City of Westminster

Pension Fund Committee

Date:	**21st June 2018**
Classification:	**General Release**
Title:	**Voluntary Scheme Pays**
Report of:	**Sarah Hay, Senior Pension and Payroll Advisor.**
Wards Involved:	**All**
Policy Context:	**Service Delivery**
Financial Summary:	**Limited**

1. Executive Summary

1.1. This report requests consent for the Westminster Pension Fund to offer Voluntary Scheme Pays (VSP) to people who have a tax charge on their Westminster City Council (WCC) Local Government Pension Scheme (LGPS) pension benefit. I have included a simple spreadsheet as Appendix 1, which includes two examples referred to in the report below.

2. Pension Tax Background

2.1. HMRC have restricted the tax benefits for pension savings over a number of years. There are restrictions on the lifetime size of an individuals' pension savings to £1M which is known as the Life Time Allowance (LTA). There are restrictions on the size an individual's pot can increase in any one year, this is currently £40,000 and this is known as the Annual Allowance (AA). Please note that some individuals AA is further restricted if their taxable income levels exceed £110,000 per annum on a tapered basis to an AA figure of £10,000. Example 1 in the appendix details the tax treatment of someone earning less than £110,000 and example 2 more than £110,000.

2.2. Protections that applied initially to many people are slowly ceasing to have any impact, and the AA and LTA limits have reduced over time. This leads to some members facing significant tax charges as a result of being in the pension scheme.

2.3. If an individual has a taxable income of more than £110,000 the AA for pension purposes will then be determined by the level of the Pension Input Amount (PIA). The PIA is a measure of how much the pension pot has grown in a year. If the PIA plus the taxable income comes to £210,000 or more then the tapered annual allowance will be £10,000. If the taxable income plus the PIA is £150,000 or less then the AA will be the standard £40,000. For people who's taxable income plus PIA amount come between £150,000 and £210,000 they will be allocated an AA figure between £10,000 and £40,000.

2.4. HMRC regulations already include a Mandatory Scheme Pays (MSP) facility that allows members who meet certain criteria to elect with HMRC to have their tax paid via their pension fund. The fund cannot elect to reject a qualifying MSP request. MSP is a right under section 237B of the Finance Act 2004.

2.5. If the member qualifies for MSP they can choose if they want to pay the tax in one lump sum or via long term deduction from their pension.

2.6. There are some circumstances where MSP does not cover an individual's full or partial tax liability. This is when an individual can request that the scheme accept a request for Voluntary Scheme Pays (VSP).

2.7. Please see example 1 in appendix 1. If someone has a taxable income of less than £110,000, they will have an AA figure of £40,000 and their pension can increase by that amount without any tax charge. In example 1, the PIA is £100,000 (this could be as a result of a large transfer of service into the scheme). The individual will have the standard AA of £40,000 but will have to pay tax on the £60,000 above the AA. The standard tax rate is normally 40% so applying this in example 1 the individual will have a tax liability of £24,000. However the member has an entitlement to have an MSP for the entire £24000. In this case the scheme would pay the £24000 and reduce the members care pension pot accrued in the year by £2162.49 which would be a permanent reduction.

2.8. Please see example 2 in appendix 1. If someone has a taxable income of £110,000 or more they will be subjected to a possible tapered allowance. In example 2 the PIA is again £100,000but in this case the combined taxable income plus PIA comes to £210,000 and the tapered allowance is therefore the minimum £10,000 figure. This member will owe tax on £90,000 due to the tapered allowance. They can only request HMRC issue a MSP election in respect of £60,000 as this is the sum in excess of a standard AA. The member will have a tax payment due at 40% of £36,000. If the scheme adopts VSP the member could as an alternative to paying that to HMRC as a lump sum have the scheme pay and a permanent reduction in pension of £3243.74. If the scheme does not offer VSP, the member would have to pay a £12,000 lump sum to HMRC as well as a reduction in pension of £2162.49.

2.9. We have a recent example of a senior employee appointed in 2017 who is facing a significant tax charge (£94K) in 2018/2019, by transferring in their previous LGPS pension to our fund and exceeding the tapered allowance described above. The individual is seeing a significant increase in their LGPS pension promise however few people will be able to find the £94K in cash. More cases will follow and would most likely impact senior appointments and could potentially impact recruitment going forward if we do not offer VSP.

2.10. There are other circumstances where an MSP election would not be effective for example, where an annual allowance charge were £2000 or less the member would not have an entitlement to an MSP election. A retiring member needs to make an election before becoming entitled to all their benefits under the scheme if for some reason they did not do this then they would be relying on VSP or would have to fund the tax payment up front to HMRC.

2.11. The Local Government Pension Scheme Regulations are silent on the matter of VSP. It is a matter for each administering authority to determine its own policy and if VSP will be offered to any member of its fund or if VSP is only offered in particular circumstances.

2.12. It is important to note that if the committee approve VSP there is no direct cost to the fund. Money will be recovered by the reducing of the members' pension permanently and so the tax remains the members' responsibility. Reductions are applied using Government Actuary Department (GAD) factors based on the members expected mortality dates. Some people will live longer than the GAD factors suggest and some less meaning that the fund will recoup more money than it pays out in some cases and less in others.

2.13. Additionally, VSP for exceeding the annual allowance currently appears to benefit members who may exceed the LTA limit. VSP reduces their overall pension pot and thus the tax exposure. HMRC rules may change going forward but in offering VSP the fund would be potentially allowing members to limit the tax they legally have to pay.

3. Recommendation

3.1 That the committee approve WCC administering authority operate an unrestricted Voluntary Scheme Pays arrangement which will apply from the current tax year 2018 / 2019.