

The Local Government Pensions Committee
Secretary: Terry Edwards

CIRCULAR

Please pass on sufficient copies of this Circular to your Treasurer/Director of Finance and to your Personnel and Pensions Officer(s) as quickly as possible

No. 235 – MARCH 2010

REDUNDANCY/ EFFICIENCY RETIREMENTS TAX CODES FOR DISABLEMENT PENSIONS LEAFLET FOR HIGH EARNERS

Purpose of this Circular

1. This Circular has been issued to:
 - remind authorities of the changes to the earliest retirement age for redundancy and efficiency retirements;
 - bring to your attention information that HMRC have asked us to publicise concerning incorrect tax codes for pensioners in receipt of a tax-exempt disablement pension; and
 - bring to your attention leaflets that have been produced outlining tax changes affecting high earners.

Changes to the earliest retirement age for redundancy and efficiency retirements

2. As authorities will be aware, the new look LGPS was introduced on 1 April 2008 in England and Wales and on 1 April 2009 in Scotland. The earliest age at which benefits for new scheme members could be paid following retirement on redundancy or business efficiency grounds was raised in the new look schemes to age 55. However, there were protections for existing scheme members.

In England and Wales, the protections mean that benefits can be paid on or after 50 and before age 55 provided the employee was a member of the scheme on 31 March 2008 and retirement on redundancy or efficiency grounds is before 31 March 2010. It should be noted that CLG are intending to amend the regulations so that the protection applies if the retirement on redundancy or efficiency grounds occurs before 1 April 2010.

In Scotland, benefits can be paid to an employee being made redundant or retired on efficiency grounds at or after age 50 and before age 55 provided the employee was a member of the scheme on both 31 March 2009 and on 5 April 2006. If the employee was a member of the scheme on 31 March 2009 but not on 5 April 2006, benefits can be paid on or after 50 and before age 55 provided retirement on redundancy or efficiency grounds is before 31 March 2010.

For those cases where the age 50 protection only applies until the end of March 2010 it is vitally important that all the paperwork to pay the pension benefits is in the hands of the Pension Fund administering authority before 6 April 2010 (as failure to meet this deadline will mean that the pension benefits then become what HMRC term to be an unauthorised payment, resulting in significant tax charges).

There are likely to be situations where an employee, who is a member of the LGPS and who is currently aged 50 or over but under age 55, is due to be made redundant post March 2010 (for example in September 2010 when he or she will still be under age 55). If that employee,

- is employed by an authority in England or Wales and was a member of the LGPS on 31 March 2008, or
- is employed by an authority in Scotland and was a member of the LGPS on 31 March 2009 but not on 5 April 2006,

the employee will clearly be aggrieved that, had he or she been made redundant before April 2010, he or she would have been entitled to the immediate payment of unreduced pension benefits from the LGPS but, as the minimum pension age for such employees increases from 50 to 55

from April 2010, he or she will not be entitled to the immediate payment of benefits upon redundancy in September 2010.

The LGPC Secretariat has been approached by a number of authorities asking what options an employer could consider in such cases.

(1) The starting position is that the employer should simply take the view that, whilst obviously upsetting for the employee, the matter is merely a reflection of the change in the law - tough on the employee concerned, but that is life. The employee would be entitled to a deferred pension, payable from age 60 at the earliest unless:

(a) the person successfully applies for earlier payment of their deferred benefits on the grounds of permanent ill health; or

(b) the person applies to the (ex) employer for early payment of their deferred benefits, on or after age 55 and before age 60, and the employer agrees to that request under their discretionary policy. The (ex) employer could agree on compassionate grounds to waive any actuarial reduction for early payment. Any strain on the fund cost for early payment and / or waiving any actuarial reduction would have to be paid to the Pension Fund by the (ex) employer.

There are other options listed below that the employer could consider, but each of these has potential difficulties.

(2) The employer could consider bringing the date of redundancy forward so that it occurs pre April 2010. However, the starting position must be that a redundancy is a factual event, driven by the closure of the workplace; the cessation of, or reduction in, the need for workers to carry out a certain type of work; or a change in the place of work of the employee. To "create" a redundancy situation earlier than it actually exists with the sole intention of ensuring the early release of pension would, based on the case of *Hinckley and Bosworth BC v Shaw* (1999) 1 LGLR 38, be potentially unlawful i.e. a local authority has no power to make a gift of taxpayers' money.

(3) Subject to the wording of the employer's discretionary policy and the needs of the employer to ensure service delivery, if the employee has been in continuous employment with them since 31 March 2008 (31 March 2009 in Scotland) the employer could consider letting the employee reduce their hours or grade in order to take flexible retirement prior to 31 March 2010. Clearly, if the employer did not agree to flexible retirement and simply made the employee redundant in September 2010 there would be no strain on the fund cost to be met, only the redundancy termination payment cost (i.e. the redundancy payment and any lump sum payment under the 104 weeks provision), based on the employee's pay at September 2010. So would flexible retirement prior to 31 March 2010 followed by redundancy at September 2010 be cheaper for the employer?

Well, if:

- the employee has not already met the 85 year rule; and
- would not have met it before age 60; and
- is granted flexible retirement at March 2010

the pension benefits built up prior to the flexible retirement would be payable immediately but, due to the actuarial reduction to be applied to the pension benefits, there would be no strain on the fund cost attached to the flexible retirement.

When the employee is subsequently made redundant in September 2010:

- the additional pension built up between April and September 2010 would not be payable immediately as the employee would still be under age 55 (so it would be a deferred pension),
- the redundancy payment and any payment under the 104 weeks provision would be less than if flexible retirement had not been granted (as the pay upon which those payments will be based will be less due to the reduction in hours or grade), and
- the employer will have saved salary between April and September (due to the reduction in hours or grade).

Overall, this would result in a saving to the authority and so such an approach might be objectively justifiable.

If, however:

- the employee has already met the 85 year rule, or would do so before age 60, and
- is granted flexible retirement prior to 31 March 2010

the pension benefits built up prior to the flexible retirement would be payable immediately and there would be a strain on the fund cost attached to the flexible retirement.

Agreeing to flexible retirement in the latter case could, nonetheless, potentially be justifiable, depending on the circumstances. If the strain on the fund cost is not offset by (or not more than offset by) the savings from the reduction in salary between April and September and the reduction in the redundancy payment and any payment under the 104 weeks provision (due to the reduction in pay resulting from the reduction in hours or grade), then the employer might be hard pressed to justify agreeing to the flexible retirement as it could be argued that the employer had only agreed to the flexible retirement to benefit the employee. The legality of this could be questionable given the ruling in *Hinckley and Bosworth BC v Shaw* (1999) 1

LGLR 38. If, on the other hand, the strain on the fund cost is offset by (or more than offset by) the savings on salary between April and September and the reduction in the redundancy payment and any payment under the 104 weeks provision, then it could be argued that this would be objectively justifiable as a good use of taxpayers' money.

However, the 85 year rule has already been found to be age discriminatory (hence its removal from the LGPS subject to certain protections). Thus, accepting or turning down a request for flexible retirement based on whether or not there is a strain on the fund cost, which in turn is determined by reference to the 85 year rule, might be open to challenge. If the employer were to agree to a case where there is no strain on the fund cost and turn down a case where there would be such a cost, the employer would, if challenged by the employee whose application has been turned down, need to be able to demonstrate objective justification - see pages 30 and 31 of the [ACAS Booklet "Age and the workplace"](#).

One other matter of which authorities need to be cognisant is that delaying a redundancy in the case of an employee who is currently age 50 or over but under age 55 until after March 2010, with the objective of avoiding strain on the fund costs (i.e. by making the employee redundant post March 2010 when the employee is under 55 and the age 50 protection has ceased), would potentially be open to challenge. If challenged, the employer would need to be able to objectively justify its decision as being a proportionate means of achieving a legitimate aim.

The principles involved in delaying a redundancy to beyond March 2010 for an employee who is currently aged 50 or over but under age 55 are, in essence, much the same as in the EAT case of London Borough of Tower Hamlets v Wooster where the authority should properly have taken steps to prolong the employment relationship but chose not to, thus ensuring that the employee on dismissal was still under age 50 and so denied access to immediate payment of his pension benefits (thereby avoiding any strain on the fund cost). Mr Wooster won his claim (although the employer appears not to have put forward any objective justification defence).

Authorities are advised to consult with their lawyers and/or external auditors and to consider all potential issues including, but not limited to, legality, discrimination (whether related to age or otherwise), etc. before embarking on any of the courses of action outlined above, other than (1).

Tax codes for tax exempt disablement pensions

3. Although the numbers of tax exempt disablement pensions paid by authorities are likely to be few (leaving aside such pensions paid under the Police and Firefighters' Pension Schemes) the LGPC Secretariat has been approached by HMRC to raise awareness amongst authorities of an issue that has recently arisen relating to tax exempt disablement pensions.

4. HMRC has recently introduced a new National Insurance and PAYE system and is using it to issue notices of tax coding for the first time. The new system creates a single record for customers and this, together with increased automation compared to previous years, is resulting in many more people having more accurate codes than before.
5. The transition to the new system has however brought to light discrepancies in HMRC's existing records and this is generating a significant increase in coding notices. There are also cases where, because the data carried over from their old system does not match employers' data, some people have received an incorrect coding notice.
6. Unfortunately a number of incorrect coding notices have been sent to individuals in receipt of a tax exempt disablement pension. The notices wrongly inform the individuals of a tax change to be applied, from April 2010, to a tax free pension received by them. This issue has arisen because, despite these pensions being tax exempt, a P14 for the tax year 2008/09 has been submitted to HMRC in respect of these pensions.
7. HMRC have asked that if any authority is paying a tax exempt disablement pension and is concerned that a code may have been issued showing that it is taxable, they should contact Sarah Woollard, Assistant Director, PAYE, SA and NICs processes, HMRC at sara.woollard@hmrc.gsi.gov.uk providing the relevant PAYE scheme reference number and the NI numbers of a sample of those who may be affected so that HMRC can explore the issue further.
8. The circumstances in which incorrect coding notices could have been sent out are:
 - the authority is paying a tax exempt disablement pension
 - the authority has submitted a form P14 for the tax year 08/09 for the tax exempt disablement pension payments.

If no P14s have been submitted in respect of these pensions, no coding notices will have been issued and no further action is necessary.

9. HMRC apologise to customers for any inconvenience caused. They are doing everything they can to rectify the position. They have advised anyone who is concerned that their tax code may be wrong to check it using the guidance included with the code and on HMRC's website. If pensioners cannot resolve their query they should call HMRC using the number provided on their Coding Notice or on 0845 3000 627 to make sure the right tax code is applied in time for the start of the new tax year on 6 April 2010. In the meantime, because of the particular issue with tax exempt disablement pensions, HMRC would like your co-operation in identifying any cases that may be affected where you pay a tax exempt disablement pension and you have submitted form P14 for the tax year 2008/09 for

that tax exempt disablement pension. HMRC will then work with you to correct this issue.

Suggested lines to take if approached by a concerned pensioner

HM Revenue and Customs (HMRC) has recently introduced a new National Insurance and PAYE system which is being used to issue tax coding notices for the first time. However, the transition to the new system has brought to light some discrepancies in HMRC's existing customer records and this is resulting in a number of incorrect coding notices being issued. HMRC very much regrets that some individuals in receipt of a public sector tax-free pension have received incorrect notices of coding.

Tax-free pensions remain exempt from tax and it was never the Government's intention to change this. If anyone in receipt of a public sector disablement pension is concerned that their tax code may be wrong they should call HMRC on the number provided on their Coding Notice or on 0845 3000 627. An amended notice of coding will then be issued to ensure that they do not pay tax on this pension.

HMRC are sorry for any distress this may have caused.

Points to stress

- no one should pay tax on those disablement pensions that are tax exempt
- HMRC are extremely sorry for any distress the inaccurate tax codes may have caused
- the new codes don't apply until April and HMRC will put them right before then wherever possible
- any individual in receipt of a tax exempt public sector disablement pension who has received an incorrect coding number should contact HMRC on the number on their Coding Notice or on 0845 300 627 to ensure that they are not taxed on this pension for 2010/11.

Leaflets for high earners

10. The LGPC Secretariat has produced two leaflets for high earners – i.e. people with incomes of £100,000 or over. One leaflet is for employees in England and Wales and the other is for employees in Scotland. The leaflets are available from the [LGE website](#) and represent the Secretariat's understanding of the four¹ areas covered below:

- the tapering away of basic tax-free personal allowance with effect from 6 April 2010 for those with incomes (after pension deductions) of over £100,000;

¹ Information on the first two bullet points for payroll practitioners can be found at <http://www.hmrc.gov.uk/comp/notes-12-3.pdf>

- the introduction of a higher tax rate of 50% from 6 April 2010 on taxable income above £150,000;
- the proposed application of a taper to the tax relief on pensions contributions from 6 April 2011 for those with pre-tax incomes, **excluding** employer pension contributions, of £130,000 or more and whose gross incomes, **including** the value of employer pension contributions, is £150,000 or more; and
- the new special annual allowance effective from 22 April 2009 and the associated anti-forestalling measures and tax charges. These will apply to high income individuals who, with a view to taking advantage of the current higher pensions tax relief that would normally apply until 5 April 2011, change their normal ongoing regular pension savings and whose total pension savings in the tax year exceed £20,000.

Any high earners potentially affected by one or more of the above measures will need to carefully consider their own position and decide whether to seek their own independent financial and tax advice.

11. Employing authorities may wish to bring the existence of these leaflets to the attention of their high earners (if any) but, before doing so, ought to check with their Pension Fund administering authority, as the administering authority may have produced its own leaflets / materials to be issued to high earners.

Actions for administering authorities

12. Administering authorities may wish to consider copying this Circular to employers in their Fund or bring the Circular to the attention of employers by directing them to the Circular on the LGE website at:
<http://www.lge.gov.uk/lge/core/page.do?pageld=4280609>

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March 2010

Distribution sheet

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