# WIRRAL COUNCIL

## PENSION COMMITTEE

## 22 JANUARY 2018

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| **SUBJECT:** | **LGPS UPDATE**<br>**[ SCHEME PAYS POLICY ]** |
| **WARD/S AFFECTED:** | **NONE** |
| **REPORT OF:** | **DIRECTOR OF PENSIONS** |
| **KEY DECISION?** | **NO** |

### 1.0 EXECUTIVE SUMMARY

1.1 This report reviews Merseyside Pension Fund's current policy concerning the provision of scheme pays for scheme members who breach HMRC's Annual Allowance limit for pension saving growth; thereby incurring a tax charge.

1.2 The Fund's current policy was approved by Members at the Pension Committee meeting dated 20 November 2012 (minute 44 refers) and limits the requirement for the Fund to meet member tax charges in circumstances of mandatory scheme pays. It is recommended that this policy is maintained subject to the transitional arrangements detailed in the report.

### 2.0 BACKGROUND AND KEY ISSUES

2.1 Under the current HMRC tax regime, individuals have a pension Annual Allowance (AA) which is the maximum amount that the value of retirement savings can increase in a year (6 April to 5 April) without incurring tax charges.

2.2 The AA limit was reduced in April 2014 from £50,000 to £40,000. If an individual's annual allowance Pension Growth in any one year (including pension savings outside of the LGPS) is greater than the annual allowance limit, the excess will be subject to the marginal rate of income tax.

2.3 Members are most likely to be affected if they have an LGPS pension based on their final salary, and they receive a significant pay rise, or pay a high level of additional voluntary contributions.

**Tapered Annual Allowance for Higher Earners**

2.4 In the 2016/17 tax year, HMRC amended the AA rules to introduce a tapering effect; such that those members with high levels of income now have a reduced AA.

2.5 This tapering only affects employees who have 'Adjusted Income' in excess of £150,000 per annum.

'Adjusted Income' is defined as pension growth plus their taxable income from other sources. For example, salary, property income, savings income, dividend income, pension income, social security income (where taxable), state pension income.

2.6 The AA for any member with 'Adjusted Income' of £210,000 or above would be reduced to £10,000, and those with income between £150,000 and £210,000 would have their AA reduced by £1 for every £2 of taxable income above £150,000 as detailed in the table below;

| Adjusted Income | Annual Allowance |
|---|---|
| Up to £150,000 | £40,000 |
| £150,000 to £210,000 | £40,000 - £10,000 |
| Over £210,000 | £10,000 |

**Carry Forward of Unused Annual Allowance**

2.7 To reduce the likelihood of tax charges, there is provision within legislation for a carry forward rule in respect of unused AA from the previous three years. This means that even if the value of a member's pension savings increases by more than the AA in a year, they may not be liable to the AA tax charge by using previous unused AA.

2.8 To carry forward unused AA from an earlier year you must have been a member of a tax registered pension scheme in that year.

**Administration Requirements – Pension Saving Statements**

2.9 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 members pension growth or pension input amount for the relevant pension input period and the previous three years, if known by the scheme;

- the annual allowance ( not the tapered allowance)for the tax year in which the relevant pension input period ends and for the previous three years.

**Scheme Pays**

2.10 There are two mechanisms that can support members who are subject to tax charges due to the increase in their pension growth:

- Mandatory Scheme Pays, and;
- Voluntary Scheme Pays.

**Mandatory Scheme Pays**

2.11 Members have a mandatory right under Section 237B of the Finance Act 2004, to notify their scheme administrator that they require the scheme to pay some or all of their AA tax charge, in return for a reduction in accrued pension rights in accordance with guidance issued by the Secretary of State.

2.12 The qualifying conditions to request Mandatory Scheme Pays are as follows:

- HMRC standard AA limit has been exceeded in the pension fund; and
- the AA tax charge exceeds £2,000 and;
- the relevant time limits for making an election have been met.

For the 2016/17 tax year the election must be made by 31 July 2018.

**Voluntary Scheme Pays**

2.13 If the conditions for Mandatory Scheme Pays do not apply, or where the tax charge stems from the tapered AA, or where the nomination is made outside of the time-limit, the member may request the Fund to pay the AA tax charge on a voluntary basis.

2.14 The introduction of the Tapered Annual Allowance has resulted in a small minority of the membership base with taxable income of £150,000 or more, potentially facing a maximum annual tax charge of £13,500 as a result of their retirement savings.

2.15 If the Fund were to introduce the option of Voluntary Scheme Pays, then the member may request the Pension Fund to pay their tax bill offset against an appropriate reduction in their pension benefits.

The Fund has received a number of such requests from members subject to the tapered AA tax charge.

**Joint and Several Liabilities**

2.16 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 Fund 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 the HMRC cannot require the scheme to make payment of any unpaid tax.

**Timeline to Invoke Scheme Pays Process.**

2.17 If pension growth exceeds the Annual Allowance, the member must submit a Self-Assessment Tax Return to HMRC by 31 January following the end of the previous tax year; stating that there is an AA tax charge and it will be met by scheme pays.

- For the Tax Year 2016/17, the tax payable under Mandatory Scheme Pays must be paid by 14 February 2019.

- For the Tax Year 2016/17, the tax payable under Voluntary Scheme Pays must be paid by the Fund by 31 January 2018.

## 2.18 Possible benefit and risks in relation to Voluntary Scheme Pays

| Recruitment | Benefit | Risk |
|---|---|---|
| **Fund & Employers** | Employers may consider this could be a bargaining tool in recruiting high level management | |
| **Members** | Access to tax Defined Benefit Pension Saving with option to meet future tax liabilities via the scheme | |

| Recovery | Benefit | Risk |
|---|---|---|
| **Fund & Employers** | | The Fund is already compelled to allow scheme pays for excess above Statutory Annual Allowance.<br><br>Scheme Member can apply at any age and on multiple occasions. It will be many years before fully recovered and if member dies before pension starts no or very little recovery may occur.<br><br>Although it is a tax on a member, initially it is the Fund that makes the payment. |
| **Members** | Reduction in benefits is taken out of gross funds rather than net income if tax paid through self-assessment.<br><br>Member is allowed a deferment in paying tax with recovery not required until many years and may not be fully recovered. | The reduction in pension may exceed the tax charge due to length of time in receipt of pension. |

| Cashflow & Liabilities | Benefit | Risk |
|---|---|---|
| **Fund & Employers** | The reduction of a member's Pension entitlement to meet tax charges reduces ongoing pension liabilities and the provision can moderately assist in the risk management of the Fund. | Tax where voluntary scheme pays applies has to be made by 31 January following the relevant tax year which is over a year before that under mandatory scheme pays.<br><br>Disproportionate demand on senior staff resource to ensure the administrative processes and controls are in place to ensure timely payment of tax failure will incur late payment interest costs. |
| **Members** | Pension offsets can be beneficial when assessing Lifetime allowance | |

2.19 The Local Government Pensions Committee Secretariat have recently received legal advice from Eversheds, noting that administering authorities in England have a general power of competence under the Localism Act 2011 to agree a Voluntary Scheme Pays approach for their LGPS Fund .

2.20 It should be noted that the introduction of Voluntary Scheme Pays is at the discretion of Pension Committee rather than the individual employers within the Fund.

## 3.0 RELEVANT RISKS

3.1 The risks to the Fund/ Employers and Members are identified within section 2.18 of the main report.

## 4.0 OTHER OPTIONS CONSIDERED

4.1 Not relevant for this report.

## 5.0 CONSULTATION

5.1 Not relevant for this report

## 6.0 OUTSTANDING PREVIOUSLY APPROVED ACTIONS

6.1 None associated with the subject matter.

## 7.0 IMPLICATIONS FOR VOLUNTARY, COMMUNITY AND FAITH GROUPS

7.1 There are none arising from this report.

## 8.0 RESOURCE IMPLICATIONS: FINANCIAL; IT; STAFFING; AND ASSETS

8.1 During the work undertaken to assess the impact of the Annual Allowance during the 2016/17 tax year, it was identified that 0.04% of the membership could potentially be subject to the tapered AA and eligible to request voluntary scheme pays.

8.2 The level of senior officer resource expended at the Fund in respect of these members, when dealing with the associated HMRC tax legislation is disproportionate to the general support provided across the overall employer and membership base.

## 9.0 LEGAL IMPLICATIONS

9.1 It is not a statutory requirement for the Administering Authority to agree to Voluntary Scheme Pays and therefore a determination is required by Pension Committee.

## 10.0 EQUALITIES IMPLICATIONS

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

No equality impact assessment is required

## 11.0 CARBON REDUCTION AND ENVIRONMENTAL IMPLICATIONS

11.1 There are none arising from this report

## 12.0 PLANNING AND COMMUNITY SAFETY IMPLICATIONS

12.1 There are none arising from this report

## 13.0 RECOMMENDATION

13.1 In view of both the financial and administrative implications of the Fund permitting the use of voluntary scheme pays, it is recommended that Committee limit the opportunity to circumstances where administrative difficulties result in the member missing the Mandatory Scheme Pays deadline.

13.2 To allow members subject to the tapered Annual Allowance for tax years 2016/17 and 2017/18, to utilise Voluntary Scheme Pays as pension saving have already been accrued.

13.3 To inform future retirement planning, the Fund will communicate thereafter that those members subject to the tapered Annual Allowance from 2018/19 cannot request the Fund invoke Voluntary Scheme Pays on their behalf.

## 14.0 REASON/S FOR RECOMMENDATION/S

14.1 There is a requirement for Members of the Pension Committee to be kept up to date with legislative developments as part of their decision making role.

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