Appendix D

Annual Allowance – Use of Voluntary Scheme Pays

Summary

For scheme members of the Local Government Pension Scheme (LGPS) who exceed HMRC's Annual Allowance limit on pension savings growth in a financial year there is an option for the tax charge to be paid by the Pension Scheme via 'Voluntary Scheme Pays' in return for a reduction to their annual pension at retirement.

The option to accept a Voluntary Scheme Pay application is at the discretion of the administrating authority i.e. the City of London Corporation.

A report was submitted to the Finance Committee on 21 November 2017 seeking approval to the use of Voluntary Scheme Pays by the Pension Fund for those scheme members affected by the introduction of the Tapered Annual Allowance.

The Finance Committee approved the use of Voluntary Scheme Pays where;

a) a scheme member is subject to the tapered Annual Allowance; **and**

b) that scheme member's total Voluntary Scheme Pays tax charge is £2,000 or more. This can be derived either from solely the tapered Annual Allowance or a combination of that tax charge and the standard Annual Allowance (where this latter tax charge is less than £2,000); **and**

c) the scheme member's tapered Annual Allowance tax charge stems only from the Annual Allowance relating to LGPS benefits in the City of London Pension fund; **and**

d) the application is received in writing by the City of London Pension fund by 31 December in the tax year following the year to which the tax charge relates.

The Finance Committee also agreed to delegate authority to the Chamberlain to consider accepting Voluntary Scheme Pays requests for other cases outside of the circumstances outlined above.

Report

1. The Annual Allowance is the amount by which pension savings can grow in a financial year before becoming subject to a tax charge. Pension growth within the LGPS is calculated in accordance with HMRC legislation. In essence a scheme member's pension benefits are measured at the start and end of the financial year and the difference between these values are multiplied by an HMRC factor - with any Additional Voluntary Contributions also being taken into account at this point. The difference between the start and end value of pension benefits is known as the Pension Input Amount.

2. The growth in pension savings in the year that is above the Annual Allowance is subject to a tax charge by the HMRC (based on an individual's tax band). However, a three year carry forward rule allows a scheme member to carry forward any unused annual allowance from the last three tax years to offset any tax charge. The scheme member is responsible for reporting to the HMRC when they exceed the Annual Allowance on a self-assessment tax return.

3. In 2016/17 the standard Annual Allowance was set at £40,000, and remains at that rate for 2017/18.

4. Scheme members are normally required to pay their tax charges directly to HMRC, however, where the standard Annual Allowance charge in a tax year exceeds £2,000, scheme members are able to elect to meet some or all of the tax charge from their future pension benefits. Where the tax charge is less than £2,000 the scheme member pays the tax directly to HMRC.
5. The Pension Fund is required to pay this tax charge on the scheme member's behalf and then to reduce their future pension benefits accordingly. This is known as the **Mandatory Scheme Pays**.
6. The deadline for scheme members who incur a tax charge and wish to apply to the Pension Fund to utilise Mandatory Scheme Pays is 31 July each year, for example, if the charge relates to the tax year 2016-17 then the notification must be received by 31 July 2018. The subsequent deadline for administering authorities to make the payment to HMRC is the following 14 February (2019 in the example). Under the Mandatory Scheme Pays the scheme member and the Pension Fund are jointly and severally liable for the tax charge.
7. In the tax year 2016/17, HMRC amended the Annual Allowance rules by introducing the **tapered Annual Allowance** for employees with taxable income in excess of £110,000. A scheme member's Annual Allowance will be tapered when their taxable income plus the growth in their pension benefits exceeds £150,000 in a financial year. For every £2 of taxable income over the excess of £150,000 the standard Annual Allowance is reduced by £1. However, this is subject to a minimum tapered Annual Allowance of £10,000.
8. An example of the above would be as follows: an employee's taxable income (including their Pension Input Amount) is £220,000. The tapered Annual Allowance would reduce the standard Annual Allowance rate of £40,000 to a lower rate by deducting £1 from it for each £2 over £150,000. In this example, tapered Annual Allowance would be set at the minimum level of £10,000 – see attached annex for worked example.
9. There is no Mandatory Scheme Pays for any tax charge relating to excess growth on a scheme member's tapered Annual Allowance – this can only be paid by the Pension Fund under the **Voluntary Scheme Pays.**
10. **Voluntary Scheme Pays:** There is technically no deadline for scheme members to request to use the Voluntary Scheme Pays option. However, subject to the administering authority's approval, the tax charge payment to HMRC must be made before 31 January in the following tax year to ensure additional interest charges are not incurred by the scheme member. For example, if the charge relates to the tax year 2016-17 then payment must be received by HMRC by 31 January 2018. To allow the Pensions Office to pay Voluntary Scheme Pays tax charges by 31 January a deadline of the 31 December in the preceding year has been set for applications to be received by.
11. The scheme member has sole liability for the Annual Allowance tax charge under the Voluntary Scheme Pays option, so even though the Pension Fund may pay over the amount of tax on the scheme member's behalf, the scheme member remains solely liable for the amount of tax due until the administering authority pays it to HMRC.

12. Following receipt of a Voluntary Scheme Pay election a scheme member will have their pension reduced; the reduction would then be applied at retirement. The reduction is calculated in accordance with the guidance issued by the Secretary of State for Communities and Local Government in conjunction with consultation by Government Actuaries Department (GAD).
13. The reduction to a pension following either a Mandatory or Voluntary Scheme Pays election is calculated to be cost neutral to the Pension Fund.

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Annex – Worked Example

Annual Allowance for 2016/17

Standard Annual Allowance for 2016/17 is £40,000

Annual pension at the start of the period		10,000
Apply factor of 16		x 16
		160,000
Add automatic lump sum		0
		160,000
Multiply by CPI (based on September 2015 CPI figure)		0%
Opening Value		**160,000**
Annual pension at the end of the period		13,906.25
Apply factor of 16		x 16
		222,500
Add automatic lump sum		0
Closing Value		**222,500**
Pension Input Amount	£222,500-160,000 =	**62,500**
Income for 2016/17		180,000
Less pension contributions in the year		22,500
Plus Pension In Amount for 2016/17		62,500
Income for measuring tapered annual allowance		**220,000**
Tapered annual allowance	£40,0000 - ((£220,000-£150,000) / 2) =	£5,000
Minimum Tapered Annual Allowance		**£10,000**
Tax Charge under Voluntary Scheme Pays (at 45%)	(40,000 - 10,000) x 45% =	**£13,500**
Tax Charge under Mandatory Scheme Pays (at 45%)	(62,500 - 40,000) x 45% =	**£10,125**
Total Tax Charge		**£23,625**