid out of pre-tax salary, so tax relief is received at the individual's marginal tax rate. The main limits that apply are:

- The [annual allowance](#) (AA) - which limits the amount of annual pension savings that benefit from tax relief. There is a tax charge if contributions, or the value of benefits accrued in a year, exceed the AA.<sup>1</sup> This is broadly intended to recoup the tax relief they would have received on the excess contributions.<sup>2</sup>
- The [lifetime allowance](#) (LTA) - which limits the amount of pension saving over an individual's lifetime that can benefit from tax relief. Pension savings are tested against the LTA at 'benefit crystallisation events', for example, when an individual becomes entitled to a lifetime annuity. A breach of the LTA leads to a charge (25%, if the excess is a pension, or 55% if it is a lump sum).<sup>3</sup>

The legislation is in the [Finance Act 2004](#) (pt4, ch5). Detailed guidance is in HMRC's [Pension Tax Manual – Lifetime Allowance](#) and [Annual Allowance](#).

For more detail, see [Pension tax relief: the annual and lifetime allowances](#), Commons Library Briefing Paper, CBP 5901, March 2021.

## 1.1 The annual allowance

At introduction in 2006, the AA was set at £215,000. It was set to increase to £255,000 by 2010.<sup>4</sup> The standard AA was reduced from £255,000 to £50,000 in 2011 and then to £40,000 in 2014. From April 2016, there has been a [tapered AA](#), applying to higher income individuals.

The NHS Pension Scheme – like the other main public sector schemes – is a defined benefit (DB) scheme i.e. one which provides pension benefits based on salary and length of service. Rights in DB schemes are measured against the tax limits not by looking at the contributions made, but at the value of

<sup>1</sup> [Finance Act 2004](#), Pt 4; HMRC [Pension Tax Manual – annual allowance](#)

<sup>2</sup> HMRC, [Pension Tax Manual - Annual Allowance: tax charge/rate of tax charge/general](#)

<sup>3</sup> Pension Tax Manual – [Pension Tax Manual – The Lifetime Allowance charge](#)

<sup>4</sup> HM Treasury, [Budget 2004](#), para 5.45

annual pension benefits that have been built up and multiplying it by a set figure. In the case of the AA, this set figure is 16.<sup>5</sup>

When bringing forward its proposals to reduce the standard AA in October 2010, the Coalition Government said those who could “save more than an AA in the range of £30,000 to £45,000 in a year are concentrated among the highest earners.”<sup>6</sup> However, the nature of DB schemes could lead to some individuals on low to moderate incomes exceeding the AA (for example, on promotion).<sup>7</sup> In particular circumstances, a combination of factors (including length of service, scheme accrual rate, level of salary, and rate of salary increase) could create uneven, and potentially sizeable, annual increases in pension in a particular year.<sup>8</sup> To mitigate the impact of this, the Coalition Government decided to allow individuals to “offset excess contributions against unused allowance from up to the previous three years.”<sup>9</sup>

At the time, the Government recognised that there would still be cases where a tax charge would arise that would be difficult to meet out of current income.<sup>10</sup> It therefore introduced “scheme pays”, whereby members who have exceeded the standard AA (£40,000) and have a tax charge of more than £40,000 can elect for the charge to be met from their pension benefits.<sup>11</sup> This involves the scheme effectively making a loan to the individual to pay the charge, which they must later repay with interest.<sup>12</sup> Pension schemes have discretion to offer ‘scheme pays’ in a wider range of circumstances.<sup>13</sup>

## The tapered AA

The tapered annual allowance (AA) was introduced in April 2016. The rules at that time were summarised in the following Parliamentary Written Answer:

tapering applies to individuals whose taxable income exceeds £110,000 and whose adjusted income exceeds £150,000. Adjusted income is taxable income plus the value of annual pension growth. The standard annual allowance is reduced by £1 for every £2 of

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<sup>5</sup> [Finance Act 2004](#), s234; Gov.UK, [Work out your reduced \(tapered\) annual allowance/work out your pension savings](#). In the case of the LTA, a multiplier of 20 applies ([Finance Act 2004](#), s212 and 276)

<sup>6</sup> HM Treasury, [Restriction of pension tax relief: a discussion document on the alternative approach](#), July 2010, para 3.1

<sup>7</sup> Ibid, para 3.4

<sup>8</sup> HM Treasury, [Options to meet high annual allowance charges from pension benefits: a discussion document](#), November 2010

<sup>9</sup> HM Treasury, [Restricting pensions tax relief through existing allowances: a summary of the discussion document responses](#), October 2010, summary and para 3.6

<sup>10</sup> [HM Treasury, Options to meet high annual allowance charges from pension benefits: a discussion document, November 2010, para 1.7](#)

<sup>11</sup> [HC Deb, 3 March 2011, c31-2WS](#); HMRC’s [Pensions Tax Manual – Annual allowance: tax charge: scheme pays: general](#)

<sup>12</sup> [HL 17506, PQ 6 August 2019](#); [NHSBA/Member Hub/Annual Allowance/Scheme Pays FAQs](#). See also NHSBA ‘[Scheme Pays Election Guide](#)’

<sup>13</sup> Ibid; NHS Pension Scheme, [Annual Allowance – scheme pays election](#)

adjusted income over £150,000, tapering down to a minimum allowance of £10,000.<sup>14</sup>

The rationale for introducing the tapered AA was “to control the cost of pensions tax relief” by ensuring that “the support provided to pension savers is affordable and targeted where it is needed most.”<sup>15</sup> The Government of the time estimated that it would save some £4bn over the six years to 2020-21, with the annual saving rising to £1.28 billion in 2020-21.<sup>16</sup> The measure was “focused on the wealthiest pension savers, to ensure that the benefit they receive is not disproportionate to that of other pension savers.”<sup>17</sup>

For guidance on the rules, see:

- NHS Pensions: [Annual allowance](#)
- NHS Employers: [Pension tax resources](#)
- Scottish Public Pensions Agency: [Annual Allowance FAQs](#)
- HMRC, [Work out your reduced \(tapered\) annual allowance](#), (updated April 2020)
- BMA, [NHS Pension annual allowance](#), updated 2 June 2021

## 1.2 The lifetime allowance

At introduction in 2006, the LTA was set at £1.5 million, to increase in stages, £1.8 million by 2010.<sup>18</sup> It reduced from £1.8 million to £1.5m in April 2012, to £1.25 million in 2014 and to £1 million in April 2016.<sup>19</sup>

The protections available to protect individuals affected by these reductions are discussed in [Pension tax relief: the annual and lifetime allowances](#), Commons Library Briefing Paper, CBP 5901, March 2021.

[The Finance Act 2016](#) (s19) provided for the LTA to rise in line with CPI inflation from £1 million from 2018/19.<sup>20</sup> This happened until it reached £1,073,000 in 2021/22.<sup>21</sup> However, in Budget 2021 the Chancellor announced that it would be frozen at its current level of £1,073,100 until April 2026.<sup>22</sup> This was legislated for in the [Finance Act 2021](#) (s28).

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<sup>14</sup> [PQ 207, 9 January 2020](#)

<sup>15</sup> HM Treasury, [Summer 2015 Budget](#), HC 264, July 2015

<sup>16</sup> HM Treasury, [Overview of tax legislation and rates](#), July 2015, p62

<sup>17</sup> [PBC Deb 13 October 2015 c83](#)

<sup>18</sup> HM Treasury, [Budget 2004](#), para 5.45

<sup>19</sup> [FA17](#), s67 & [Sch18](#); [FA13](#), s48; [FA16](#), s19

<sup>20</sup> [FA16](#), s19

<sup>21</sup> There is a table showing the rates in each year since 2006 in [CBP 5901](#), section 2

<sup>22</sup> HM Treasury, [Budget 2021](#), March 2021, para 2.77

## 2 The tapered AA

### 2.1 Impact in the NHS

In March 2019, the British Medical Association (BMA) wrote to the then Chancellor of the Exchequer, Philip Hammond, saying that the rules were “forcing some of our most experienced doctors to retire, reduce their workload, abandon leadership positions and stop covering vacancies.” The operation of the tapered annual allowance meant some of its members were facing “significant – four, five and six figure - charges, in addition to PAYE and other tax charges.”<sup>23</sup>

In July 2019, the Review Body on Doctors’ and Dentists’ Remuneration said the combination of reductions in the AA and the introduction of the taper meant that “staff are now much more likely than they were before to find themselves having breached annual allowances, and hence to be in receipt of sometimes substantial tax charges.”<sup>24</sup>

The Department of Health & Social Care (DHSC) said that the nature of work in the NHS meant the tapered AA was having a particular impact there. It was having an impact in 2019/20 because the capacity to carry forward unused annual allowances from previous years had by then been greatly reduced:

1.12 NHS consultants and GPs have the opportunity to take on additional work each year and can flex their income up or down. Consultants typically volunteer for additional non-pensionable sessions of work, often at short notice, to cover service pressures. As payment for this work counts towards the tapered annual allowance, many more senior clinicians are being caught by pension tax. The design of the taper also creates cliff edges. It has been argued by some that the operation of the taper is difficult to predict, particularly when a senior clinician is unsure what level of income that they will earn within a tax year. Around a third of NHS consultants and GP practice partners have earnings from the NHS that could potentially lead to them being affected by the tapering annual allowance.<sup>25</sup>

The effect for some high earners – particularly NHS consultants and GPs - was that their total reward package was diminished compared with members at lower earnings levels. There was evidence that some senior clinicians were

<sup>23</sup> [BMA letter to Chancellor to the Exchequer, Philip Hamond, March 2019](#)

<sup>24</sup> [Review Body on Doctors’ and Dentists’ Remuneration, 47<sup>th</sup> Report, CP148, July 2019, para 1.17](#)

<sup>25</sup> DHSC, [NHS Pension Scheme: proposed flexibility](#), 22 July 2019

“managing their annual allowance tax charge liability by reducing their workload, turning down extra responsibilities or opportunities and/or retiring early.” Consequently, there was a reduction in NHS service capacity and patient care was adversely affected.<sup>26</sup>

Professional bodies highlighted concerns. In October 2019, the Royal College of Physicians said a survey of its members had revealed that almost half (45%) had decided to retire at a younger age than previously planned, with 86% of them citing pension concerns as one of their reasons.<sup>27</sup>

On 4 November 2020, the Academy of Royal Medical Colleges wrote to the Government with evidence that it said painted “a stark picture of the negative impact across different specialties and across the UK.” It urged the Government to consider reform of the pension tax rules. It was particularly concerned with the taper on the annual allowance.<sup>28</sup> The Royal College of Surgeons also highlighted concerns from a survey of its members.<sup>29</sup> In January 2020, a report by NHS Providers highlighted the impact on non-clinical and well as clinical staff.<sup>30</sup>

## Impact elsewhere

This was not just an issue for the NHS. The pension tax rules apply in the same way across registered pension schemes in the public and private sector. However, the nature of work in the NHS - with consultants having the opportunity to volunteer for additional sessions of work, often at short notice, to cover service pressures - may mean there is more of an impact in this area. The BMA also raised concerns about the impact on doctors in the Defence Medical Services.<sup>31</sup> The impact on other public servants - including the senior military, the judiciary, and senior civil servants - had featured in reports of the pay review bodies.<sup>32</sup>

In evidence to the Treasury Select Committee in 2019, the then Chancellor of the Exchequer, Philip Hammond said there appeared to have been less of an impact in the private sector, possibly because increased flexibility in private sector remuneration packages meant that someone at risk of a tapered annual allowance charge “change to their remuneration package, so they get more pay and less pension contribution.”<sup>33</sup>

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<sup>26</sup> Ibid para 1.2

<sup>27</sup> [Pension tax driving doctors to retire early. Royal College of Physicians, October 2019](#)

<sup>28</sup> [Academy response to doctors' pension tax issue](#), Academy of Royal Medical Colleges, November 2019

<sup>29</sup> [RCS Survey on the NHS Pension Scheme](#), 7 November 2019; [Royal College of Surgeons press release](#), 22 November 2019

<sup>30</sup> NHS Providers, [An unnecessary divide](#), Jan 2020

<sup>31</sup> BMA, [Armed forces committee: report to ARM 2020](#)

<sup>32</sup> For example, Review Body on Senior Salaries, [Cm 9694](#), Sept 2018, para 3.89-90; Review Body on Doctors' and Dentists' Remuneration, [Cm 9670](#), July 2018

<sup>33</sup> [Evidence to the Treasury Select Committee, 24 April 2019, Q336 \[Philip Hammond\]](#)

## 2.2

## The Government's response

A number of commentators argued strongly that making the NHS pension scheme more flexible would not go far enough - changes to pension tax rules, particularly in relation to the tapered annual allowance, were needed. Royal London for example, has said the “best solution would be to remove a complex and unpredictable feature of the tax system – the tapered annual allowance – even if this required a reduction in the overall annual allowance.”<sup>34</sup> On 6 August 2019, the then Chancellor of the Exchequer, Sajid Javid, said HM Treasury would “review how the tapered annual allowance supports the delivery of public services such as the NHS.”<sup>35</sup> NHS Providers argued that the outcome of the review should not be limited to NHS clinicians.<sup>36</sup> Trade unions called for it to apply equally across the public sector.<sup>37</sup>

In Budget 2020, the Government announced that it would increase the income limits used to calculate a tapered annual allowance and reduce the minimum tapered annual allowance:

- The threshold income (broadly net income before tax, excluding pension contributions), would increase from £110,000 to £200,000.
- The adjusted income (broadly net income, plus pension accrual) would increase from £150,000 to £240,000.
- The minimum tapered annual allowance would decrease from £10,000 to £4,000.<sup>38</sup>

The Government estimated that the changes announced in Budget 2020 would impact an estimated 250,000 individuals then affected by the tapered annual allowance and cost the Exchequer £2.175 billion over the five years to 2024/25.<sup>39</sup>

In its November 2020 report, the Office for Budget Responsibility produced a revised estimate, reducing the expected yield by an average of £0.1 billion a year (14%) from 2022-23 onwards, to reflect its lower CPI inflation and earnings forecasts.<sup>40</sup>

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<sup>34</sup> [Letter to the Prime Minister on July 2019; Royal London, Finding the right medicine, May 2019.](#)

<sup>35</sup> [NHS pensions for senior clinicians – new changes announced to improve care.](#) DHSC and HM Treasury, August 2019

<sup>36</sup> NHS Providers, [An unnecessary divide: the impact of pensions taxation on NHS Trust leaders](#), January 2020

<sup>37</sup> ‘[Unions threaten legal challenge over pension measures](#)’, *Financial Times*, 7 August 2019 (£); [FDA calls on Cabinet Office for greater pensions flexibility](#), August 2019

<sup>38</sup> HMRC policy paper, March 2020

<sup>39</sup> HMRC policy paper, [Pension tax changes for income thresholds for calculating the tapered annual allowance from 6 April 2020](#), 11 March 2020

<sup>40</sup> OBR, [Economic and Fiscal Outlook](#), November 2020, p188, para A.38

## Finance Act 2020

[Finance Act 2020 \(s22\)](#) amended the definition of “high-income individual” in FA04 s228ZA so that the tapered AA would only apply to individuals whose adjusted income was greater than £240,000 (previously £150,000) and whose threshold income was greater than £200,000 (previously £110,000). It also decreased the minimum tapered annual allowance from £10,000 to £4,000.<sup>41</sup>

## 2.3

## Compensation in 2019/20

To address the impact of the tapered AA in 2019/20, governments introduced compensation schemes for senior NHS clinicians incurring an annual allowance charge.

### England

On 18 November 2019, Chief Executive of the NHS, Simon Stevens, wrote to Health Secretary Matt Hancock asking for his agreement to a proposal to compensate certain senior NHS clinicians who would incur a tapered annual allowance charge arising from their membership of the NHS Pension Scheme in 2019/20.<sup>42</sup> In a letter of 22 November, Mr Hancock gave his consent to these proposals. He advised that that in drafting the details of the scheme, the NHS should take steps to minimise the risk of it constituting tax avoidance.<sup>43</sup>

The *Financial Times* reported that the BMA was seeking a “legal guarantee from the National Health Service that it will cover pension tax bills as front-line staff appear sceptical about a government plan to convince them to work extra shifts to prevent a winter care crisis.”<sup>44</sup> On 7 December 2019, the Secretary of State for Health confirmed that these contractual commitments would be honoured when clinicians retired.<sup>45</sup> However, the majority of respondents to a survey by NHS providers did not think this would encourage clinical staff to work additional shifts again.<sup>46</sup>

The Office for Budget Responsibility was unclear what the compensation package would cost: it would depend how clinicians respond to the offer (for example in terms of opting back into the scheme if they had left it to avoid such charges or increasing their hours if they had been turning down shifts for the same reason).<sup>47</sup>

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<sup>41</sup> [Finance Bill 2019-20 – Explanatory Notes](#)

<sup>42</sup> [Letter from Simon Stevens to Matt Hancock, 18 November 2019](#)

<sup>43</sup> [Letter from Matt Hancock to Simon Stevens, 22 November 2019](#)

<sup>44</sup> ‘Doctors seek legal guarantee from NHS on pensions tax’, *FT*, 28 November 2019

<sup>45</sup> Gov.UK, [Statement from the Secretary of State on the Clinician Pension Tax Scheme](#); 7 December 2019; Gov.UK, [Senior Clinicians Pensions, Letters between DHSC and NHS England; NHS England, Pension tax annual allowance](#)

<sup>46</sup> NHS Providers, [An unnecessary divide](#), Jan 2020

<sup>47</sup> OBR, Economic and fiscal outlook, March 2020, p175

## Wales

On 13 November 2019, Health Minister in the Welsh Government, Vaughan Gething, expressed significant concern over the impact the rules were having and advised health bodies in Wales to use the available pension flexibilities while the UK Government conducted its review of the tax rules:

I had previously requested an urgent review of these arrangements in the context of increasing clinical and other workforce challenges in the NHS of all four UK nations. Hospital consultant staff within NHS Wales, as with other parts of the United Kingdom, have been affected by the changes made. This has meant that a number of senior consultants have been unwilling to carry out additional work above their contracted hours as the additional work would trigger a tax liability.<sup>48</sup>

NHS Employers Wales produced guidance explaining that affected staff could opt out of the NHS pension scheme mid-year and that their employers could use discretionary flexibility to maintain the value of the clinicians' total reward packages.<sup>49</sup>

On 22 January 2020 Mr Gething wrote to Health Secretary Matt Hancock saying that, although he fundamentally disagreed, he had been left with no option but to consider compensating senior clinicians from the NHS Budget, as had been done in England. He said the harm being done by the issue was undeniable:

The significant loss of activity is felt by our patients and it is hard to understate the loss of goodwill from our staff. In the period from April to the end of December, Health Boards in Wales have reported that they have lost around 3,200 sessions which has affected nearly 27,000 outpatients, inpatients/daycare of diagnostics.<sup>50</sup>

Guidance on NHS Wales' Pensions Annual Allowance Charge Compensation Policy explained that "staff who go over their annual allowance for the 2019/20 tax year and who use scheme pays to pay the tax charge can be compensated in retirement for any reduction to their NHS Pension Scheme benefits."<sup>51</sup>

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<sup>48</sup> [Written Statement, Vaughan Gething AM, 13 November 2019](#)

<sup>49</sup> NHS Wales Employers, [Pension tax guidance from employers](#), October 2019

<sup>50</sup> [Vaughan Gething, Letter to Matt Hancock, 22 January 2020](#)

<sup>51</sup> [NHS Wales 2019/20 Pensions Annual Allowance Charge Compensation Policy - information for members](#) (viewed 27 May 2021)

## Scotland

The Scottish Government has the power to make regulations for the NHS Pension Scheme in Scotland.<sup>52</sup> Pension tax legislation is reserved to the UK Government.<sup>53</sup>

In August 2019, BMA Scotland called on it to “respond rapidly to ensure Scottish doctors are in no way disadvantaged compared to UK counterparts.”<sup>54</sup> In November 2019, the Scottish Government announced a short-term scheme to mitigate the impact: NHS Scotland staff would have the option of opting out of the NHS Scotland Pension Scheme and receiving the employer contributions, net of employer National Insurance Contributions, for tax year 2019-20.<sup>55</sup> BMA Scotland described it as “fiendishly complicated,” with several hoops to jump through, but “a welcome step in the right direction.”<sup>56</sup> On 17 December, the BMA called for the compensation scheme for senior clinicians in England also to be an option in Scotland, until a longer-term resolution was found.<sup>57</sup> However, this did not happen.<sup>58</sup> On 3 February 2020, Scottish Health Secretary, Jeanne Freeman, called on the UK Chancellor to “take decisive action to ensure pension and taxation rules no longer undermine delivery of frontline health services for the people of Scotland and other UK nations.”<sup>59</sup>

## Guidance

There is guidance on the rules in the different countries:

- NHS England - [2019/20 Pensions Annual Allowance Charge Compensation Policy](#)
- NHS Pensions - [annual allowance FAQs](#)
- NHS Wales - [Pensions Annual Allowance Charge Compensation Policy - information for employers](#)
- BMA - [Guidance on the NHS England and NHS Wales annual allowance repayment scheme 2019/20](#)
- [NHS Scotland staff pension policy on recycling employer contributions circular, NHS circular PCS \(PP\) 19/1](#)

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<sup>52</sup> [Public Service Pensions Act 2013](#), s2 AND Sch 2

<sup>53</sup> [Finance Act 2004](#), Part 4; [Scotland Act 1998](#), (as amended), Sch 5 (II) (A1); Library Briefing Paper [CBP 8544](#)

<sup>54</sup> [BMA Scotland respond to Westminster Pension Tax Announcement](#), 7 August 2019

<sup>55</sup> [NHS circular PCS \(PP\) 19/1](#)

<sup>56</sup> BMA Scotland blog, [Pensions update – a small step forward](#), November 2019

<sup>57</sup> [Scottish doctors must have access to all options to mitigate pension tax charges](#), BMA press release, 17 December 2019

<sup>58</sup> [What do I need to do about annual allowance charges relating to the NHS Pension Scheme?](#) PWS financial services, October 2020

<sup>59</sup> [Permanent solution required for NHS Pensions, Scottish Government](#), 3 Feb 2020

## 2.4

## Proposals for flexibility in scheme rules

Before deciding to change the rules on the tapered annual allowance in *Finance Act 2020*, the Government considered introducing flexibility in pension scheme rules. These proposals were not taken forward for reasons discussed below.

On 10 April 2019, the then Health Minister Stephen Hammond said scope of the ‘voluntary scheme pays’ facility in the NHS scheme would be extended to cover the payment of tax charges from breaches of the tapered AA (i.e. individuals could apply to have a charge arising from the tapered annual allowance to be paid from their pension benefits).<sup>60</sup>

On 22 July 2019, the DHSC launched a consultation on introducing more flexibility into the NHS Pension Scheme – in the form of a “50:50 option whereby senior clinicians who expect to be affected by the annual allowance can elect at the beginning of the year to reduce their contributions and their pension accrual by 50%.”<sup>61</sup> However, in August, it said it would replace this with a further consultation for more flexibility.<sup>62</sup> This further consultation, launched on 11 September, included proposals that would allow clinicians whose ‘work patterns meant they have a reasonable prospect of incurring an annual allowance tax charge’ to:

- Choose before the start of each scheme year (1 April) a personal accrual level and pay correspondingly lower employee contributions. The accrual level chosen would be a percentage of the normal scheme accrual level in 10% increments. For example, 50% accrual with 50% contributions, 30%:30% or 70%:70%.
- Fine tune their pension growth towards the end of the scheme year by updating their chosen accrual level when they are clearer on total earnings. For example, go from 50%:50% to 60%:60%. The updated accrual level would be higher than initial level and have retrospective effect from the start of the scheme year. Contribution arrears from the higher accrual level would be payable by the member and employer before the end of the scheme year.

Where clinicians use the flexibilities to choose a lower accrual level than the full rate, the employer will also pay lower contributions. Employers have the discretion to pay to the member unused employer contributions in these circumstances, although this would be a decision for individual employers. Unused employer contributions could be paid by nonrecurrent

<sup>60</sup> [PQ 239952, 10 April 2019](#)

<sup>61</sup> *Ibid*, para 1.21

<sup>62</sup> HMT, [NHS pensions for senior clinicians: new changes announced to improve care](#), 7 Aug 2019

lump sum at the end of the scheme year after any updating of the chosen accrual level for that year.<sup>63</sup>

The Department would also work on measures to help those affected “understand their tax liability and how these new flexibilities can be best used to support individual circumstances and preferences.” In its response to the consultation published on 23 October 2019, the BMA described the proposals as a ‘sticking plaster’ and said changes in the pension tax rules were needed.<sup>64</sup>

In Budget 2020, the Government said that proposals to offer greater pay in lieu of pensions for senior clinicians in the NHS pension scheme would not be taken forward.<sup>65</sup>

In its report on public service pensions in March 2021, the National Audit Office looked at the impact of public service pension rules on recruitment and retention. It referred to the particular operational difficulties experienced by the DHSC and the NHS resulting from some senior clinicians not wishing to continue working paid overtime because pension payments would trigger a significant tax liability. HM Treasury had said there were limits to the flexibility it could provide:

3.19 Employers told us that they have looked at options for more flexible pension arrangements. In September 2019, DHSC consulted on proposed changes to the NHS Pension Scheme that would provide greater flexibility. HM Treasury has rejected proposals for more general flexibility, although it has allowed some employers to implement more flexible arrangements in specific cases. HM Treasury told us that because pensions are relatively inflexible, it has used other approaches to recruit and retain staff – for example, introducing pension tax measures to help avoid senior clinicians reducing their overtime hours and retiring early. HM Treasury told us there are some limits to the flexibility that it can provide because of the government’s commitment to making no major changes to public service pensions for 25 years and the need for an enhanced consultation process on some elements of the schemes (such as accrual rates and normal pension age). HM Treasury also told us that, as with all other areas of policy, it must consider the short-term impact on the public finances of any proposals.<sup>66</sup>

The DHSC published its response to the consultation in February 2021. It said that most respondents took the view that providing flexibility was no substitute for tax reform:

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<sup>63</sup> [NHS Pension Scheme: increased flexibility](#), September 2019

<sup>64</sup> [‘Government pension plans threaten ‘significant’ cuts in doctors’ pay, warns BMA’](#), GP online, 24 October 2019

<sup>65</sup> HM Treasury, [Budget 2020](#), para 2.185

<sup>66</sup> NAO, [Public service pensions](#), HC 1242 2019-21, 19 March 2021, para 3.19

The British Medical Association (BMA) did not consider it possible for the impact of pension tax legislation to be resolved by changes to an individual pension scheme. They concluded that even the most appropriate and creative flexibilities would only be a workaround in the absence of tax reform. The NHS Pension Board offered similar views, recognising that the proposals were driven primarily by the impact of tax laws rather than being particularly matters of scheme design. The Royal College of Nursing welcomed an announcement by the Treasury to review the operation of the taper, concluding that reforming the tax system is a more effective approach to addressing the impact on NHS services. The Royal College of General Practitioners agreed with this view, suggesting that flexibility in the NHS Pension Scheme would not be needed if not for the consequences of features of the wider pension tax system.<sup>67</sup>

In its response to the consultation in February 2021, the DHSC said that the majority of consultation responses had “argued that tax reform would be the simplest way of solving the issue of senior clinicians limiting their NHS work for fear of large unexpected annual allowance charges.” It confirmed that it would not be proceeding with proposals for increased flexibility in NHS Pensions. This was because changes to the tapered annual allowance in *FA 2020* had achieved “the same intended policy aim as the proposed flexibilities but without the additional complexity that the latter would introduce.” It would concentrate on improving information about the interaction of the pension scheme and the pension tax rules:

Where individuals breach their annual allowance, the Scheme Pays facility provides a proportionate way of meeting the charge without needing to find funds up front. Analysis by the Government Actuary's Department shows that at retirement the Scheme Pays deduction is expected to be a relatively small proportion of the pension growth achieved that year. It may therefore be considered a sound financial decision to incur an annual allowance charge and use Scheme Pays, because the pension accrued that year once the deduction is applied still represents a good return on the contributions made. Members are encouraged to seek regulated finance advice to explore their tax position and make informed choices about their pension. It will therefore be important to improve the transparency of the Scheme Pays facility so that members can see the interaction with their benefits.<sup>68</sup>

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<sup>67</sup> DHSC, [NHS Pension Scheme: Pension flexibility: response to consultation, Feb 2021](#)

<sup>68</sup> Ibid

## 3

## Freezing of the LTA until April 2026

In the March 2020 Budget, the Government said the Lifetime Allowance would be frozen at its current level of £1,073,100 until April 2026.<sup>69</sup>

The BMA said this was “going to push doctors out of the NHS”:

Unlike in the private sector, doctors’ only real mechanism to avoid tax bills running in to the tens of thousands of pounds, as a result of taking on extra work, was to reduce their working commitments or to leave the profession. We know that the lifetime allowance is a potent driver of early retirement. Our survey ahead of the Budget asked what impact a freeze on the level of the lifetime allowance would have on their retirement plans and work patterns. 72% of doctors said that they are likely to retire even earlier as a result of the lifetime allowance being frozen. In addition, 61% of doctors said they would reduce their hours and over 40% indicated they would give up additional roles and responsibilities within the NHS as a result of these changes.<sup>70</sup>

The Review Body on Doctors’ and Dentists’ Remuneration also expressed concern about “the potential for issues of retention for the most senior doctors to be exacerbated by changes to the pensions taxation system, most recently the freezing of the Lifetime Allowance until 2025-26.” It expected the Government and employers to “explain how they anticipate this and other changes to the pensions system to affect retention and what can be done to address this and help to improve retention amongst the medical and dental workforces.” One option, already used at times in Scotland and some NHS Trusts in England, was “the practice of ‘recycling’ – paying unused employer contribution as salary to those who opt out of the NHS Pension Scheme as a result of having reached the annual or lifetime allowance.” Better information and advice to support decision-making was also needed.<sup>71</sup>

The impact on retention of senior public servants was raised by Liberal Democrat Peer, Baroness Kramer, when the Finance Bill was before Parliament.<sup>72</sup> For the Government, Lord Agnew said that “maintaining the pensions lifetime allowance at current levels affects only those with the largest pensions—those worth more than £1 million.”<sup>73</sup>

<sup>69</sup> HM Treasury, [Budget 2021](#), March 2021, para 2.67

<sup>70</sup> BMA, [Impact of freezing the Lifetime Allowance on the NHS workforce](#), March 2021

<sup>71</sup> *Ibid*, para 4.86

<sup>72</sup> [HL Deb 8 June 2021 c1396](#)

<sup>73</sup> *Ibid* c1367

In response to PQs, Ministers have pointed to the cost of pension tax relief:

Pensions tax relief is one of the most expensive reliefs in the personal tax system. In 2017-18 income tax and employer National Insurance Contributions reliefs cost £54 billion, with around 60 per cent going to higher and additional rate taxpayers. 92% of individuals approaching retirement over the next 5 years will have a pension below the lifetime allowance and so will not be affected by this change.<sup>74</sup>

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<sup>74</sup> [PQ835, 18 May 2021](#)

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## 4

# Calls for further pension tax reform

In a report in October 2019, the Office of Tax Simplification (OTS) published its report on [Taxation and Life Events](#), looking at ways to improve people's experience of the tax system at key events in their lives. It suggested removing the application of the Annual Allowance from defined benefit pension schemes (such as the NHS scheme):

3.73 The Lifetime Allowance Charge and the Annual Allowance Charge can present significant complexities for pension savers in different circumstances, and in either DB or DC schemes.

3.74 Given the policy aim of limiting the overall amount of pensions savings tax relief available to any one individual, applying both the AA and LTA charges to pensions may be unnecessary.

3.75 One possibility would be for the AA to apply in relation to DC schemes and the LTA in relation to DB schemes, reflecting the most natural operational and administrative fit between the two approaches and the type of scheme involved.<sup>75</sup>

As discussed above, the Government made changes in the [Finance Act 2020](#) to mitigate the impact of the tapered AA. Although these changes were welcomed by stakeholders, they argued that more needed to be done. The BMA argued that the Government should have gone further and removed the AA from defined benefit schemes altogether:

We believe that the annual allowance is unsuited to defined benefit schemes such as the NHS. Many doctors with incomes far below the new threshold income will face tax bills as a result of exceeding the standard annual allowance which remains at £40,000. This can happen simply following a modest rise in pensionable pay, for example when receiving a pay increment, taking on a leadership role or being recognised for clinical excellence. In addition, there is no change to the Lifetime Allowance and many doctors will still need to consider taking early retirement. Furthermore, there remains an essential requirement to speed up the delivery of information to GPs about their annual pension contributions.

Raising the level of the threshold income for all workers, including those in the private sector, will ultimately prove more costly to the Treasury than the BMA's proposed solution of removing the annual allowance from defined benefit pension schemes, a proposal also

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<sup>75</sup> Office of Tax Simplification, [Taxation and Life Events](#), October 2019 and para 3.57

suggested by the Government’s own independent advisors, the Office of Tax Simplification. However, the fact that Government has committed to significant taxation reform demonstrates that our campaigning on behalf of members has been effective and will help the majority of doctors.<sup>76</sup>

Industry commentators agreed that more was needed. The ABI said that “further tinkering with pensions tax relief is not a long-term solution. The system needs fundamental reform.”<sup>77</sup>

The Review Body on Doctors’ and Dentists’ Remuneration’s 2021 report said:

4.31 The BMA said that repeated surveys had demonstrated that pensions taxation was one of the major factors causing doctors to either retire early or reduce their hours, and that the current taxation system was unfair and punitive to doctors working in the NHS. They said that the pension taxation system must be urgently reformed to avoid the NHS further feeling the consequences, and that whilst the changes announced in March 2020 offered some mitigation, the fundamental problems remained. They said that the decision to freeze the lifetime allowance until 2025-26 would exacerbate the already precarious workforce situation, and that the age discrimination remedy proposed by the government added a further layer of complexity to an already complicated pension scheme.<sup>78</sup>

This is not just an issue in the NHS. In its 2021 report, the Review Body on Senior Salaries<sup>79</sup> recommended making better advice available and considering flexibility for employees to take some of their remuneration as non-pensionable pay. It noted, for example, that “nearly all members of the senior military will still incur breaches of the lifetime allowance.”<sup>80</sup>

## 4.1

### The option of a tax un-registered scheme

The BMA has called for the same approach to be taken for senior NHS staff as has been taken for judges, who are to be offered a tax-unregistered scheme:

An exemption to the punitive effects of pension taxation was agreed by the Government in February for the judiciary, by introducing a tax-unregistered scheme. An unregistered defined benefit pensions scheme is one where the member does not receive tax relief on their contributions, and therefore in exchange these benefits are not

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<sup>76</sup> [BMA says Government has ‘finally listened’ to months of lobbying to fix pension taxation crisis and improve patient care, 11 March 2020](#)

<sup>77</sup> [ABI responds to Budget 2020](#), March 2020; [Budget 2020](#), Professional Adviser, March 2020

<sup>78</sup> [Review Body on Doctors’ and Dentists’ Remuneration](#), Forty-Ninth Report 2021, CP 479, July 2021; [NHS in midst of workforce shortfall, BMA, 12 July 2021](#)

<sup>79</sup> Remit group includes senior civil service (SCS), the senior military and the judiciary

<sup>80</sup> [Forty-third annual report on senior salaries](#), CP 494, July 2021

tested against the annual or lifetime allowance. This scheme was introduced for the judiciary as they faced very similar issues with recruitment and retention to doctors, and the BMA firmly believes that the government should offer a similar tax unregistered defined benefit pension scheme for those affected in the NHS.

This view was supported by our member survey which showed that 77% of doctors responding would be less likely to leave the NHS if they were exempt from the impact of the lifetime allowance, and 73% said if offered a similar scheme to the judiciary they would be more likely to work for more years than previously planned.<sup>81</sup>

The position with judges is that the 1981 and 1993 judges' pension schemes were tax-unregistered. This means that contributions to the scheme do not attract tax relief and that the annual and lifetime allowances do not apply.<sup>82</sup>

However, the new scheme introduced in 2015 under the [Public Service Pensions Act 2013](#) was not. Under transitional protection arrangements in the Act, those judges 'closest to retirement' in April 2012 were allowed to remain in the legacy schemes, whereas younger members were transferred to the reform scheme.<sup>83</sup> In January 2017, the Employment Tribunal held in [McCloud v Ministry of Justice](#) that the transitional arrangements for the introduction of NJPS 2015 constituted unlawful discrimination. The tax-registered status of the reform was a key issue.<sup>84</sup> In December 2018, the [Court of Appeal](#) held that the transitional protections for both judges and firefighters were unlawfully discriminatory on grounds of age.<sup>85</sup> Having been denied leave to appeal, the Government accepted that the discrimination would need to be remedied across public service pension schemes.<sup>86</sup>

In relation to the judges, the Government intends to:

- Introduce a new pension scheme for future service from April 2022 that will not be tax un-registered.<sup>87</sup>
- Those judges within scope of the McCloud remedy will be given the option, once the new scheme has been introduced, of whether to have built up benefits in either the 2015 scheme or one of the legacy schemes between April 2015 and April 2022.<sup>88</sup>

In relation to the main unfunded public service pension schemes – including the NHS scheme - the Government is proposing to move all active scheme

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<sup>81</sup> BMA press release, [Lifetime allowance freeze](#), March 2021

<sup>82</sup> HL Deb 15 December 2005, cc WS151-152; For more on the background, see Library Briefing Paper SN-3308, *Judicial Pensions Bill 2005-06* (December 2005)

<sup>83</sup> [Public Service Pensions Act 2013](#), s18

<sup>84</sup> [McCloud and Others v Ministry of Justice, January 2017, para 31-2](#)

<sup>85</sup> [Lord Chancellor and Secretary of State for Justice v McCloud and Mostyn, Home Secretary and Welsh Ministers v Sargeant, 2018 EWCA Civ 2844](#)

<sup>86</sup> [HCWS 1725, 15 July 2019](#)

<sup>87</sup> MoJ, [Proposals for a reformed judicial pension scheme consultation](#), July 2020; MoJ, [A reformed judicial pension scheme. Response to consultation](#), Feb 2021

<sup>88</sup> MoJ, [Consultation on the proposed response to McCloud](#), July 2020

members to the (tax-registered) 2015 schemes in April 2022. Those within scope of the McCloud remedy, are to have the option (to be exercised at the point at which benefits come into payment) of whether to have built up benefits in the relevant reform or legacy scheme between April 2015 and April 2022.<sup>89</sup>

The BMA has argued that there are important parallels between the situation faced by judges and by many doctors:

The unfair taxation on pensions that has caused retention and recruitment issues for judges, are the very same taxes that are having a terrible impact on the NHS with doctors having to reduce the work they do for patients or retire early, despite doctors wanting to provide more care for patients,' he said.

Given the very similar problems faced by doctors to those in the judiciary, it is only correct that the Government look to provide doctors with a long-term solution to enable them to care for their patients without detriment.<sup>90</sup>

The Government's view is that the circumstances of the judiciary are unique:

The unique circumstances of judiciary appointments mean that it is necessary to reform their pension arrangements. Judges are not able to work in private practice after taking up office, and many judges take a significant pay cut to join the judiciary. The combination of these factors is why the Government is committed to introduce a reformed judicial pension scheme. Such a scheme would not benefit the vast majority of NHS staff, as members would receive no tax relief on their contributions.<sup>91</sup>

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<sup>89</sup> HM Treasury, [Public service pension schemes: changes to the transitional arrangements to the 2015 schemes. Government response to consultation](#), Feb 2021

<sup>90</sup> [BMA press release](#), 26 February 2021

<sup>91</sup> [PQ835, 18 May 2021](#)

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