WIRRAL COUNCIL

PENSIONS COMMITTEE

20 NOVEMBER 2012

SUBJECT:	**ANNUAL ALLOWANCE TAX CHARGE AND SCHEME PAYS PROCESS**
WARDS AFFECTED:	**ALL**
REPORT OF:	**INTERIM DIRECTOR OF FINANCE**
RESPONSIBLE PORTFOLIO HOLDER:	
KEY DECISION	NO

1.0 EXECUTIVE SUMMARY

1.1 This report seeks Members approval of Merseyside Pension Fund's proposed policy under HM Revenue & Customs (HMRC) Annual Allowance Scheme Pays Process.

2.0 BACKGROUND AND KEY ISSUES

The Annual Allowance and Revised Tax Legislation

2.1 The Local Government Pension Scheme is a tax registered defined benefit scheme, and as such, members' pension contributions are deducted before tax and lump sums paid on retirement are tax free. Prior to April 2006, HMRC placed limits on pension benefits that were tax relievable and contributions within the LGPS were limited to 15% with a two thirds limit on pension benefits based on pensionable pay.

2.2 HMRC tax simplification legislation with effect from 6 April 2006 replaced the above limit on contributions with the Annual Allowance (AA) which was initially set at £215,000 and introduced a prescriptive methodology to value defined benefit pension growth.

2.3 The AA is the amount by which the value of a person's overall pension savings may increase (the Pension Input Amount) in any one year (the Pension Input Period) without having to pay a tax charge. Pension Input Periods in the LGPS run from 1 April to 31 March. This facilitated a significant increase in tax relieved pension contributions and pension growth that a person could achieve each year.

2.4 The taxation legislation was amended with effect from 6 April 2011 reducing the AA from £255,000 to £50,000 and revised the method for valuing pension benefits on a more stringent basis to ensure pension tax remained fair, affordable and sustainable.

2.5 As a result of this substantial reduction, it is expected that there will be many more people with significant membership who receive pay increases in the region of £10,000, whose benefit accrual could exceed the AA subjecting them to a tax charge.

2.6 To reduce the likelihood of tax charges, the legislation contains transitional provisions – if a person's pension growth for any year is less than £50,000, the unused element can be carried forward for up to three years from 2008/9 to 2010/11.

Administration Requirements - Pension Saving Statements

2.7 Where the aggregate of a member's pension saving in respect of all their arrangements in a given scheme exceeds the annual allowance, the scheme administrator must provide the member, within six months of the end of the tax year (i.e. by 6 October) a pension saving statement showing;

- ❖ the member's pension growth known or pension input amount for the relevant pension input period and the previous three periods, if known by the scheme;
- ❖ the annual allowance for the tax year in which the relevant pension input period ends and for the previous three periods.

Scheme Pays

2.8 Whilst the Government is committed to restricting tax relief on pension savings, there has been a facility introduced to assist individuals who face tax charges for exceeding the AA. This facility is called the 'Scheme Pays' option and permits the member to elect that the pension scheme meets their tax liability in return for a reduction in pension benefits – as opposed to meeting the tax charge from their current income.

2.9 The reduction of scheme benefits does not impact on contingent survivor benefits. The tax charge can be met from a member's AVC pot if there is sufficient value in the AVC fund.

2.10 The Local Government Pension Scheme (Miscellaneous) Regulations 2012 made provision to allow Funds to pay the tax charge and for the reduction in accrued pension rights to be calculated in accordance with guidance issued by the Secretary of State. The relevant guidance was issued on 6 September 2012.

2.11 It is compulsory for all registered schemes to offer "Scheme Pays"; however, the facility has both a mandatory and voluntary element.

Mandatory Scheme Pays

2.12 The compulsory criteria for the LGPS to offer the facility at the request of any member for any tax year from 2011/12 is as follows;:

- ❖ The pension saving within the year running from 1 April to 31 March exceeds £50,000; and
- ❖ The total tax charges for the member from all schemes exceeds £2,000 for the tax year

The legislation does not provide for the Fund to charge for the calculation and administration work involved in operating the Scheme Pays Option on the basis that it would appear inappropriate if a mechanism designed to help individuals manage the charge would actually increase their overall financial outlay.

Voluntary Scheme Pays

2.13 Individuals with an annual allowance charge of more than £2,000, who have exceeded the annual allowance by virtue of savings across multiple pension schemes, without exceeding it in any one scheme, will be able to request that one of their schemes operates this facility. However, no scheme will be compelled to do so.

Joint and Several Liability

2.14 When a member makes an election requiring the pension scheme to pay the AA charge the scheme and the member will become jointly liable for the tax charge. The scheme must pay the tax but the member will have to report the amount of tax that the scheme will pay on their Self Assessment Tax return. Joint and Several Liability will not apply if the scheme agrees to pay the tax voluntarily and HMRC can not require the scheme to make payment of any unpaid tax.

Annual Allowance Tax Charge

2.15 The tax charge for exceeding the annual allowance is based on the member’s rate of marginal income tax. The excess over the annual allowance is classed as income and the charge is the income tax that would be due on that income.

Timeline to invoke Scheme Pays Process

2.16 To prevent individuals from delaying engagement with their schemes and to ensure schemes can comply with deadlines for payment of the tax charge, members will be required to make their irrevocable election for the Fund to pay by 31 July following the relevant Self Assessment filing deadline.

In the first year of this new tax regime the deadline for individuals to make an irrevocable election will be extended to 31 December 2013. The complete timeline to invoke the election in respect of Scheme Pays is attached as Appendix 1.

2.17 When the Fund is required to pay an AA charge liability for a particular tax year the deadline for paying the tax is the second February that follows the end of the tax year to which the liability relates. For example, a liability relating to the 2012-13 tax year, payment must be remitted by 14 February 2015.

2.18 It is the member’s responsibility to ensure that the amount of the tax charge is correctly calculated as the Fund will not be in a position to calculate the tax liability given the scheme is not aware of a member’s total income and income tax position.

3.0 RELEVANT RISKS

3.1 If the Fund agrees to exercise Scheme Pays on a voluntary basis it could compromise the Fund’s ability to demonstrate diligent governance in its fiduciary duty - by reducing cash flows in meeting tax charges relating to non LGPS related pension savings.

3.2 Exercising the voluntary element would also introduce a risk in regard to member disclosure of correct tax charges related to other schemes. If a member does not advise the Fund of the correct tax charge payable, the member’s benefits in payment would be reduced to cover the additional tax. The pension payments would then be classed as unauthorised payments and both the member and the Fund would be subject to a surcharge of at least 40% on all future pension payments.

3.3 Conversely, the reduction of a member’s pension entitlement to meet tax charges also reduces ongoing pension liabilities in relation to that individual. Therefore the ‘Scheme Pays’ provision can assist moderately in the risk management of the Fund.

4.0 OTHER OPTIONS CONSIDERED

4.1 The Option to invoke voluntary options has been considered.

5.0 CONSULTATION

5.1 There has been no consultation undertaken or proposed for this report.

6.0 IMPLICATIONS FOR VOLUNTARY, COMMUNITY AND FAITH GROUPS

6.1 There are none arising from this report.

7.0 RESOURCE IMPLICATIONS: FINANCIAL; IT; STAFFING; AND ASSETS

7.1 The Fund will be required to pay tax charges to HMRC on an annual basis for some members and will not realise the financial benefit for a significant period - until the member is entitled to receipt of the reduced pension.

7.2 Scheme Pays is likely to be attractive to many members who are subject to the AA tax charge as the reduction in benefits is taken out of gross funds rather than net income if the tax is paid by the individual through self assessment.

7.3 The option to invoke Scheme Pays and the resultant reduction to benefits can have a substantial impact on a member’s net benefits.

7.4 Staffing resources will be required to ensure the necessary administrative and controls are in place to develop the overall process, specifically the calculation of the benefit reductions and the engagement with members in communicating the impact of any reduction in benefits.

7.5 Officers will be monitoring staff resources, and the number of 'pension saving statements' that the Fund must produce for members who exceed the reduced AA.

8.0 LEGAL IMPLICATIONS

8.1 There are none arising from this report.

9.0 EQUALITIES IMPLICATIONS

9.1 Has the potential impact of your proposal(s) been reviewed with regard to equality?

The Scheme Pays provision has already been assessed by Government with regard to equality.

10.0 CARBON REDUCTION IMPLICATIONS

10.1 None arising from this report

11.0 PLANNING AND COMMUNITY SAFETY IMPLICATIONS

11.1 None arising from this report

12.0 RECOMMENDATION/S

12.1 That Members agree to the officers' recommendation that the Fund should only exercise the mandatory element of 'Scheme Pays'.

To clarify, the mandatory option covers circumstances when a tax charge arises when the value of the Annual Allowance attributable to benefits accrued within the LGPS is £50,000 and the tax charge resulting is more than £2,000

Requests from individuals to meet tax charges incurred in non-LGPS related schemes should be refused.

13.0 REASON/S FOR RECOMMENDATION/S

13.1 There is a requirement for Members of the Pension Committee to be kept up to date with legislative developments to carry out their decision making role in order to enable them to make informed decisions.

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APPENDICES

1- **Timeline of Scheme Pays Process.**

REFERENCE MATERIAL
HMRC – Tax guide
SUBJECT HISTORY (last 3 years)

Council Meeting	Date

Appendix 1- Scheme Pays Timeline: The Process

Date	Action
April	• HMRC sends notice to the individual to file their tax return for the tax year just ended
April – October	• Pension scheme identifies individuals who have exceeded the AA in their Scheme for the tax year just ended • Individual requests a pension statement from their pension scheme(s) where they may not receive it automatically. (Could be at any time in the year)
October	• Pension schemes send pension statements covering the tax year just ended and the previous three years to individuals who have exceeded the AA
October onwards	• Individual establishes whether they have any pension savings in excess of the AA (after utilising any unused allowance carried forward) • Individual considers whether they want to meet the charge directly from their current income, or from their pension benefits • Individual corresponds with their scheme about making an election, schemes explain potential impacts on pension benefits of meeting an AA liability in this way
January	• Individual completed SA tax return and reports the amount to be met from pension benefits • Individual pays the tax charge from their current income where they do not meet the qualifying conditions or where they choose not to make an election
January onwards	• Individual notifies the scheme that they have opted to meet their AA liability form their pension benefits (if they have not already done so) • Scheme processes the election, and individual confirms they wish to proceed • Scheme works out the offsetting adjustment to the individual's pension benefits • Scheme informs the member about the impact on their future pension benefits
31st July	• Deadline for individual to make the irrevocable election
By December* **	• Scheme reports the tax to be paid to HMRC on the Accounting for Tax return • Scheme pays the tax to HMRC via the Accounting for Tax system (45 days allowed – up to mid-February)
After January	• HMRC compliance checks to mach elections with scheme payments • If no payment by the scheme due to no election, charge reverts to the individual and HMRC sends a demand for late paid tax

* In the first year of the regime these figures may be based on estimates
** This deadline will be extended to 31st December 2013 in the first year for the regime
*** This deadline will be extended to the Accounting for Tax return quarter ending on 31st March 2014 in the first year of the regime