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

Introduction

1. This update document provides further information on ‘Scheme Pays’ and steps necessary to implement Voluntary Scheme Pays in respect of the 2016-17 tax year to assist Scheme Managers, employers and administrators

   The information contained in this document is the author’s interpretation of the current Regulations and legislation. It should not be construed as legal advice or guidance.

   Readers should take their own legal advice on the interpretation of any particular piece of legislation.

   No responsibility whatsoever will be assumed by LGA, FSAB or their partners for any direct or consequential loss, financial or otherwise, damage or inconvenience, or any other obligation or liability incurred by readers relying on information contained in this document.

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Background

2. The Annual Allowance (AA) is the amount of tax-free pension savings UK taxpayers may make in any one pension input period (PIP). Since 2015-16, the PIP for all pension arrangements has been aligned with the tax year. The AA is currently £40,000.

3. Where the full amount of the Annual Allowance is not used in any one PIP, there is a facility to carry forward the unused part of the AA for up to three years thereafter and use it in a subsequent year to allow inputs which might exceed one year's AA.

4. Where a member breaches the annual allowance (AA) in relation to any input period, and there is no available AA from previous years to offset against the pension growth, they may face a tax charge on the excess amount.

5. Under certain conditions, individuals may elect that the pension scheme pays any tax due to HMRC on their behalf. A scheme pays pension facility works by having the pension scheme pay the member's tax charge initially from the pension fund, with the debt repaid by the member as a permanent debit is applied to their pension once it comes into payment.

Mandatory Scheme Pays (MSP)

6. Schemes must agree to a 'Mandatory Scheme Pays' (MSP) election where a member has a mandatory right under section 237B of the Finance Act 2004 to make such an election (and does so within the relevant timescale).This mandatory provision covers most instances where the member has breached the AA and its operation is provided for in Regulations.

7. MSP applies where:

- their tax charge is over £2,000 and
- the individual is subject the standard annual allowance (currently £40k) and
- this relates to a single scheme and to the immediately preceding tax year.

8. The individual does not need to seek the consent of the Fire & Rescue Authority before they make their election, but they must confirm their decision in writing within the prescribed time limits. In particular, before they take any scheme pension benefits.

9. If the conditions are met, then the scheme administrator becomes jointly and severally liable (with the member) for the annual allowance charge and must pay this to HMRC within a given timescale. They must also make a consequential adjustment to the member's pension savings or their benefits under the pension scheme.

10. The pension scheme will meet the immediate tax charge due and apply a permanent pension debit to the pension. If this occurs again in subsequent years, further debits will apply.

11. Mandatory Scheme Pays will therefore cover the majority of cases where a tax charge is due as a result of the member's AA limit being breached in the Fire pension schemes.

MSP Process

12. All fire pension scheme administrators should, by 6 October 2017, have issued pension savings statements to those members of the firefighters' pension schemes who have breached the annual allowance in 2016-17.

13. For those members who identify a tax liability (for example, exceed the standard AA in one scheme and have no carried forward 'available AA' from previous years) and who intend to pay the tax charge themselves, the payment deadline is the normal self–assessment deadline i.e. 31 January following the end of the relevant tax year.

14. So, for an annual allowance excess in the 2016/17 tax year, the tax charge must be paid by 31 January 2018.

15. If a member wishes to use MSP and meets the above criteria to use MSP, this deadline is much later. The member must give their scheme a notice stating (amongst other information) the amount of AA charge they require their scheme to pay and the tax year this relates to. The deadline for submitting the notice is by 31 July in the year following the year in which the tax year to which the AA charge relates ended.

16. Using an AA excess in respect of the 2016/17 tax year, this deadline will be 31 July 2018.

17. The scheme then administers the 'Accounting for Tax (AFT)' process, which works on quarterly returns and specific set payment dates, meaning the tax charge may be paid as late as 14 February 2019.

18. You can find full details of the AFT process and timings here.

19. AA charges can also be partly paid by 'Scheme Pays', with the remainder being paid by the member.

Voluntary Scheme Pays

20. In May 2017, a technical note for FRAs was issued to confirm that Fire & Rescue Authorities, were able to satisfy a tax charge that had arisen in certain conditions on a member's behalf using Voluntary Scheme Pays.

21. A summary of that note is below

Summary

22. 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'

23. 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.

24. 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'.

25. 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.

26. The Fire Authority as the 'scheme administrator' have an express power under Rule 2, paragraph 2 of the Modification of Scheme Regulations SI 2011/1791, to allow for an adjustment to be made to the pension (i.e. in this case a scheme pays debit)

Who is likely to want to use VSP?

27. There are members who are not able to use MSP who will consider utilising scheme pays.

28. In accordance with regulation 14A of The Registered Pension Scheme (Provision of Information) Regulations 2006 each scheme should have issued by 6 October 2017 a pension savings statement to members-

    whose pension input amount under a single fire pension scheme for the tax year 2016/17 was more than £40,000, or

    whose combined pension input amounts under more than one of the schemes are more than £40,000 (this may not be a requirement, but it is good practice)

    Transition Members

29. Transition members with growth in two schemes in excess of £40,000 may wish to use VSP.

30. With the introduction of the 2015 Scheme, any unprotected members of the 1992 Firefighters' Pension Scheme and 2006 Firefighter' Pension Scheme will have transferred into the 2015 Scheme on 1 April 2015.

31. 1992 and 2006 Scheme members who are subject to tapered protections will transfer to the 2015 Scheme during the period 1 April 2015 to 31 March 2022.

32. Once transferred, all these 'transitional members' will effectively be members of two pension schemes and will see pension benefit growth in both schemes until retirement.

33. Through accruing their pension growth across two, rather than one, pension schemes, there is an increased likelihood that a transitional member will fail to satisfy the first qualifying condition for using MSP to pay any resultant AA tax charge,

Tapered Annual Allowance Members

34. Members subject to the tapered annual allowance may wish to use VSP.

35. The standard Annual Allowance limit is currently £40,000 as confirmed in section 228(1) of the Finance Act 2004. However, from 6 April 2016 a tapered annual allowance applies to higher earners.

36. Individuals who have an **adjusted income** greater than £150,000 and whose **threshold income** is greater than £110,000 will see their annual allowance reduced by £1 for every £2 of adjusted income over £150,000, subject to a remaining annual allowance of not less than £10,000. Those affected by these limits should speak to a financial adviser.

37. **Threshold income** £110,000 includes

Salary / bonuses / pension income in payment
•P11d earnings
•interest on savings
•rental income
•dividend payments
•salary sacrificed in pension arrangement set up or increased after 9/7/2015

Less reliefs (which will include member pension contributions) but not allowances (such as the personal allowance).

38. **Adjusted income** £150,000 includes

Threshold Income plus

- Total pension contributions to a Defined Contribution arrangement –e.g. AVCs
- Total pensions accrual in a Defined Benefit scheme –e.g. Firefighter Pension Schemes

39. As an employer it is not possible to know whether a member would be subject to a tapered annual allowance, as this calculated by reference to all their income, however you may wish to consider communicating with those who;

    a. had earnings in the fire service of more than £110,000 after reliefs during the 2016/17 tax year or

    b. had earnings in the fire service in excess of £100,000 after reliefs and other taxable income during the 2016/17 tax year

Issues for Scheme Managers to consider

a) Which types of case (if any) should be accepted?

40. This is clearly a matter for each Scheme Manager to consider and decide upon. Fire Authorities are not be compelled to agree to any VSP requests and can simply decide not to do so.

41. The Home Office consulted with the Scheme Advisory Board in March 2017 on use of VSP in 2 specific circumstances identified above where members are unable to use MSP:

    Members subject to the tapered Annual Allowance
    Transition members with pension growth across 2 schemes

42. The technical note issued in May 2017, paragraphs 18 to 20 considers which scenarios an FRA might consider as having 'sound reasons' for accepting a VSP arrangement.

43. The Scheme Manager could, therefore, wish to restrict agreement to such cases.

44. Alternatively, they might decide to agree these 2 circumstances and consider other requests.

45. Some further examples of where VSP may be requested by members are:

AA liability in external arrangement

46. The member has a MSP right in respect of benefits accrued in the firefighters' pension scheme and also has an AA tax charge in respect of benefits accrued in another scheme (including outside of the fire schemes).

Money Purchase Annual Allowance Applies

47. The member has an AA charge liability as a result of the application of the money purchase AA with a reduced AA for defined benefit schemes of £30,000.

Failed to make MSP election

48. A retiree fails to make an MSP election before they have become entitled to all of their benefits under the scheme, or before a BCE5, 5A or 5B occurs.

49. Or, due to administrative difficulties, the member misses the MSP deadline (e.g. the member was not provided with the necessary information on time).

50. Or a member's AA tax charge is less than £2,000.

b) Should there be a minimum level of charge payable

51. If accepting VSP requests, an FRA should consider whether there is a minimum level of annual allowance tax charge that the member must be facing.

52. Scheme Managers should bear in mind that the conditions for MSP require a minimum tax charge of £2,000. It would have been open to members to have their tax bill settled through an adjustment of their new tax code, provided that:

- they owed less than £3,000 on their outstanding tax bill
- they already pay tax through PAYE
- they submitted a paper tax return by 31 October or online tax return by 30 December.

c) Should there be a minimum level of contribution requested from the member

53. Fire Authorities, may wish to consider whether they wish to request members to make a contribution from their own finances and in what circumstances

54. The Home Office proposal to legislate for a VSP arrangement, considered by the Firefighters Scheme Advisory Board at their meeting of 6 March 2017, proposed that where a member was subject to the tapered annual allowance, the member should be required to make an initial contribution of £2,000 from their own finances towards the resultant AA tax charge. (Paragraph 6 of the technical note refers.)

55. However, Fire Authorities, may wish to consider that if the Home Office wish to impose an initial contribution, they should do so via legislation.

d) Can you accept a combination of MSP and VSP? What are the differences?

56. Situations may arise where members have a tax charge which can be met by MSP and one which cannot.

57. For example this might be where the pension savings in the 1992 scheme is above £40k, but the pension savings in the 2015 scheme is less than £40k. The 1992 scheme can be treated as MSP, but the 2015 scheme should be treated as VSP.

58. However, it is important to note that there are differences in timings, processes and liabilities.

59. Unlike MSP there is, technically, no deadline by which a member must make the VSP election.

    However, if the member does not wish to incur interest charges and/or penalties in respect of the tax charge due in respect of the 2016-17 year, the member would have to make the relevant VSP election well before to enable the FRA to make the annual allowance tax charge payment to HMRC by 31 January

60. A VSP election can be made and processed after 31 January, though the member will then incur a late payment interest charge and be responsible for paying that interest charge to HMRC. Unlike MSP, the liability under VSP for payment of tax rests solely with the member.

61. The deadline for the FRA to pay over the tax charge in respect of the MSP election is 14 February of the following year e.g. for 2016/17 the deadline is 14 February 2019.

e) How should the deduction from pension be made, where a member has both a final salary and CARE pension?

62. The deduction to pension should be proportioned across the value of the Final Salary and Career Average 'pension savings', in line with the following formula

Final Salary Scheme Pays Deduction (A ÷ C) × D ÷ E

Career Average Scheme Pays Deduction (B ÷ C) × D ÷ F

Where:

A = Final Salary Pension Savings
B = Career Average Pension Savings
C = Total Pension Savings [A + B]
D = Tax charge as declared by the member
E = Final salary scheme pays factor
F = Career Average scheme pays factor

Further guidance on how to apply this formula can be found here

f) How should an FRA account for a voluntary SP tax charge on their AFT return?

63. PTM056430 confirms that, if an FRA agrees to pay an amount of a member's annual allowance charge liability on a voluntary basis, the scheme would not have joint and several liability for the tax charge and the liability for the annual allowance charge would remain with the member.

64. The payment made by the scheme on a voluntary basis should therefore be paid to the member's normal Self-Assessment deadline. If the AFT process is being used to report and pay the tax being paid by the scheme on a voluntary basis, the scheme administrator will need to consider which quarterly period to use.

Actions for Scheme Managers

65. In the event that Scheme Managers decide to take forward VSP in time for the submission of self-assessment returns in respect of 2016-17, they will need to put in place the following steps:

    (i) Record a formal decision by the Fire Authority to allow VSP, with any restrictions or specific requirements (Form attached) and communicate to Pension Administrator.

    (ii) Communicate the provision to those affected across the workforce about Annual Allowance, the use of VSP, how to access it, reporting to HMRC, penalties etc. and the impact on pension. (Draft communication attached).

    (iii) Facilitate effective liaison between the individual officer affected and pension administrator. It remains at all times the responsibility of the member to correctly determine the level of tax charge (taking into account previous years' pensions savings, their Annual Allowance and available Annual Allowance position, any non-employment income and tax reliefs) and to notify the administrator of their personal liability.

(iv) Completion of a formal VSP Election Form by any individual and the form passed by the individual to whom it relates to the Pension Administrator. (Information attached)

(v) Calculation by the administrator of pension debit.

(vi) Employer notification of tax due by the pension administrator and reporting and payment of the sum to HMRC on quarterly Accounting For Tax (AFT) return and pays the tax to HMRC on behalf of the employee, charging it to the pension fund.

(vii) If penalties and/or interest arises as a result of this process, it will be for members to settle any debts owed to HMRC. Under no circumstances will a Fire Authority or pension administrator be liable for interest or penalties arising from late payment of the amount due to HMRC by 31 January 2018.

Final Note

66. Version 1 of this note was published on 15 January 2018 for Fire Authorities consideration by the Local Government Association. It does not constitute legal advice and should not be treated as so.

67. Version 2 of this note, published on 23 January 2018 edited paragraphs 62 and 66

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Draft Communication to Scheme Members

Pensions and Tax

The Annual Allowance (AA) is the amount of tax-free pension savings UK taxpayers may make in any one pension input period (PIP). Since 2015-16, the PIP for all pension arrangements has been aligned with the tax year. The AA is currently £40,000.

Where the full amount of the Annual Allowance is not used in any one PIP, there is a facility to carry forward the unused part of the AA for up to three years thereafter and use it in a subsequent year to allow inputs which might exceed one year's AA.

Where a member breaches the annual allowance (AA) in relation to any input period, and there is no available AA from previous years to offset against the pension growth, they may face a tax charge on the excess amount.

Under certain conditions, individuals may elect that the pension scheme pays any tax due to HMRC on their behalf.

A 'scheme pays' pension facility works by having the pension scheme pay the member's tax charge initially from the pension fund, with the debt repaid by the member as a permanent debit is applied to their pension once it comes into payment.

I have decided, as Scheme Manager, to allow Voluntary Scheme Pays to operate in respect of Annual Allowance charges due for the 2016-17 tax year.

Any scheme member who has determined that a tax charge is due as a result of pension accrual during the 2016-17 tax year should contact……..to establish whether Mandatory or Voluntary Scheme Pays may be used to discharge their liability this year.

FAQs

<u>How do I know if tax is due?</u>

You may have received a pensions savings statement in October 2017 which shows your annual pension growth in the Firefighters' Pension Schemes. If it exceeds the Annual Allowance, you may have to pay tax. But you'll need to look at your pension growth over the past three years, and maybe longer, to determine whether any tax is due.

If you earned over £110,000 in total in the year 2016-17, from your Fire income and other sources, less any tax relief, you may owe some tax, as your Annual Allowance may be subject to a reduction.

You need to speak to your pensions administrator to get the figures and may need to consult an independent financial adviser.

<u>Can I pay the tax myself?</u>

Yes. If tax is due, you need to report it on your self-assessment tax return. If you want to pay the bill directly yourself, the tax return will calculate what you owe. You need to pay it by 31 January 2018 in respect of the 2016-17 tax year.

How do I access Scheme Pays?

Speak to your administrator in the first instance. You'll need to complete a form. If your administrator is unable to make payment by 31 January 2018, you may be liable for interest or a penalty. You'll have to pay these yourself once you have received notification from HMRC.

What will happen to my pension?

It will be permanently reduced to recover the cost of the tax paid on your behalf. This will also impact the overall commutation available under the 1992 scheme (because the value of the pension is lower). But survivor benefits are not affected by the reduction.

Annual Allowance Scheme Pays Election Notice (Pension Input Period 2016- 2017)

You should complete this election only if you want the Firefighters' Pension Scheme to pay some or all of your Annual Allowance charge because the growth in your pension scheme pension benefits is in excess of your available Annual Allowance in respect of the 2016-17 Pension Input Period.

Mandatory Scheme Pays

A Scheme Pays election notice on a **mandatory** basis requires the following conditions to be met:

i. pension growth in either:

- the 1992 Scheme or
- the 2006 Scheme or
- the 2015 Scheme

must exceed the standard Annual Allowance, and

ii. your total Annual Allowance charge must be more than £2,000, and

iii. your election must be received by 31 July 2018

Voluntary Scheme Pays

Your Scheme Manager will determine the circumstances under which Voluntary Scheme Pays may be made available if you do not qualify for MSP as set out above. This may include transition members who exceed the Annual Allowance through membership of more than one scheme, or those subject to the Tapered Annual Allowance (see below).

If the scheme pays your Annual Allowance charge on a Voluntary Scheme Pays basis, you remain liable for this charge; unlike Mandatory Scheme Pays, there is not joint liability.

Even though we will pay over the charge on your behalf you will remain solely liable until it is paid.

You will be responsible for any interest HMRC may charge where the Annual Allowance charge is paid after the self-assessment tax return deadline. The Scheme Manager will not be responsible under any circumstances for any interest charges or penalty in respect of a Voluntary Scheme Pays election.

You need to report the amount of Annual Allowance charge being paid by the 1992/2006 Scheme and 2015 Scheme on your self-assessment tax return.

Annual Allowance

The standard Annual Allowance limit is currently £40,000 as confirmed in section 228(1) of the Finance Act 2004.

Tapered Annual Allowance

Although the standard annual allowance is £40,000, from 6 April 2016 a tapered annual allowance applies to higher earners.

Individuals who have an **adjusted income** greater than £150,000 and whose **threshold income** is greater than £110,000 will see their annual allowance reduced by £1for every £2 of adjusted income over £150,000, subject to a remaining annual allowance of not less than £10,000. If you think you're affected by these limits you should speak to a financial adviser.