

LGA Query 6:

How to value LGPS benefits for the purpose of Individual Protection 2016 (IP16) where the member elects for a scheme pays offset (mandatory or voluntary) in respect of excess pension benefits built up during the 2015/16 Pension Input Period (PIP)?

Contents

This report looks at the above question and raises three questions for Technical Group to consider prior to the meeting on 12 December 2017.

If members of the Technical Group do not agree to the conclusions reached within the three questions, please can they submit their alternative conclusions to the group prior to the meeting on 12 December 2017 for consideration?

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Legislative Review

Although this query has been raised primarily to address Individual Protection 2016 (IP16) the query equally applies to Individual Protection 2014 (IP14).

When an individual applied (or may still apply in respect of IP16) for:

- IP14 their relevant amount on 5 April 2014 must have been greater than £1,250,000¹
- IP16 their relevant amount on 5 April 2016 must have been greater than £1,000,000²

The relevant amount³ is made up of amounts:

- A – pre 6 April 2006 pensions in payment
- B – pre 6 April 2016 benefit crystallisation events
- C - uncrystallised rights at end of 5 April 2016 under registered pension schemes
- D - uncrystallised rights at end of 5 April 2016 under relieved non-UK schemes

For the purpose of this query we are addressing how to calculate ‘Amount C’ with reference to the relevant amount for IP14 and IP16.

Both Finance Acts 2014⁴ and 2016⁵ state that ‘Amount C’ is the total value of the individual's uncrystallised rights at the end of 5 April 2014/2016 under arrangements relating to the individual under registered pension schemes of which the individual is a member as determined in accordance with section 212 of FA 2004.

Section 212 of the Finance Act 2004 prescribes how to calculate the value of the member's uncrystallised rights under the arrangement on a given date. For the purpose of this query the given date is either 5 April 2014 (IP14) or 5 April 2016 (IP16). However, in a different circumstance it could quite equally be the date of the BCE 2.

What seems clear due to the references within Finance Acts 2014⁶ and 2016⁷ is that the same principles are applied when calculating the value of the member's uncrystallised rights under the arrangement on a given date.

If we accept that the same principles do apply when calculating the value of the member's uncrystallised rights under the arrangement on a given date, we need to look at how we calculate the value of the member's uncrystallised rights under the

¹ Paragraph 1(1), Schedule 6, Finance Act 2014

² Paragraph 9(1), Schedule 4 Finance Act 2016

³ IP14 – Paragraph 1(5), Schedule 6, Finance Act 2014. IP16 – Paragraph 9(4), Schedule 4, Finance Act 2016

⁴ Paragraph 4, Schedule 6, Finance Act 2014

⁵ Paragraph 12, Schedule 4, Finance Act 2016

⁶ Paragraph 4, Schedule 6, Finance Act 2014

⁷ Paragraph 12, Schedule 4, Finance Act 2016

arrangement for a BCE 2 in order to determine how to calculate those same rights for the purpose of IP14 or IP16 on either 5 April 2014 or 2016 respectively. To do this we would look to section 212(6) of the Finance Act 2004 (note this is the same section that is quoted in Finance Acts 2014⁸ and 2016⁹ re IP14 and IP16) which states that the value of the member's uncrystallised rights under the arrangement on the date is:

- $(RVF \times ARP) + LS$

Where:

- RVF is the relevant valuation factor (see section 276),
- ARP is the annual rate of pension to which the member would, on the valuation assumptions, be entitled under the arrangement on the date if, on the date, the member acquired an actual (rather than a prospective) right to receive a pension in respect of the rights, and
- LS is the amount of any lump sum to which the member would, on the valuation assumptions, be entitled under the arrangement on the date (otherwise than by way of commutation of pension) if, on the date, the member acquired an actual (rather than a prospective) right to payment of a lump sum in respect of the rights.

In order to determine 'ARP' we need to look at paragraph 9 of Schedule 32 of the Finance Act 2004 which states that for the purpose of a BCE 2 'P' is the amount of the pension which will be payable to the individual in the period of 12 months beginning with the day on which the individual becomes entitled to it (assuming that it remains payable throughout that period at the rate at which it is payable on that day). Therefore, the value of 'P' must have taken into account any scheme pays offset(s) to which the member may have elected during the course of their scheme membership. This chimes with paragraph 2.23 of the Secretary of State guidance titled 'Annual Allowance Charges: calculation of scheme pays offset – elections on or after 1 April 2014' dated 12 April 2016.

Possible conclusion

Ultimately, there does not appear to be any definitive prescription concerning this area and it might be that very few members are affected by this query. However, the fact that Finance Acts 2014¹⁰ and 2016¹¹ make reference to section 212 of the Finance Act 2004 to value of the member's uncrystallised rights under the arrangement on a given date, does seem to suggest that the methodology should be the same regardless of the circumstance.

To conclude: Does Technical Group:

⁸ Paragraph 4, Schedule 6, Finance Act 2014

⁹ Paragraph 12, Schedule 4, Finance Act 2016

¹⁰ Paragraph 4, Schedule 6, Finance Act 2014

¹¹ Paragraph 12, Schedule 4, Finance Act 2016

- Q1)** Agree that section 212 of the Finance Act 2004 applies equally to the calculation of IP14, IP16 and a BCE 2? If yes
- Q2)** Agree that the same principles should be followed throughout and any scheme pays offset, relevant to benefits built up prior to the given date (regardless of when the member made an election to proceed with the offset) should be deducted from the value of the member's uncrystallised rights under the arrangement on either 5 April 2014 (for IP14) or 5 April 2016 (for IP 16), i.e. the given date?

If members of the Technical Group do not agree to the above conclusions then please can they submit their alternative theories to the group prior to the meeting on 12 December 2017 for consideration?

Communications

If Technical Group agrees to the previous conclusions then we must now turn our attention to communications.

Quite clearly, there will be circumstances whereby an Administering Authority will value the member's uncrystallised rights under the arrangement on a given date (this will be either 5 April 2014 (for IP14) or 5 April 2016 (for IP16)), after which it comes to light that the member is subject to an annual allowance charge in respect of excess pension benefits built up prior to the given date. Any annual allowance charge in respect of benefits built up after the given date would not affect the value of the member's uncrystallised rights under the arrangement on the given date.

Pension Saving Statements will need to include reference to the fact that if a member has obtained IP14 or IP16, or intends to obtain IP16, then in the event that there is an annual allowance charge in respect of benefits built up (mandatory or voluntary) before the given date, then if the member:

- Pays the annual allowance charge themselves, this won't affect the value of the member's uncrystallised rights under the arrangement on the given date, or
 - Elects for a scheme pays offset, this will affect the value of the member's uncrystallised rights under the arrangement on the given date and the member may lose their protection and subsequently pay more tax (due to the fact that the value of the member's uncrystallised rights under the arrangement on the given date has dropped below the relevant amount).
- Q3)** Does Technical Group agree that PSS statements should be revised to include the above references?

Appendix 1 – LGA Secretary of State Guidance - Query 6

Guidance		Date
Annual Allowances Charges: Calculation of Scheme Pays Offset		26/02/2015
Query 6:	Interaction of Individual Protection 2016 (IP2016) with an annual allowance scheme pays offset	
Brief description: How should pension benefits be valued for IP2016 where a scheme pays election for an annual allowance charge has a relevant date of prior to 5/4/2016 but the paperwork is not completed by that date?		
The situation is reasonably clear that if a scheme pays debit has a relevant date after 5/4/2016 then that debit could not be allowed for in the valuation of a pension at 5/4/2016. The situation is less clear for a scheme pays debit with a relevant date prior to 5/4/16 for which the paperwork is not complete by that date.		
HMRC have confirmed that in relation to the adjustments having to be made to the member's benefits, they cannot be prescriptive as to when or how the adjustment has to be made, all they would say is simply that an adjustment must be made to the member's benefit rights.		
Query first raised on 16/07/2016		

Appendix 2 – Response from GAD to LGA Secretary of State guidance - Query 6

Response from GAD 18 September 2017

LGA query 6 asks about the interaction of scheme pays with Individual Protection 2016. This was first raised in February 2016 before the enabling legislation had been passed by parliament. The legislation has now been enacted and no relevant changes have been made so GAD's position on the correct approach as expressed in [Lynda Jones' email of 16 February 2016](#) is unchanged.

This is a legal question of how to interpret HMRC legislation rather than an actuarial question so it does not feel that it is appropriate to be placed in actuarial guidance that is issued by the DCLG SoS. I would therefore expect that the next review of the guidance would take out the similar material on other, earlier, protections.

LGA may wish to set out a common approach for LGPS Funds in LGA guidance and GAD would be very happy to provide support in drafting this.

Appendix 3 – Email exchange between – Fund – LGA – DCLG (2015 – 2016)

From: Lynda Jones [<mailto:Lynda.Jones@communities.gsi.gov.uk>]
Sent: 16 February 2016 11:34
To: Terry Edwards <Terry.Edwards@local.gov.uk>
Cc: Jeff Houston <Jeff.Houston@local.gov.uk>; Cornelius Hargrave <Cornelius.Hargrave@local.gov.uk>; Lorraine Bennett <Lorraine.Bennett@local.gov.uk>; Tim Hazlewood <Tim.Hazlewood@local.gov.uk>; Jayne Wiberg <Jayne.Wiberg@local.gov.uk>
Subject: Scheme pays debit and effect on value of benefits for Individual and Fixed Protection 2016

Terry

I consulted GAD colleagues who have looked at ‘should a scheme pays debit be allowed for when assessing the value of a pension as at 5/4/2016 for the purpose of individual and fixed protection 2016?’

It is their view that it is reasonably clear that if a scheme pays debit has a relevant date after 5/4/2016 then that debit could not be allowed for in the valuation of a pension at 5/4/2016. That may be what the “FAQ” quoted was discussing. A scheme pays debit with a relevant date prior to 5/4/2016 for which the paperwork is all completed by 5/4/2016 should probably be taken off the gross amount of pension to satisfy these requirements.

The situation is less clear for a scheme pays debit with a relevant date prior to 5/4/16 for which the paperwork is not complete by that date.

HMRC have now published draft legislation on this point and some explanatory notes:

<https://www.gov.uk/government/publications/finance-bill-2016-draft-legislation-overview-documents>

The draft legislation (see paragraph 12 of the schedule to clause 12) says that the pension should be valued in line with section 212 of Finance Act 2004. Subparagraph 6 is the relevant bit of s212 for defined benefit arrangements and this states that the amounts considered should be:

- the annual rate of pension to which the member would, on the valuation assumptions, be entitled under the arrangement on the date if, on the date, the member acquired an actual (rather than a prospective) right to receive a pension in respect of the rights*
- the amount of any lump sum to which the member would, on the valuation assumptions, be entitled under the arrangement on the date (otherwise than by way of commutation of pension) if, on the date, the member acquired an actual (rather than a prospective) right to payment of a lump sum in respect of the rights*

The valuation assumptions are in s277 of FA2004:

For the purposes of this Part the valuation assumptions in relation to a person, benefits and a date are-

Appendix 3 – Email exchange between – Fund – LGA – DCLG (2015 – 2016)

*(a)if the person has not reached such age (if any) as must have been reached to avoid any reduction in the benefits on account of age, that the person reached that age on the date, and
(b)that the person's right to receive the benefits had not been occasioned by physical or mental impairment.*

The Pensions Tax Manual does not provide clear guidance on the timing of scheme pays debits:

<http://www.hmrc.gov.uk/manuals/ptmanual/ptm056460.htm#IDARE2JB>

This is based on GAD's non-legal interpretation of the partly draft legislation.

Lynda

From: Terry Edwards
Sent: 16 July 2015 13:07
To: Lynda.Jones@communities.gsi.gov.uk
Cc: >
Subject: Lifetime Allowance and Scheme Pays debits

Lynda

Sorry to have to approach you on the matter in the e-mails below and in the attached correspondence with HMRC but I simply don't know what the answer is. Given that it is the Secretary of State guidance that refers to an "offset" can DCLG or GAD give a view on the correct approach?

Terry

From: Terry Edwards
Sent: 06 July 2015 17:28
To:
Subject: Lifetime Allowance and Scheme Pays debits

Yes, will do (although I suspect they may well say it is not a question for them to decide but, rather a matter for the Secretary of State to say whether or not the "offset" on 1 April is a "reduction" on that date). I'll keep you posted when I get a response.

Terry

From:
Sent: 06 July 2015 17:19
To: Terry Edwards
Subject: UNCLASSIFIED: RE: Lifetime Allowance and Scheme Pays debits

Hi Terry,

That's ideal thank you. Will you be able to let me know the response from HMRC please?

Best regards,

Appendix 3 – Email exchange between – Fund – LGA – DCLG (2015 – 2016)

From: Terry Edwards [<mailto:Terry.Edwards@local.gov.uk>]
Sent: 06 July 2015 16:39
To:
Subject: Lifetime Allowance and Scheme Pays debits

Sorry, I hadn't fully grasped the question you were asking.

If IP2016 works in the same way as IP2014, then the answer given at the bottom of page 14 of the document at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/347961/140821_published_standalone_v4.pdf will apply i.e.

I have had an annual allowance charge and have asked my scheme to operate scheme pays. Will this affect the value of my pension savings?

No. Your pension rights will be valued on 5 April 2014. If your scheme reduces your benefits after this date as a result of scheme pays your relevant amount will not be adjusted.

As the current (updated) Secretary of State guidance on scheme pays makes clear, the Relevant Date for scheme pays elections made on or after 1 April 2014 is the day coincident with the end of the relevant pension input period. Thus, a scheme pays election for an annual allowance charge resulting from benefit accrual in 2015/16 will have a Relevant Date of 31 March 2016. This clearly falls before 5 April 2016. According to the Secretary of State guidance, the scheme pays offset for an active member “is expressed as a deduction to the member’s pension which is to be recovered from the member’s normal pension age” and “the pension payable to the member on retirement at normal pension age will be reduced by an amount equal to the member’s pension offset”. One could argue that the member’s benefits would not actually be reduced until after 5 April 2016 (assuming the member does not retire before that date) because until an actual deduction is made when the benefits are brought into payment, the scheme pays debit is held as an “offset”, the actual amount of which is not known until the member draws benefits (as the actual reduction may need an actuarial reduction or actuarial increase applied if benefits are drawn before or after normal pension age). That would mean that the value of the member’s pension rights on 5 April 2016 would be valued, for the purposes of IP2016, as if they were no scheme pays deduction. In some ways, that does not feel right as, if the member had retired before 5 April 2016, the value of their benefits for the purposes of the LTA would have been net of the scheme pays deduction, so why should anyone who prior to 6 April 2016 has elected for scheme pays have their pension rights valued for IP2016 based on their gross (pre scheme pays deduction) benefits? In other ways it does feel right given that a member who had exceeded to annual allowance in 2015/16 would not have to make a scheme pays election until the end of July 2017 and so, as at 5 April 2016, the value of the benefits (if valued on that date) would be the gross value (as it would for a member who chose to pay the annual allowance tax charge direct rather than using scheme pays).

I can't say with any degree of certainty what the answer to your question is and so I will raise the matter with HMRC.

Appendix 3 – Email exchange between – Fund – LGA – DCLG (2015 – 2016)

Turning to your second question (re APCs), it applies from 1 April 2014.
Terry

From:
Sent: 01 July 2015 11:10
To: Terry Edwards
Subject: RE: UNCLASSIFIED: Lifetime Allowance and Scheme Pays debits

Hi Terry,

Thank you for your reply below but I don't think I explained my question quite how I meant to as I'm happy about how to calculate a members LTA on retirement but I'm wondering how we treat the 'Scheme Pays' debit when assessing the value of the LTAs for active members @ 31/03/2016 assuming HMRC will issue a protection similar to that in 2014?

Sorry to be a pain but I've got a further question now as I see in the latest administration guide for APCs that it is confirmed additional pension purchased by the employer under Regulation 31 isn't reduced if members leave on redundancy/efficiency grounds and I remember this being looked into but is there a date from which this applies please?

Thanks again,

From: Terry Edwards [<mailto:Terry.Edwards@local.gov.uk>]
Sent: 26 June 2015 12:54
To:
Subject: RE: UNCLASSIFIED: Lifetime Allowance and Scheme Pays debits

My current understanding is that a scheme pays debit should be deducted from pension values before the LTA is calculated when assessing the value of members LTA. I am not aware of anything to the contrary – see <http://www.hmrc.gov.uk/manuals/rpsmanual/RPSM11104240.htm>

Of course, I cannot say for certain that will remain the case given that no details have yet been issued on quite how the reduction in LTA to £1 million will work in practice.

Terry

From:
Sent: 25 June 2015 16:02
To: Terry Edwards; Tim Hazlewood
Subject: UNCLASSIFIED: Lifetime Allowance and Scheme Pays debits
Importance: High

Hi Both,

Re: Lifetime Allowance and Scheme Pays debits

Appendix 3 – Email exchange between – Fund – LGA – DCLG (2015 – 2016)

Please could I have your opinions on whether or not scheme pays debits should be deducted from pension values before the LTA is calculated when assessing the value of members LTAs @ 31/03/2016 when the limit reduces to £1m from £1.25m.

If the LTA is calculated after deducting the scheme pays debit from the pension is it the current value of the debit @ 31/03/16 that is used (i.e. the value at 65/SPA + CPI to date) or should the debit be adjusted at all?

have a Chief Officer who is potentially > £1.25m if the scheme pays is ignored but > £1m and < £1.25m if it isn't hence the question.

Thanks a lot,

Appendix 4 – LGA query to HMRC (raised 6 July 2015) and their response (15 July 2015)

LGA Query to HMRC on 6 July 2015

If IP2016 works in the same way as IP2014, then the answer given at the bottom of page 14 of the document at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/347961/140821_published_standalone_v4.pdf would apply when determining how a scheme pays election is to be taken into account for the purposes of IP2016.i.e.

I have had an annual allowance charge and have asked my scheme to operate scheme pays. Will this affect the value of my pension savings?

No. Your pension rights will be valued on 5 April 2014. If your scheme reduces your benefits after this date as a result of scheme pays your relevant amount will not be adjusted.

As the current (updated) Secretary of State guidance for the LGPS on scheme pays makes clear, a scheme pays election for an annual allowance charge resulting from benefit accrual in 2015/16 will, from 1 April 2016, be held as an “offset” against the member’s benefits. This date clearly falls before 5 April 2016. According to the Secretary of State guidance, the scheme pays offset for an active member “is expressed as a deduction to the member’s pension which is to be recovered from the member’s normal pension age” and “the pension payable to the member on retirement at normal pension age will be reduced by an amount equal to the member’s pension offset”.

One could argue that the member’s benefits would not actually be reduced until after 5 April 2016 (assuming the member does not retire before that date) because until an actual deduction is made when the benefits are brought into payment, the scheme pays debit is held as an “offset”, the actual amount of which is not known until the member draws benefits (as the actual reduction may need to be actuarially reduced or actuarially increased if benefits are drawn before or after normal pension age). That would mean that the value of the member’s pension rights on 5 April 2016 would be valued, for the purposes of IP2016, as if they were no scheme pays deduction.

In some ways, that does not feel right as, if the member had retired before 5 April 2016, the value of their benefits for the purposes of the LTA would have been net of the scheme pays deduction, so why should anyone who prior to 6 April 2016 had elected for scheme pays have their pension rights valued for IP2016 based on their gross (pre scheme pays deduction) benefits?

In other ways it does feel right given that a member who had exceeded the annual allowance in 2015/16 would not have to make a scheme pays election until the end of July

2017 and so, as at 5 April 2016, the value of the benefits (if valued on that date) would be the gross value (as it would for a member who chose to pay the annual allowance tax charge direct rather than using scheme pays).

Appendix 4 – LGA query to HMRC (raised 6 July 2015) and their response (15 July 2015)

I know the finer details of IP2016 have not yet been published by the same issue arises in relation to IP2014.

I can't say with any degree of certainty whether the value of the benefits should be valued gross or net of any scheme pays election where an "offset" is held against a member's pension rights at that date but no physical deduction has actually been made. Do you have a view (or is it simply a question for the Secretary of State to clarify whether or not an "offset" is a deduction when valuing a member's benefits for the purposes of assessing

the value of a member's benefits at 5 April 2014 or 5 April 2016 for IP2014 or IP2016?

HMRC response to LGA on 15 July 2015

From:]

Sent: 15 July 2015 11:01

To: Terry Edwards

Subject: RE: Another query

Hi Terry,

I have been informed that in relation to the adjustments having to be made to the member's benefits, we cannot be prescriptive as to when or how the adjustment has to be made, all we would say is simply that an adjustment must be made to the member's benefit rights.

Thanks & regards