Wouldn't there be unauthorised payments if we reduced pensions in payment?

Below is a summary of the questions that have been raised with HM Treasury as to whether unauthorised payments would arise if negative revaluation was applied to pensions in payment:

If a negative revaluation order (of -0.1%) is issued it would mean that all members total accrued CARE pension would reduce in value by 0.1% at one second after midnight on 31st March 2016. As this would mean the pension paid to anyone who had retired between 1 April 2015 and 31 March 2016 would be reduced, the reduced pensions subsequently paid to such members might then become unauthorised payments (with all the consequential unauthorised payments tax implications). This is because under the Finance Act 2004 (as supplemented by The Pension Schemes (Reduction in Pension Rates) Regulations 2006 – SI 2006/138, as amended) reductions in pension, otherwise than is excepted circumstances, are not authorised. Everything hinges on the interpretation of paragraph 2(4)(b) of Schedule 28 to the Finance Act 2004. It says that an authorised deduction is:

(4)(b) a reduction in the rate of the pension which applies to all the scheme pensions being paid to or in respect of members of the pension scheme,

The LGPS final salary and CARE schemes are, by virtue of regulation 3(4) of the LGPS (Transitional Provisions, Savings and Amendment) Regulations 2014 treated as a single scheme where a person was a member of both the final salary arrangement (for pre 1 April 2014 membership) and the CARE arrangement (for post 31 March 2014 membership). So, whilst all retirees during 2015/16 would have a reduction to their CARE pension under the scheme the reduction does not apply to all of their pension (and nor does it apply to all the scheme pensions being paid to or in respect of members of the pension scheme, as most pensioners will not have any post 31st March 2014 benefits). Does this mean that the reduction would result in unauthorised payments? If so, it would constitute a major problem for public service pension schemes. It would be helpful if HMT took a legal opinion on this and, if necessary, sought to amend paragraph 2(4) of Schedule 28 to the Finance Act 2004 to provide that a reduction due to a negative Treasury Order issued under section 9 of the Public Service Pensions Act 2013 would not constitute an unauthorised reduction.

Additional, related points have also been raised with SPPA, DCLG and HM Treasury:

1) Many members who left part way through 2015/16 and drew retirement benefits would have elected, at the time of retirement, to commute pension into lump sum and take the maximum possible i.e. 25% of the value of their pension benefits at the time. If a negative Treasury Revaluation Order is applied to pensioners it will mean the Scheme will have, in effect, paid a lump sum greater than 25% of the value of their benefits. Would schemes be required to recoup the "excess" (overpaid) lump sum? We suspect not, given that under regulation 33 of the LGPS Regulations 2013 the member was entitled to a maximum off 25% of the value of their benefits at the Benefit Crystallisation Event, and at the BCE date the value of their benefits was the higher amount – it is only subsequently that the value of the benefits drop.

Nevertheless, HM Treasury need to consider this point, as it is a matter that could affect all public service pension schemes and not just the LGPS.

2) Is the “excess” lump sum (if not recovered) an unauthorised, and thus taxable, payment under the Finance Act 2004? For it to be an authorised payment it would have to fall within regulation 17 of The Registered Pension Schemes (Authorised Payments) Regulations 2009 [SI 2009/1171] which says:

17 Commencement lump sums based on pension errors

(1) A payment of a lump sum the whole of which is intended to represent a pension commencement lump sum, but which exceeds the permitted maximum, if-

(a) the lump sum exceeds the permitted maximum only because it has been calculated by reference to the amount of a relevant pension; and

(b)

(i) the payment of the pension is a payment within regulation 13 or 14(1)(b)

And regulation 13 says:

13 Pensions paid in error

(1) A payment made in error which is intended to represent a payment permitted by the pension rules or the pension death benefit rules to or in respect of a member, if the scheme administrator or insurance company making the payment (in either case, "the payer") believed that -

(a) the recipient was entitled to the payment, and

(b) the recipient was entitled to it in that amount.

It seems unlikely that the “excess” lump sum falls within regulation 17 of The Registered Pension Schemes (Authorised Payments) Regulations 2009 [SI 2009/1171] as it was not based on a pension “payment made in error”. The higher level of pension was not paid in error; it was correct at the time but has subsequently been reduced due to negative inflation. Thus, any “excess” lump sum paid will (if not recovered) be an unauthorised payment and lead to tax charges under the Finance Act 2004.

3) Members who left part way through 2015/16 and drew retirement benefits would have had their benefits assessed for Lifetime Allowance (LTA) purposes. If, their benefits exceeded the LTA they had the choice of taking the excess as pension (subject to a tax of 25%) or as a lump sum (subject to a tax of 55%). If the value of the accrued CARE pot at the date of leaving is reduced on 1 April 2016 due to the Treasury Revaluation Order then the benefits in excess of the LTA will now be less than had originally been assessed. If the member took the original excess as a lump sum, that means the lump sum paid was too much (as the excess is now lower). Do they have to pay back that part of the lump sum which it turns out has now been paid incorrectly (as the excess is lower)? And would HMRC refund the amount of tax

originally paid at 55% on that part of the lump sum which the member would now be repaying? Equally, if the member took the excess as additional pension, the pension in payment would drop, but would HMRC refund the amount of tax originally paid at 25% on that “excess” pension?