

Southwark Pension Fund

Scheme Pays Policy

Issue Date **09 March 2018**

Review Date **09 March 2021**

Version 0.1



SCHEME PAYS POLICY

Summary

Scheme Pays is a process which may allow part of your annual tax charge to be paid by the Southwark Pension Fund, in exchange for a reduction in your pension benefits. There are two types of Scheme Pays, Mandatory and Voluntary, and this document covers both.

Introduction

If the overall value of your pension benefits increases above a certain amount in any Pension Input Period (currently aligned to the tax year), you may become liable to an additional tax charge. This follows the introduction in 2006 of the Annual Allowance which sets a threshold over which tax may be payable.

In certain cases, members have an automatic entitlement under Section 237B of the Finance Act 2004 to ask the Southwark Pension Fund ('the Fund') to pay the tax charge on their behalf, and in return have a corresponding reduction to their benefits when they leave the scheme¹. The reduction is applied to the member's pension account in the relevant tax year, and will be increased with inflation until the benefits are paid. This is known as Mandatory Scheme Pays.

In other cases, members may ask the Fund to pay the tax charge, but there is no automatic entitlement and the Fund does not have to agree. Where the Fund does agree to pay the tax charge, the members benefits will be reduced accordingly. The reduction is applied to the member's pension account in the relevant tax year, and will be increased with inflation until the benefits are paid. This is known as Voluntary Scheme Pays.

Members cannot use Scheme Pays once they are in receipt of their benefits, although it can still be used where the member has taken flexible retirement and is still building up further benefits in the Fund which are then subject to an Annual Allowance tax charge.

This document sets out the Scheme Pays Policy of the Southwark Pension Fund, which is managed by Southwark Council. The policy details the circumstances in which a request (an election) for Voluntary Scheme Pays will be accepted by the Southwark Pension Fund.

This Scheme Pays Policy is established to provide clarity for Fund members who may wish to make an election for Voluntary Scheme Pays, and to ensure consistency of approach across the Fund. The Pensions Manager is responsible for ensuring that this policy is followed.

¹ Only the member's pension is reduced as a result of electing for either Mandatory Scheme Pays or Voluntary Scheme Pays. Other benefits, including dependants' pensions and death in service payments, are not affected.

Aims and Objectives

Our key objectives relating to administration are as follows:

- Provide a high quality, seamless, informative, timely and customer focused administration service to the Fund's stakeholders.
- Administer the Fund in a cost effective and efficient manner utilising technology appropriately, with the focus on a 'digital first' approach.
- Be accountable and take responsibility for our actions.
- Ensure the Fund's employers are aware of and understand their roles and responsibilities under the LGPS regulations and in the delivery of the administration functions of the Fund.
- Ensure benefits are paid to, and income collected from, the right people at the right time in the right amount.
- Maintain accurate records and ensure data is protected and has authorised use only.
- Put in place standards for the Fund and its employers and ensure these standards are monitored and developed as necessary.

Having a policy setting out the circumstances in which an application for Voluntary Scheme Pays will be accepted is integral to the Administering Authority achieving its objectives.

Background

This is a brief outline of the Annual Allowance and it is the member's responsibility to seek advice on the specific requirements. Further information is available on the HMRC website: <https://www.gov.uk/tax-on-your-private-pension/annual-allowance>

The concept of the Annual Allowance was introduced from April 2006 under the Finance Act 2004 and is the amount that the overall value of your pension benefits can increase over a Pension Input Period (currently aligned to the tax year) before tax is due.

The current Standard Annual Allowance for the majority of people is £40,000, and if the increase in the value of your pension benefits (your Pension Input Amount) in the relevant tax year exceeds that amount a tax charge may be due. Scheme members can carry forward any unused allowance from the previous three years to offset a potential tax charge.

The Pension Input Amount is the amount that the overall value of your benefits has increased between the start and end of the tax year.

Higher earners and those with substantial taxable income from other sources (including pensions in payment) could be subject to the Tapered Annual Allowance,

giving them an Annual Allowance lower than the Standard Annual Allowance and which could be as low as £10,000. This affects anyone who meets BOTH of the following criteria:

- Threshold Income is £110,000 or more. Threshold Income is taxable income after employee pension contributions are deducted, and includes taxable income from all sources, not just salary.
- Adjusted Income exceeds £150,000. Adjusted Income is Threshold Income plus Pension Input Amount.

If someone meets both criteria, their individual Annual Allowance is reduced by £1 for every £2 that their Adjusted Income exceeds the £150,000 threshold. However, the member's Tapered Annual Allowance cannot be reduced below £10,000. Further information is available on the HMRC website: <https://www.gov.uk/guidance/pension-schemes-work-out-your-tapered-annual-allowance>

Members who have previously 'flexibly accessed' benefits from a separate defined contribution pension plan will be subject to the lower Money Purchase Annual Allowance, currently £4,000, and must inform Southwark Council if this applies as this reduces the Annual Allowance used to test the LGPS benefits. Further information can be found in the section headed 'Lower allowance if you take money from a pension pot' on the HMRC website: <https://www.gov.uk/tax-on-your-private-pension/annual-allowance>

Tax arising from exceeding the Annual Allowance is charged at the member's marginal rate of income tax (20%, 40% or 45% in whole or in part depending on total taxable earnings) on the amount of pension input that exceeds the member's Annual Allowance, taking account of any carry forward of unused allowance from previous years. It is the member's responsibility to determine the rate of tax applied.

Mandatory Scheme Pays

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 Southwark Pension Fund when ALL of the following criteria are met:

- The member's Annual Allowance tax charge exceeds £2,000, and
- The member has a Pension Input Amount within the LGPS in England and Wales² exceeding the standard Annual Allowance (currently £40,000), and
- 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 2017/18 year the Mandatory Scheme Pays election must be made by 31 July 2019) or before they retire, if earlier, and
- The member's full retirement benefits from the Fund are not yet in payment.

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.

Where a member does meet all the above criteria, Southwark 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.

Note that 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. Members should note that their pension cannot be reduced below the level of their Guaranteed Minimum Pension (GMP) (if any), so the Fund may not be able to pay the full tax charge if the corresponding reduction to benefits would reduce the pension below GMP³.

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.

Voluntary Scheme Pays

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 their 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 or the Money Purchase Annual Allowance, and their Pension Input Amount in the LGPS exceeds their Tapered/Money Purchase Annual Allowance but does not exceed the Standard Annual Allowance. See example below.
- The member is subject to the Tapered Annual Allowance or the Money Purchase Annual Allowance, and their Pension Input Amount in the LGPS exceeds both the Tapered/Money Purchase Annual Allowance and the Standard Annual Allowance – there is a right to Mandatory Scheme Pays in respect of the input above the Standard Annual Allowance, but not for the input between the Tapered/Money Purchase Annual Allowance and 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

³ Guaranteed Minimum Pension is the minimum amount of pension that the Fund must pay in respect of any scheme membership between 1978 – 1997 that was contracted-out of the State Earnings Related Pension Scheme (SERPS).

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 2018 for a tax charge arising in the 2016/17 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.

Tapered Annual Allowance Examples

- 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.
- 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.

Southwark Pension Fund Policy

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

- A member is subject to the Tapered Annual Allowance or the Money Purchase Annual Allowance and has a tax charge of more than £2,000 relating to input in the Southwark Pension 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 2018 for input in the 2017/18 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 Southwark 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.

- 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 arises (i.e. 31 December 2018 for input in the 2017/18 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 2018 for input in the 2017/18 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. Southwark 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.

The Fund **will not** accept applications for Voluntary Scheme Pays in the event that 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 Southwark Council.

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.

Members approaching retirement

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.

If 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.

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 Southwark Council well before the retirement date so that the relevant reduction can be calculated and applied before the benefits are put into payment.

It should be noted that 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.

Key Risks

The key risks to the delivery of this policy are outlined below. All of these could result in a member not being correctly informed about the options available to them. The Strategic Director of Finance and Governance will monitor these and other key risks and consider how to respond to them.

- Insufficient training or poor understanding in relation to individuals' roles on pension fund matters
- Insufficient training or failure to communicate the requirements of this policy
- Absence of the individual nominated to manage the operational aspects of this policy and no one deputising, or failure of that individual to carry out the operational aspects in accordance with this policy

Costs

All costs related to the operation and implementation of this policy will be met directly by Southwark Pension Fund. Paying the tax charge should be broadly cost neutral for the Fund, as the Government Actuary's Department has issued guidance for calculating the reduction to the member's benefits which should ensure that the Fund does not lose out. However, the Fund will incur administration costs for the time taken in dealing with member requests and paying the tax due to HMRC.

It has been considered whether to apply an administration charge to members wishing to use Scheme Pays, but due to the low numbers expected to take up this option it has been decided not to levy a charge at this time. This will be reviewed should it transpire to be administratively onerous to operate this policy.

Approval, Review and Consultation

This Scheme Pays Policy was approved by the Strategic Director of Finance and Governance on 09 March 2018. It will be formally reviewed and updated at least every three years or sooner if there are any changes to the LGPS or other relevant Regulations or Guidance which need to be taken into account.

Further Information

If you require further information about anything in or related to this Scheme Pays Policy, please contact:

Jo Anson,

Head of Financial and Information Governance, Southwark Council

E-mail – jo.anson@southwark.gov.uk

Telephone – 020 7525 4308