



# Commutation

## Introduction

When you retire from the Local Government Pension Scheme (LGPS), the Pension Fund will calculate your standard benefits. Your **Standard Benefits** are made up of an **annual pension**, paid in 12 equal monthly payments and adjusted to keep up with the cost of living every year, plus an **automatic tax-free cash lump sum** if you were a member of the LGPS on or before the 31st March 2008.

If you became a member on or after 1st April 2008, you will **not** have built up an automatic tax-free cash lump sum, but you will have the option to **swap** some annual pension for a **tax-free cash lump sum** (even if you already have an automatic tax-free cash lump sum). This is called **Commutation**.

## How does it work?

For every £1 of annual pension you choose to give up, you will increase your tax-free cash lump sum by £12. HM Revenue Customs (HMRC) rules mean that most people can take up to 25% of the Capital Value of their pension benefits as a tax-free cash lump sum. This includes any automatic tax-free cash lump sum you may have if a member or before 31st March 2008. This is called your **Maximum Benefits**.

You can either choose to:

- 1) take payment of your **standard benefits** (annual pension and any automatic tax-free cash lump sum); or
- 2) take payment of your **maximum benefits** (lower annual pension and highest amount of tax-free cash available, including any automatic tax-free cash lump sum); or
- 3) choose to give up an amount of annual pension, which is in between your standard and maximum benefits.

## What if I had paid Additional Voluntary Contributions (AVC), Additional Pension Contributions (APC), Additional Regular Contributions (ARC), or bought added years?

If you paid into an AVC using the Pension Fund's in-house AVC provider(s), the value of your AVC pot will be included when calculating the Capital Value of your LGPS benefits.

If you bought extra pension through an APC / ARC arrangement or added years, these will be included in the calculation of your standard annual pension.

## How is the Capital Value of your LGPS benefits calculated?

The Capital Value of your LGPS benefits is calculated using the following steps:

### Example

When Gareth retires, his **Standard Benefit** and **Maximum Benefit** choices are:

Option 1 - Standard Benefits	
Annual Pension:	£10,000
Automatic Lump Sum:	£24,000

Option 2 - Maximum Benefits	
Lower Annual Pension:	£7,714.29
Maximum Lump Sum:	£51,428.57

### **Step 1**

#### **Calculating the Capital Value of LGPS Benefits**

120 x Annual Pension + 10 x Automatic Lump Sum (if any) ÷ 7 =  
Capital Value of LGPS Benefits

$$120 \times \text{£}10,000 + 10 \times \text{£}24,000 \div 7 = \text{£}205,714.28$$

The Capital Value of Gareth's LGPS Benefits is **£205,714.28**

### **Step 2**

#### **Calculating the Maximum tax-free cash lump sum**

Capital Value x 25% = Maximum tax-free Lump Sum

$$\text{£}205,714.28 \times 25\% = \text{£}51,428.57$$

Gareth's Maximum Lump Sum is **£51,428.57**

### **Step 3**

#### **Reducing Annual Pension for Maximum tax-free cash lump sum**

Maximum tax-free cash lump sum – Automatic tax-free cash lump sum ÷  
12 = Annual Pension swapped for Maximum Lump Sum\*

Annual Pension – Annual Pension swapped = Lower Annual Pension

$$\text{£}51,428.57 - \text{£}24,000 \div 12 = \text{£}2,285.71$$

$$\text{£}10,000 - \text{£}2,285.71 = \text{£}7,714.29$$

Gareth's Lower Annual Pension is **£7,714.29**

*\*(Rate £12 lump sum for £1 of Annual Pension)*

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However, Gareth can choose **Option 3**, where he would choose to give up an amount of annual pension, which is in between Option 1 and Option 2 i.e., his standard benefits and maximum benefits.

This could be a tax-free cash lump sum between £24,000 and £51,428.57, with a proportionately lower annual pension due to the swap.

### **When do I choose my tax-free cash lump sum?**

The Pension Fund will send you a retirement pack which you need to complete before your pension can be paid to you. This will include your standard and maximum benefit figures. You need to make your choice about your tax-free cash lump sum before your LGPS benefits can be paid to you. Remember, when you have made your choice it cannot be changed once your LGPS benefits are paid to you.

If you want to choose an amount in between the standard and maximum benefits, you should contact the Pension Fund to discuss your choice.

### **Will my Survivors' Benefits be reduced?**

If you choose to swap some of your annual pension for an extra tax-free cash lump sum, it will not reduce any Survivors' Benefits paid to your spouse, civil partner, co-habiting partner, or any eligible children when you die.

The Pension Fund is unable to provide you with any financial advice, therefore please consider seeking Independent Financial Advice when you retire to ensure that the most appropriate option is taken.

## Can I take all my in-house AVC pot as tax-free cash?

You may be able to take all your in-house AVC pot as tax-free cash in the LGPS, alongside your main LGPS benefits when you retire. This will depend on whether doing so will take you over the Lifetime Allowance limits set by HMRC.

You will be able to take all your in-house AVC pot as tax-free cash in the LGPS, if your in-house AVC pot, when added to any lump sum taken from your main LGPS benefits, does not:

- go over 25% of the Capital Value of your LGPS benefits.
- take you over 25% of the Lifetime Allowance limit of £1,073,100 (2021/22). For 2021/22, the maximum tax-free cash amount is set at £268,275.
- take you over 25% of your remaining Lifetime allowance if you have previously taken payment of any pension benefits (**not just in the LGPS**).

### Example

When he retires, Gareth also has an in-house **AVC pot** of £27,000, which he wants to take as tax-free cash, if possible.

To assess if this is possible, the **Capital Value** of his benefits would need to be recalculated to find out his new maximum tax-free cash lump sum.

#### Step 1

#### Calculating the Capital Value of LGPS Benefits

$120 \times \text{Annual Pension} + 10 \times \text{Automatic Lump Sum (if any)} + 10 \times \text{in-house AVC pot} \div 7 = \text{Capital Value of LGPS Benefits}$

$120 \times £10,000 + 10 \times £24,000 + 10 \times £27,000 \div 7 = £244,285.71$

The Capital Value of Gareth's LGPS Benefits and his in-house AVC pot is **£244,285.71**.

## **Step 2**

### **Calculating the Maximum tax-free cash lump sum**

Capital Value x 25% = Maximum tax-free Lump Sum

£244,285.71 x 25% = £61,071.42

Gareth's Maximum tax-free Lump Sum is **£61,071.42**.

## **Step 3**

### **Reducing Annual Pension for Maximum tax-free cash lump sum**

Maximum tax-free cash lump sum -

Automatic tax-free cash lump sum -

In-house AVC pot ÷ 12 =

Annual Pension swapped for Maximum Lump Sum

Annual Pension - Annual Pension swapped = Lower Annual Pension

£61,071.42 - £24,000 - £27,000 ÷ 12 = £839.28

£10,000 - £839.28 = £9,160.72

Gareth's Lower Annual Pension is **£9,160.72**.

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Gareth's retirement options with his in-house AVC pot would be:

<b>OPTION 1 - Standard Benefits</b>	
<b>Annual Pension:</b>	£10,000
<b>Tax-free cash Lump Sum</b> (automatic lump sum of £24,000 + in-house AVC pot of £27,000)	£51,000*
*Gareth can choose to take the combined value of his automatic lump sum and in-house AVC pot as tax-free cash, as it is less than his maximum tax-free cash lump sum option of £61,071.42.	

<b>OPTION 2 - Maximum Benefits</b>	
<b>Annual Pension:</b> (standard annual pension of £10,000 - annual pension swapped of £839.28)	£9,160.72
<b>Maximum tax-free cash Lump Sum</b> (automatic lump sum of £24,000 + in-house AVC pot of £27,000 + scheme commutation of £10,071.42)	£61,071.42**
**To take the maximum tax-free cash lump sum, Gareth will need to lower his annual pension by £839.28 to generate the extra tax-free cash of £10,071.42, which is the difference between the tax-free cash available under Option 1 (standard benefits) and this option.	

Plus, Gareth would still be able to choose Option 3, instead of Option 1 or 2.

### What if my in-house AVC pot is too much to take it all as tax-free cash?

Sometimes, a member's in-house AVC pot may be so much in value that when added to any automatic lump sum, it is more than their allowable maximum tax-free cash lump sum. In this case, the amount of their maximum tax-free cash lump sum can be taken as tax-free cash, but the rest then must be used to buy extra pension in the LGPS or buy an annuity with another provider.

#### Example

If, on retirement, Gareth had an in-house AVC pot of £45,000 and an automatic lump sum of £24,000 ( $£45,000 + £24,000 = £69,000$ ), he would not be able to take it all back as tax-free cash, as his maximum tax-free cash lump sum allowance would be **£67,500**, which means there would be an excess of **£1,500** ( $£69,000 - £67,500 = £1,500$ ).

Note that Gareth retires on his 67th birthday, which is his Normal Pension Age (NPA) under the LGPS, and he started his in-house AVC pot before 1st April 2014.

### **Step 1**

#### **Calculating the Capital Value of LGPS Benefits**

120 x Annual Pension + 10 x Automatic Lump Sum (if any) +  
10 x in-house AVC pot ÷ 7 = Capital Value of LGPS Benefits

120 x £10,000 + 10 x £24,000 + 10 x £45,000 ÷ 7 = £270,000

The Capital Value of Gareth's LGPS Benefits and his in-house AVC pot is **£270,000**.

### **Step 2**

#### **Calculating the Maximum tax-free cash lump sum**

Capital Value x 25% = Maximum tax-free Lump Sum

£270,000 x 25% = £67,500

Gareth's Maximum tax-free Lump Sum is **£67,500**

### **Step 3**

#### **Reducing Annual Pension for Maximum tax-free cash lump sum**

As Gareth's in-house AVC pot (£45,000), when added to his automatic lump sum (£24,000) is £69,000 in total, there is no reduction to be made to his standard annual pension of £10,000, as his maximum tax-free cash lump sum (£67,500) has been exceeded.

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Gareth's retirement options after using the excess of his in-house AVC pot (£1,500) to buy extra LGPS pension would be:

<b>OPTION 2 - Maximum Benefits</b>	
<b>Annual Pension:</b> (standard annual pension of £10,000 + added annual pension of £88.05, bought from the excess of his in-house AVC)***	£10,088.05
<b>Maximum tax-free cash Lump Sum</b> (automatic lump sum of £24,000 + £43,500, which is the balance of Gareth's in-house AVC pot to the maximum tax-free cash lump sum allowance)	£67,500
<p>***The excess of Gareth's in-house AVC pot (£1,500) has been used to buy £88.05 of extra annual pension, which is then added to his standard annual pension (£10,000).</p> <p>The added annual pension has been calculated by using guidance published by the Government Actuary's Department (GAD), which is reviewed from time to time. The relevant factor is dependent on a member's age and whether they decide that the added pension bought is to benefit their survivor's following their death.</p> <p>In this example, it has been assumed that Gareth does <b>not</b> want the added pension bought to benefit his survivor's benefits.</p> <p>The equation is:</p> <p>In-house AVC pot excess ÷ 100 x GAD factor = added annual pension</p> <p>£15,000 ÷ 100 x 5.87 = <b>£88.05</b> added annual pension</p>	

**Please Note**

The Pension Fund will inform a member at the earliest opportunity if there is an excess to their in-house AVC pot and the options available to them, to avoid any unnecessary delay to the payment of your benefits.

## Where can you find more Information?

This factsheet gives general guidance only, if you need further information, please contact the Gwynedd Pension Fund:

Tel: 01286 679982

Email: [pensions@gwynedd.llyw.cymru](mailto:pensions@gwynedd.llyw.cymru)

## Disclaimer

The Pension Fund is unable to provide any financial advice. After reading this factsheet, you may want to seek independent financial advice to make an informed decision.

These bodies may be able to help you:

Unbiased: <https://unbiased.co.uk/>

Money Helper: [Choosing a financial adviser \(moneyhelper.org.uk\)](http://moneyhelper.org.uk)