

‘Voluntary Scheme Pays’ in the Firefighters’ Pension Schemes.

Background

Mandatory Scheme Pays (‘MSP’).

1. Individuals whose annual growth in pension savings during the Scheme’s ‘Pension Input Period’ exceeds **HMRC’s standard Annual Allowance Limit (‘HMRC AA Limit’)**, currently set at £40,000, and who have no unused Annual Allowance to carry forward from the previous three tax years will be subject to an **Annual Allowance tax charge (‘AA tax charge’)**.
2. The individual can pay the AA tax charge from their own personal finances, however, the Finance Act 2004 provides that a pension scheme must provide a ‘Scheme Pays’ facility¹ where all of the following qualifying conditions are met:
 - i. the HMRC AA limit (currently set at £40,000) has been exceeded in the pension scheme that the Scheme Pays election is made; and
 - ii. an AA tax charge exceeding £2,000 has been triggered; and
 - iii. the relevant time limits for making an election have been met.

Voluntary Scheme Pays ‘VSP’

3. Where a member does not meet the conditions for Mandatory Scheme Pays ‘**MSP**’ to apply or they do not make their nomination in time then a scheme may decide to pay the member’s annual allowance charge on a voluntary basis ‘**VSP**’.
4. Changes to the tax rules now mean that some high earning members with income of more than £150,000 per annum are now subject to a **Tapered Annual Allowance (‘tapered AA’)** which reduces from £40,000 to £10,000 incrementally for those earning between £150,000 and £210,000 per annum.

Members who are subject to a tapered AA will incur an AA tax charge where their pension growth exceeds their tapered AA. The tapered AA will be lower than the £40,000 HMRC AA limit and therefore these members cannot use MSP to pay this charge.

¹ A scheme pays facility works by having the pension fund pay the member’s tax charge initially. This is then repaid by the member as a debit is added to their pension once it comes into payment.

5. With the introduction of the 2015 Scheme, members of the 1992 Firefighters' Pension Scheme ('1992 Scheme') and 2006 Firefighters' Pensions Scheme ('2006 Scheme') who have transferred into the 2015 Scheme on or after 1 April 2015 will effectively be members of two pension schemes and will see pension benefit growth in both schemes until retirement:

By virtue of accruing their pension growth across two rather than one pension scheme, there is an increased likelihood that although the member's total annual pension growth across both schemes may exceed £40,000, the pension growth in any one of the schemes may fall short of the HMRC AA limit. As such, they will not be eligible to use MSP to pay the AA tax charge.

Home Office Proposal

6. At their meeting of 6th March 2017, the Firefighters Scheme Advisory Board considered and agreed an initial proposal from the Home Office to amend the Firefighter Pension Regulations to allow the charge to be met in the circumstances below using Voluntary Scheme Pays (**VSP**)
 - (i) transitional members with pension growth of over £40,000 across both schemes (HMRC AA limit) and a corresponding tax charge, to use the scheme to pay this cost initially, before it is repaid by a pension debit added to the member's pension when it comes into payment
 - (ii) members subject to a tapered AA, to use the scheme to pay their charge initially and then this be repaid via a pension debit. For this option, it is also recommended that the member should be required to make an initial contribution of £2,000 from their own finances towards the resultant AA tax charge.
7. It is now for the Home Office to seek the new administration's views on the proposal after the General Election. Assuming this is taken forward the working assumption is that these changes would be introduced via an amendment to the pension scheme regulations rather than guidance. Legislative amendments take time and therefore will not be introduced in the short term.
8. **It is important to note that this is simply a proposal at this time and is not a guarantee that legislation will change. It will be dependent on a number of factors.**
9. Therefore unless or until that legislation is introduced it is for the FRA to consider their approach to this issue ensuring that what they do is both lawful and appropriate.

Can an FRA operate Voluntary Scheme Pays?

10. This note therefore considers whether FRAs have the ability to offer **Voluntary Scheme Pays 'VSP'** without an amendment to the Firefighter Pension Regulations, and that it is both lawful and appropriate.
11. LGA has recently sought legal advice on behalf of English FRAs, in order to determine whether an FRA can offer voluntary scheme pays, without the need for a change to legislation.
12. **The legal advice was prepared solely for the Local Government Association ("LGA"). Sharing of this legal advice does not amount to a waiver of legal privilege by Eversheds Sutherland.**
13. To operate voluntary scheme pays there are two different steps.
 1. The first is for the Fire Authority to pay the annual allowance charge on behalf of the scheme member to HMRC
 2. The second is for the Fire Authority to adjust the members benefit to reflect the payment made by the administrator

Step 1 – Can the Fire Authority satisfy a member's annual allowance charge on a voluntary basis?

14. The legal advice we have sought opines 'yes, we consider that it is possible for an FRA to operate voluntary "scheme pays"'.

The instruction to Eversheds Sutherland from LGA was

"Does a FRA have the power to agree to voluntary "scheme pays", taking into account both the relevant provisions of the FPS Regulations and the FRA's general powers, and to pay the member's tax liability from the Firefighters' Pension Fund (the "FPF") maintained under the FPS Regulations?"

15. The short answer was 'yes' the longer answer (paraphrased) was 'yes because they have a power of general competence, which may be exercised reasonably where there are sufficient grounds for doing so'.

16. Extract from the 'executive summary' of the legal advice

3. In relation to the specific questions posed:

3.1 Yes, we consider that it is possible for a FRA to operate voluntary "scheme pays":

3.1.1 A FRA which is a county council in England can operate voluntary "scheme pays" relying on s.1 of the Localism Act 2011 and reg.2 of the Modification Regulations. It would be possible to construct an argument that the necessary powers are conferred by virtue of s.111 of the Local Government Act 1972, but the position is less clear-cut than under the Localism Act.

3.1.2 For those FRAs which are metropolitan county FRAs or created by Order as a combined FRA the power to operate such a scheme is derived from s.5A of the Fire and Rescue Services Act 2004 which was inserted by s.9 of the Localism Act 2011.

3.1.3 Where a FRA agrees to operate voluntary "scheme pays", it can properly pay the amount of the tax charge which is due to HMRC from its FPF without contravening the FPS Regulations.

17. Extract from the 'detailed advice' of the legal advice

3.2 First, as regards the question of whether a FRA may agree to meet a member's liability to the annual allowance charge, the arrangements for the administration of the FPS are set out in regulations which are complex in nature and very prescriptive. This is true of many areas of local government activity, and through the Localism Act 2011 the then Government introduced a means by which specific regimes can be supplemented by the exercise of a broad general power of competence for local authorities.

3.3 Those FRAs which are county councils may exercise this power to enter into the necessary arrangements with the member and HMRC. This power cannot be exercised where there is express prohibition of the action proposed. However, since there is no express prohibition of the action proposed here, the FRA may participate in such an arrangement.

3.4 The power of general competence, like all local authority powers, must be exercised reasonably. The FRA must be satisfied that there are sound reasons to make the payments and that the interests of the authority are not harmed by so doing.

3.5 We believe that there are sufficient grounds on which the authority could conclude that there are sound reasons for offering a voluntary "scheme pays" facility, given that (for instance) the effect of the recently introduced tapered annual allowance is that scheme members may now face a substantial tax charge without being able to access the mandatory "scheme pays" facility (because the latter provisions remain based upon the standard annual allowance). Similarly, the interests of the authority will not be harmed, provided that the authority is able to make a consequential adjustment under the Modification Regulations, because the payment will ultimately be met from the member's benefit entitlement, and because the authority will have discretion as to when to offer voluntary "scheme pays", meaning that the administrative burden of such arrangements can be retained within manageable bounds.

3.6 It should be noted that the Localism Act 2011 provisions apply only to English local authorities.

3.7 For those English fire and rescue authorities which are not county councils there is power in the Fire and Rescue Services Act 2004 to enter into voluntary "scheme pays" arrangements subject to the same principles and constraints as apply to county councils.

3.8 Section 5A of the Fire and Rescue Services Act 2004 was inserted by s.9 of the Localism Act 2011. This provides as follows:

“Powers of certain fire and rescue authorities

(1) A relevant fire and rescue authority may do—

(a) anything it considers appropriate for the purposes of the carrying-out of any of its functions (its “functional purposes”),

(b) anything it considers appropriate for purposes incidental to its functional purposes,

(c) anything it considers appropriate for purposes indirectly incidental to its functional purposes through any number of removes,

(d) anything it considers to be connected with—

(i) any of its functions, or

(ii) anything it may do under paragraph (a), (b) or (c), and

(e) for a commercial purpose anything which it may do under any of paragraphs (a) to (d) otherwise than for a commercial purpose.

(2) A relevant fire and rescue authority's power under subsection (1) is in addition to, and is not limited by, the other powers of the authority.

(3) In this section “relevant fire and rescue authority” means a fire and rescue authority that is—

(a) a metropolitan county fire and rescue authority,

(b) the London Fire and Emergency Planning Authority,

(c) constituted by a scheme under section 2, or

(d) constituted by a scheme to which section 4 applies.”

[Sections 2 and 4 relate to combined FRAs.]

3.9 Reliance upon s.111 of the Local Government Act 1972 requires the FRA to be satisfied that it is doing something “*which is calculated to facilitate, or is conducive or incidental to, the discharge of any of their functions*”. The purpose of the incidental power is to enable actions to be taken in support of statutory functions, so it is necessary to identify the function before the authority can be said to be acting incidentally to it. The functions of a local authority acting as a FRA and as scheme administrator (for tax purposes) are defined by statute and regulation, and it can be argued that entry into a voluntary “scheme pays” arrangement is incidental or conducive to the performance of those functions (though the position is necessarily not as clear-cut as with the general power of competence under the Localism Act). Again, the test of reasonableness is to be applied.

‘Exercised reasonably where there are sufficient grounds for doing so’

18. The power of general competence that allows an FRA to satisfy an annual allowance charge on a voluntary basis, must be exercised reasonably and the FRA must be satisfied there are sound reasons for doing so.
19. LGA consider that the circumstances below proposed by the Home Office and agreed by the Scheme Advisory Board should be considered as sound reasons.
 - Transitional members with service in one of the 1992 or 2006 Schemes, and the 2015 Scheme, are able to access a VSP arrangement in the same way that a protected 1992 or 2006 scheme member, or a member with service only in the 2015 Scheme, can do so through Mandatory Scheme Pays.
 - Scheme members with a tapered annual allowance are able to use a VSP arrangement to pay a tax charge in a circumstance where the pension growth in one scheme (or more schemes) is less than the £40,000 general AA limit but more than their own tapered AA limit.
20. Any fire authority wishing to make a Voluntary Scheme Pays arrangement for reasons outside of the two listed are advised to consider whether to do so is a reasonable exercise of their powers and they would have sound reasons for doing so. For example they may not consider allowing a VSP arrangement for a member who would have been eligible for Mandatory Scheme Pays but did not notify the authority within the statutory limit to be a reasonable exercise of their powers.

Step 2 - Can a fire authority adjust a members benefits to reflect the payment made?

21. Having established that the fire authority has the vires in order to satisfy the members charge. The second question for consideration, is does the Fire authority have the power to adjust the members benefit (ie the scheme pays debit) to recover the charge?
22. The Modification of Scheme Rules [\[SI 2011/1791\]](#), Rule 2, Paragraph 2 allows for such an adjustment to be made to the pension (ie the scheme pays debit)

2.—(1) This regulation applies where a scheme administrator of a registered pension scheme (“the scheme”) satisfies all or part of a member’s liability to the annual allowance charge, either on a voluntary basis or pursuant to a liability under section 237B of the Finance Act 2004(1).

(2) The rules of the scheme shall be modified so as to allow for a consequential adjustment to be made to the entitlement of the member to benefits under the scheme on a basis that is just and reasonable having regard to normal actuarial practice. This paragraph is subject to paragraph (3).

(3) Any modification to the scheme’s rules made by virtue of paragraph (2) is subject to section 159 of the Pension Schemes Act 1993(2) or section 155 of the Pension Schemes (Northern Ireland) Act 1993(3) (inalienability of guaranteed minimum pension etc).

23. The intent of this regulation is explicitly laid out in the explanatory memorandum paragraph 2.1

This instrument provides that where a scheme administrator of a registered pension scheme satisfies an annual allowance charge on behalf of a member of the pension scheme from the member's pension benefits, any rules of the pension scheme which prevent such an adjustment to the member's pension benefits are modified to allow for such adjustments.

For the avoidance of doubt who is the 'scheme administrator'?

24. The modification of scheme rules refers to the 'scheme administrator' for the avoidance of doubt, LGA sought legal guidance onto whom this refers in the case of a Fire Authority.

Does a FRA count as the "scheme administrator" for the purposes of reg.2(1) of The Registered Pension Schemes (Modification of Scheme Rules) Regulations 2011 (the "**Modification Regulations**"), taking into account the effect of The Registered Pension Schemes (Splitting of Schemes) Regulations 2006 (the "**Split Scheme Regulations**")?

25. The legal advice opines that the FRA in this case is the 'scheme administrator'.

4.1 Yes. The Split Scheme Regulations provide in reg.2(1)(a) that all registered pension schemes listed in Schedule 1 to the regulations are to be treated as "split schemes". Both the 1992 scheme and the 2015 scheme are listed by name, and although the 2006 scheme (the NFPS) is not expressly listed by name, it is clear that the intention is for the reference in Sch.1 to the "Firefighters Pension Scheme" to cover both the 1992 and the 2006 schemes, since reference is made expressly to s.34 of the Fire and Rescue Services Act 2004, which is the enabling legislation for the 2006 scheme.

4.2 On the basis that all three FPS schemes are to be treated as "split schemes", this therefore means that under reg.3(2) of the Split Scheme Regulations, in the provisions referred to in Schedule 3 to those regulations, "any reference to the scheme administrator shall be read as a reference to the sub-scheme administrator". Schedule 3 includes the Modification Regulations.

4.3 Under reg.1, the "sub-scheme administrator" for a split scheme is "the scheme administrator of a sub-scheme appointed in accordance with the rules of the split scheme to be responsible for the discharge of the functions conferred or imposed on the sub-scheme administrator by or under these Regulations".

4.4 In relation to the 2015 scheme, this is clearly the FRA as "scheme manager" for the purposes of the 2014 Regulations. Under reg.177 of the 2014 Regulations:

*"177 Scheme administrator for the purposes of the Finance Act 2004
The scheme manager is appointed to be responsible for all liabilities and responsibilities connected with the functions conferred or imposed on the scheme administrator by or under Part 4 of FA 2004 which the scheme manager assumes as sub-scheme administrator under regulation 3 of, and Schedule 3 to, the Registered Pension Schemes (Splitting of Schemes) Regulations 2006."*

4.5 In relation to the 2006 scheme and the 1992 scheme, there is no explicit statement under either the 2006 Order or the 1992 Order confirming who is to act as scheme administrator for the purposes of the Finance Act 2004. However, given that under both sets of provisions, the FRA is expressly required to deduct tax / lifetime allowance charges which are due on any payments, it can be inferred that the intention was for the FRA also to be the scheme administrator for Finance Act purposes.

4.6 Therefore, a decision by a FRA to operate voluntary "scheme pays" would constitute a "scheme administrator" satisfying "all or part of a member's liability to the annual allowance charge" for the purposes of reg.2(1) of the Modification Regulations. As such, it would trigger the operation of reg.(2)(2), which would override the provisions of the FPS to the extent needed to make the "consequential adjustment" to the member's benefit entitlement.

Summary

26. In certain circumstances, an individual cannot use Mandatory Scheme Pays 'MSP' to pay a relevant HMRC tax charge. This note considers whether an FRA can satisfy the tax charge on a members behalf using Voluntary Scheme Pays 'VSP'
27. The Home Office is considering amendment to the legislation that would allow an FRA to use 'VSP' in certain circumstances only. However, unless or until that legislation is introduced it is for the FRA to consider their approach to this issue ensuring that what they do is both lawful and appropriate.
28. Having taken Legal advice on behalf of FRA's, LGA can confirm that an FRA (including County Councils, combined Fire Authorities and Metropolitans) can offer Voluntary Scheme Pays arrangements in order to pay the tax bill where a member of the scheme cannot use mandatory scheme pays because they have a power of general competence, which may be exercised reasonably where there are sufficient grounds for doing so'.
29. It is considered that FRAs should consider the test of 'exercised reasonably where there are sufficient grounds for doing so' to be in line with the two circumstances proposed by the Home Office and agreed by the Scheme Advisory Board:
 - Transitional members with service in one of the 1992 or 2006 Schemes, and the 2015 Scheme, are able to access a VSP arrangement in the same way that a protected 1992 or 2006 scheme member, or a member with service only in the 2015 Scheme, can do so through Mandatory Scheme Pays.
 - Scheme members with a tapered annual allowance are able to use a VSP arrangement to pay a tax charge in a circumstance where the pension growth in one scheme (or more schemes) is less than the £40,000 general AA limit but more than their own tapered AA limit.
30. The Fire Authority as the 'scheme administrator' have an express power under [Rule 2, paragraph 2](#) of the Modification of Scheme Regs SI 2011/1791, to allow for an adjustment to be made to the pension (ie in this case a scheme pays debit)

Final Note

31. This note was prepared on 31st May 2017 for Fire Authorities consideration by the Local Government Association. It does not constitute legal advice and should not be treated as so.

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