

## PENSIONS COMMITTEE

11 March 2020

<b>Title:</b> Annual Allowance Scheme Pay Policy	
<b>Report of the Chief Operating Officer</b>	
<b>Open Report</b>	<b>For Decision</b>
<b>Wards Affected:</b> None	<b>Key Decision:</b> No
<b>Report Author:</b> Justine Spring, Pensions Manager	<b>Contact Details:</b> Tel: 020 8227 2607 E-mail: <a href="mailto:Justine.Spring@lbbd.gov.uk">Justine.Spring@lbbd.gov.uk</a>
<b>Accountable Director:</b> Philip Gregory, Director of Finance	
<b>Accountable Strategic Leadership Director:</b> Claire Symonds, Chief Operating Officer	
<b>Summary</b>  This report outlines the Annual Allowance tax charge policy which the London Borough of Barking and Dagenham Pension Fund will adapt. There are two types of Scheme Pays: Mandatory and Voluntary. Members have a right to Mandatory Pay Schemes from the LBBD Pension Fund when certain criteria are met. If the Mandatory Scheme Pay criteria is not met, a member can ask the scheme to allow a Voluntary Scheme Pays election.	
<b>Recommendation(s)</b>  Members are asked to agree the funds policy to allow for a Voluntary Scheme Pays arrangement when a member is not entitled to Mandatory Scheme pays.	

### 1. Introduction and Background

- 1.1 This report outlines the Annual Allowance tax charge policy which the London Borough of Barking and Dagenham Pension Fund will adapt. The annual allowance tax is a charge which a member must pay when the annual allowance has been exceeded in a tax year. The Pension Scheme is required to pay this charge for members if a certain criterion is met in return for a reduced benefit. If the criteria are not fully met, the fund may still pay the tax charge for the member under a voluntary scheme pays arrangement.

## **2. Mandatory Scheme Pays**

2.1 Where a member has a tax charge as a result of breaching the Annual Allowance, they have a right to Mandatory Scheme Pays from the LBBB Pension Fund when all the following criteria are met:

- The member's Annual Allowance tax charge exceeds £2,000.
- The member has a Pension Input Amount within the LGPS in England and Wales exceeding the standard Annual Allowance (currently £40,000).
- An irrevocable election for Mandatory Scheme Pays is made by 31 July in the year following that in which the tax charge arose (i.e. for a tax charge arising from the 2019/20 year the mandatory Scheme Pays election must be made by 31 July 2021) or before they retire, if earlier.
- The member's full retirement benefits from the Fund are not yet in payment.

2.2 Although the LGPS is administered by 89 funds across England and Wales, it is considered one scheme by HMRC and therefore, when assessing pension input in the LGPS, members must take into account ALL benefits they hold in different funds in the LGPS across England and Wales. The LGPS in Scotland, and the LGPS in Northern Ireland, are considered separate schemes by HMRC.

2.3 Where a member meets all of the above criteria the LBBB Pension Fund must pay the tax to HMRC on the member's behalf when requested and must notify the member of the resulting reduction to their benefits. The Fund is not allowed to levy an administration charge for Mandatory Scheme Pays elections.

2.4 A member does not need to ask the Fund to pay the full tax charge – the member can request that a lower amount is covered by Mandatory Scheme Pays and would have to make their own arrangements to pay the remaining tax charge to HMRC.

2.5 For Mandatory Scheme Pays, the member must indicate to HMRC that they will be using Mandatory Scheme Pays on their self-assessment tax return by 31 January in the year following that in which the tax charge arose, but the election to the Fund does not have to be made until 31 July, six months later, and the Fund then has until the following 14 February to pay the tax.

## **3. Voluntary Scheme Pays**

3.1 The list below shows some potential situations in which a member may have incurred a tax charge but does not have an entitlement to Mandatory Scheme Pays. In these situations, the member can ask the scheme to allow a Voluntary Scheme Pays election, but the scheme does not have to agree. This list is not intended to be exhaustive:

- The member is subject to the Tapered Annual Allowance and their Pension Input Amount in the LGPS exceeds their Tapered Annual Allowance but does not exceed the Standard Annual Allowance (See example below).

- The member met all the other criteria for a Mandatory Scheme Pays election but did not make the election by the 31 July deadline.
- The member has not exceeded the Annual Allowance based on their pension benefits in the LGPS in England and Wales, but in aggregate across all pension arrangements they have exceeded the Annual Allowance and the member's total tax charge when taking input from other arrangements into account is more than £2,000.
- The member has a Mandatory Scheme Pays right in respect of pension input in the LGPS in England and Wales, but also has a tax charge relating to input in a separate pension arrangement and wants to use Voluntary Scheme Pays from the Fund to cover this as well.
- The member's tax charge is less than £2,000. There is no time limit set in the legislation for an election for Voluntary Scheme Pays (if permitted), but members should note that if the tax is not paid by 31 January in the year following the year in which the tax charge arises (i.e. 31 January 2020 for a tax charge arising in the 2018/19 year) interest and late payment penalties will be due. Interest and late payment penalties do not apply for tax charges that are settled by Mandatory Scheme Pays, assuming the member provides the appropriate notifications to HMRC via self-assessment or otherwise, because in this circumstance the member and the Administering Authority are jointly and severally liable for the payment of the tax charge, whereas the member remains solely liable for any tax due that is not covered by Mandatory Scheme Pays.

#### **4. Tapered Annual Allowance Examples**

- 4.1 Member's Pension Input Amount is £60,000 and they are subject to a Tapered Annual Allowance of £10,000. The tax charge will be £20,000 assuming they are a 40% taxpayer and have no carry-forward available. Mandatory Scheme Pays only applies to £8,000 of that tax charge (in respect of the input in excess of £40,000). The remaining £12,000 of the tax charge would need to be settled by the member directly with HMRC, unless a Voluntary Scheme Pays arrangement is agreed with the Fund.
- 4.2 Member's pension input is £39,000 and they are subject to a Tapered Annual Allowance of £10,000. Their tax charge will be £11,600 assuming they are a 40% taxpayer and have no carry-forward available. This does not qualify for Mandatory Scheme Pays as the pension input is less than the Standard Annual Allowance of £40,000, so would need to be settled by the member directly with HMRC, unless a Voluntary Scheme Pays arrangement is agreed with the Fund.

*It should be noted that it is the member's responsibility to notify the Fund if they are subject to a Tapered Annual Allowance and the amount of tax due. The Fund cannot calculate this as it does not have details of total taxable income.*

## **5. LBBB Pension Fund's Policy**

5.1 The Fund will accept applications for Voluntary Scheme Pays in the following circumstances:

- A member is subject to the Tapered Annual Allowance and has a tax charge of more than £2,000 relating to input in the LBBB Pension Fund (or associated Prudential AVC Fund), and the irrevocable election is received by 31 December following the end of the tax year in which the input arises (i.e. 31 December 2020 for input in the 2019/20 year).
- A member meets all the criteria for Mandatory Scheme Pays but was unable to meet the 31 July deadline due to an administrative error or omission by LBBB Council (e.g. the member was not notified of their pension input in time for them to meet the deadline). In these circumstances the application for Voluntary Scheme Pays should be made within two months of the member receiving notification of their pension input.

5.2 The Fund will not accept applications for Voluntary Scheme Pays in the following circumstances:

- The member's tax charge relating to pension input in the LGPS in England and Wales is less than £2,000, but they have applied for Voluntary Scheme Pays because their total tax charge when taking input from other arrangements into account is more than £2,000, and the irrevocable election is received by 31 December following the end of the tax year in which the input rises (i.e. 31 December 2020 for input in the 2019/20 year). It is the member's responsibility to notify the Fund at this time of the amount of tax due. The Fund cannot calculate this as it does not have details of the input from the member's other arrangements.
- The member has a Mandatory Scheme Pays right in respect of pension input in the LGPS in England and Wales, but has also asked the Fund to pay a tax charge relating to input in a separate pension arrangement, and the irrevocable election is received by 31 December following the end of the tax year in which the input arises (i.e. 31 December 2020 for input in the 2019/20 year). It is the member's responsibility to notify the Fund at this time of the amount of tax due. The Fund cannot calculate this as it does not have details of the input from the member's other arrangements.
- The member's total tax charge, including when taking input from other arrangements into account is less than £2,000. LBBB Council has not set a minimum level of tax charge that the member must face before they can make an application but will consider each such request on its merits.

- Where the member in question did not meet the 31 July deadline for applying for Mandatory Scheme Pays, and this failure to meet the deadline was not due to any administrative error or omission by LBBB Council.

5.3 A Voluntary Scheme Pays request in any other scenario will be considered on its merits. Following the acceptance of an election for Voluntary Scheme Pays, the member's benefits will be reduced by an amount corresponding to the tax charge paid by the Fund, using the guidance issued by the Government Actuary's Department.

## **6. Members approaching retirement**

6.1 There are situations where a member may breach the Annual Allowance in the Pension Input Period in which they retire, even if they retire relatively near the start of the tax year. This could be, for example, where there has been an ill health enhancement (and the member did not meet the severe ill-health condition under S229(4) of the Finance Act 2004) or a large pay increase, bonus or service enhancement before or at retirement.

6.2 Where a member breaches the Annual Allowance in the tax year in which they receive their final retirement benefits, Scheme Pays can only be used if the election is made and processed before the benefits are put into payment (or "crystallise"). Otherwise members will have to pay the tax charge directly. Members in this situation may choose to pay the tax charge using any lump sum payable on retirement.

6.3 The Fund will issue an individual pension savings statement to those active members who become a pensioner member during the Pension Input Period and who have exceeded the standard Annual Allowance. This will be provided when the retirement benefits are notified rather than under the usual timescales. This gives the member the time to determine whether a Mandatory Scheme Pays option applies and/or whether they wish to make an election for Mandatory or Voluntary Scheme Pays. If the member wishes to use Scheme Pays they should contact LBBB Council well before the retirement date so that the relevant reduction can be calculated and applied before the benefits are put into payment.

6.4 It is the member's responsibility to notify the Fund at this time if they are subject to a Tapered Annual Allowance and the amount of tax due. The Fund cannot calculate this as it does not have details of total taxable income.

## **7. Legal Implications**

*Implications completed by Dr Paul Feild Senior Governance Solicitor*

7.1 There is a limit on how much tax relief a person can receive set by the Finance Act 2004 as amended by the Finance Act 2011. This is set by an annual allowance on their pension contribution. The allowance has been varied from time to time. The current figure is £40,000. This is calculated across all the

pension schemes to which a person is a member and includes any Additional Voluntary Contributions.

- 7.2 Where a scheme member has an annual allowance charge and certain defined conditions are met, they can give their scheme administrator notice that they want the pension scheme to pay some or all of their annual allowance charge liability on their behalf to HMRC in return for an appropriate reduction in their pension benefit.
- 7.3 As pointed out in the body of this report, the Pension Scheme is required to pay this charge for members if a certain criterion is met in return for a reduced benefit see paragraph 2.1 supra. If the criteria are not fully met, the fund may still pay the tax charge for the member under a voluntary scheme pays arrangement see paragraph 31 supra.

## **8. Other Implications**

- 8.1 There are no other immediate implications arising from this report.

### **Background Papers Used in the Preparation of the Report:**

- The Finance Act 2004 & 2011
- Explanatory Memorandum to the Registered Pension Schemes (Notice of Joint Liability for the Annual Allowance Charge) Regulations 2011 No 1793 Notes)
- HMRC Pensions Tax Manual

**List of appendices: None**