

**Agenda Item No.6 (d)**

**DERBYSHIRE COUNTY COUNCIL  
PENSIONS AND INVESTMENT COMMITTEE**

**14 June 2017**

**Report of the Director of Finance**

**Annual Allowance - Voluntary Scheme Pays**

**1. Purpose of the Report**

To inform the Committee of the availability of 'Voluntary Scheme Pays' for members of the Local Government Pension Scheme who breach HMRC's Annual Allowance limit on pension savings growth in a financial year.

Further to this, because offering the Voluntary Scheme Pays provision is a discretionary option for pension funds, to ask the Committee, as the administering authority of the Derbyshire Pension Fund, to agree the circumstances for accepting such applications.

**2 Information and Analysis**

The annual allowance is the annual limit on pension savings that can be made in each financial year which will receive tax relief. If the value of pension benefits grows by more than this allowance then the excess amount becomes subject to a tax charge.

The 2016/17 annual allowance was set at £40,000, and remains at that rate for 2017/18.

Derbyshire Pension Fund has a statutory duty to write to scheme members who breach the annual allowance by 6 October in the following tax year, (i.e. 6 October 2017 for charges arising from tax year 2016/17).

'Scheme Pays' is a mechanism by which an individual can request that their annual allowance charge is met by the Pension Fund, and requires the Fund to make an equivalent reduction to the member's pension benefit. 'Mandatory Scheme Pays' has been available for many years, and 'Voluntary Scheme Pays' has recently been identified by the Local Government Pensions Committee following legal advice as potentially available to LGPS members. The legal advice confirmed that

administering authorities that are local authorities have the vires to agree to a Voluntary Scheme Pays request. The differences between the mandatory and voluntary schemes are explained as follows;

### **Annual Allowance - Mandatory Scheme Pays**

Scheme members are normally required to pay their tax charges directly to HMRC, however, where the annual allowance charge in a tax year exceeds £2,000, members are able to elect to meet some or all of the tax charge from their future pension benefits. This is known as the Mandatory Scheme Pays option.

This option requires the Pension Fund to pay the tax charge on the member's behalf and then to reduce their future pension benefits accordingly.

### **Annual Allowance – Voluntary Scheme Pays**

Where the scheme member's annual allowance tax charge is less than £2,000 the member may ask the Pension Fund to pay their annual allowance tax charge on a voluntary basis via the Voluntary Scheme Pays option with a corresponding reduction to their LGPS benefits. This, however, is subject to the administering authority's approval which is discretionary.

An important consideration however is that, 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 £150,000 (including the value of the employer's pension contribution). For every £2 of income over £150,000 the standard annual allowance is reduced by £1. However, this is subject to a minimum reduced annual allowance of £10,000.

Example: an employee's income (including the employer's pension contribution) is £220,000. The tapered annual allowance would reduce the standard rate of £40,000 to a lower rate by deducting £1 from it for each £2 over £150,000. However, in this example, as the reduction would otherwise take their tapered annual allowance below £10,000 for the tax year, their reduced annual allowance for that year is set at £10,000.

As it currently stands, therefore, high earning scheme members whose pension growth in a year breaches the Mandatory Scheme Pays limit, have only the following options:

- Pay the tax charge directly to HMRC
- Opt for Mandatory Scheme Pays option for the breach over £40,000

In an example such as the one above where the member's annual allowance has been reduced to £10,000, (s)he would have no option

other than to pay a potentially significant tax charge directly to HMRC on the amount between £40,000 and their tapered annual allowance, i.e. £30,000.

The Voluntary Scheme Pays option could be utilised to the benefit of Derbyshire Pension Fund members in such circumstances by enabling the tax charge on the £30,000 tapered annual allowance in this example to be paid by the Pension Fund and recouped from future benefits.

For clarity, however, if a member exceeds the annual allowance by virtue of savings across multiple pension schemes, without exceeding the annual allowance in any one scheme and a tax charge were to arise, it would not be appropriate for Derbyshire Pension Fund to offer the Voluntary Scheme Pays option.

### **Timeline**

HMRC have introduced different timelines for payment of the tax charges between Mandatory and Voluntary Scheme Pays.

**Mandatory Scheme Pays** - The deadline for members who incur a tax charge and wish to apply to the pension fund to utilise Mandatory Scheme Pays is 31 July each year. The subsequent deadline for administering authorities to make the payment to HMRC is the following 14 February

**Voluntary Scheme Pays** – There is technically no deadline for 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 member.

The tax liability in a Voluntary Scheme Pays case rests solely with the member, so even though the Scheme may pay over the amount of tax on the member's behalf, the member remains solely liable for the amount of tax due until the administering authority pays it to HMRC.

If a tax charge being dealt with through Voluntary Scheme Pays is not paid by 31 January (i.e. 31 January 2018 for charges arising from tax year 2016/17) the following HMRC late payment penalties may become due by the member:

Penalty for late filing of tax return to HMRC -	£1,000
Penalty for late payment of tax charge -	5% of tax charge
Interest for late payment of tax charge -	2.75% p.a.

In order to apply a consistent approach the Pension Fund will seek all Mandatory and Voluntary Scheme Pays applications in writing by 30 November in the following tax year (ie 30 November 2017 for charges arising from tax year 2016/17) to enable the Derbyshire Pension Fund to meet the January deadline.

### **3 Financial Considerations**

Guidance on the calculation of the reduction in pension benefits following a Scheme Pays election has been issued by the Secretary of State for Communities and Local Government in conjunction with consultation by Government Actuaries Department (GAD) in order to ensure that the Scheme Pays offset is cost neutral to the scheme.

### **4 Legal Considerations**

There is no statutory requirement for an administering authority to agree to Voluntary Scheme Pays requests. It is therefore for each authority to determine its policy on 'Voluntary Scheme Pays' requests.

### **5 Officer Recommendation**

**5.1** That the Pensions and Investment Committee, in its role as the administering authority of the Derbyshire Pension Fund approves the use of Voluntary Scheme Pays where:

- a member's pension savings within the Derbyshire Pension Fund are subject to the tapered annual allowance, **and**
- that member's total tax charge exceeds £2,000, **and**
- the tapered breach stems only from the member's Derbyshire Pension Fund LGPS benefits rather than via growth in multiple pension schemes, **and**
- the application is received in writing by Derbyshire Pension Fund by 30 November in the tax year following the year to which the tax charge relates

**5.2** That the Committee also allows for consideration of other cases outside the circumstances recommended above, with each case considered on its own merits.

**PETER HANDFORD**

**Director of Finance**

May 2017