Item 19/39 Appendix C

DORSET & WILTSHIRE FIRE AND RESCUE AUTHORITY

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| MEETING | Dorset & Wiltshire Fire and Rescue Authority |
| DATE OF MEETING | 13 December 2018 |
| SUBJECT OF THE REPORT | Firefighters' Pension Scheme - Voluntary Scheme Pays |
| STATUS OF REPORT | For open publication |
| PURPOSE OF REPORT | For approval |
| EXECUTIVE SUMMARY | This report sets out a recommendation to introduce a Voluntary Scheme Pays arrangement for the Firefighter Pension Schemes.<br><br>In addition to paying tax on their earned income members of the firefighters and other pension schemes can become liable to pay tax on the benefits they build up in their pension pots. Each taxpayer has an annual allowance (AA) allocated to their pension pot. A liability to pay tax only arises if the value of benefits built up in the pot in a particular year exceed the AA. The AA is currently £40,000 per annum (where the member's annual 'adjusted income' is less than £150,000).<br><br>Pay as you earn enables an employer to withhold tax on an employee's salary and the net balance is received by the employee after deduction of tax. The taxation of pensions pots works differently. A breach of the AA gives rise to a liability to a tax charge in the present but the increase in the value of the pension pot giving rise to that tax liability is not accessible to the individual to enable them to meet the tax charge.<br>In some instances, the tax charge arising from an increase in the value of a pension pot can be very considerable and beyond the ability of most people to pay. |

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| | ‘Scheme Pays’ is a process that allows the tax charge to be paid by the pension Scheme Administrator on a Scheme member’s behalf. The tax charge is then recovered over time by the Scheme Administrator through a reduction in the pension paid to the scheme member.<br>There are two types of Scheme pays arrangements:<br>**Mandatory and Voluntary.**<br>**Mandatory Scheme Pays (MSP)**: which applies where a scheme member has made a request and:<br>• Pension savings growth in the Scheme exceeds the HMRC standard AA limit during the tax year; and<br>• An AA tax charge exceeding £2,000 has been triggered.<br>**Voluntary Scheme Pays (VSP)** where an employer can choose to introduce a scheme pays arrangement with different triggers or thresholds than those in the mandatory scheme (the tax still being recovered later through a reduction in pension benefits).<br>Due to the introduction of the 2015 Firefighters’ Pension Scheme and changes to tax rules on tapered AA, some Scheme members are no longer eligible for MSP but still face the burden of having to pay tax upfront on a pension that will be received in the future. The burden of meeting these upfront tax charges could be covered by a VSP arrangement as recommended in this report. |
| RISK ASSESSMENT | Given the reduction in the annual allowance, the potential increased tax liability faced by employees on promotion could dissuade individuals from applying for promotion and have a negative impact on recruitment and retention of middle and senior managers. A VSP would alleviate this problem to some extent, with no financial risk to the Authority. |
| COMMUNITY IMPACT ASSESSMENT | None for the purposes of this report |
| BUDGET IMPLICATIONS | There would be no additional cost to the Authority. |
| RECOMMENDATIONS | Members are asked to agree that:<br>1. A Voluntary Scheme Pays arrangement is introduced for the payment of pension Annual Allowance tax liabilities but applicable only in one (or both) of the circumstances set out in paragraph 3.6 of this report. |

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| | 2. This policy is applied retrospectively to any individual affected by the tax liabilities change (2015-16 onwards). |
| BACKGROUND PAPERS | None |
| APPENDICES | Appendix A - LGA Voluntary Scheme Pays in the Firefighters' Pension Schemes |
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## 1. Introduction

1.1. This report seeks to provide the Authority with background information relating to the personal tax liability on pension savings for a member of the Firefighters' Pension Scheme 1992 and Firefighters' Pension Scheme 2015.

1.2. It outlines the position on the annual allowance arrangements as they relate to firefighter pension schemes and detail changes to the annual allowance arrangements that lead to the need for the Authority to consider whether voluntary scheme pays arrangements should be put in place.

## 2. Background

2.1 Each taxpayer has an annual allowance which may be allocated to his or her pension 'pot' without incurring liability to tax. Tax is usually paid if savings in the individual's pension increase by more than the annual allowance which is currently £40,000 a year. This annual allowance has been significantly reduced over the last six years from £255,000 to the current £40,000 level. Put another way, the annual allowance is the maximum amount of tax exempt pension savings, from all registered pension arrangements, that can be built up in one tax year. In a defined benefit scheme, such as the firefighters' pension scheme, the "value" of the amount of pension and lump sum which is built up across the tax year is estimated. Any increase in value of pension and lump above the annual allowance is subject to the annual allowance tax charge. Annual allowance tax charge will be at the individual's marginal rate of tax.

2.2 Any increase in the value of a pension over the year is multiplied by a factor of 16 meaning that a middle or high earning employee who receives a significant promotion or pay rise has is likely to be affected by this tax liability.

2.3 Changes to the annual allowance, known as "tapering", see the annual allowance reduce as low as £10,000 for high earning individuals, from April 2016.

2.4 Scheme pays is a mechanism that allows an individual to ask the pension scheme administrator to pay any tax charge due in relation to an excess of pensions savings above the annual allowance. In return there is a reduction pension benefits. Fire authorities must agree to a 'mandatory scheme pays' election under section 237B of the Finance Act 2004 provided that the election is made within the relevant timescales. Mandatory scheme pays has been used with the firefighters' pension schemes since 2012.

2.5 Mandatory scheme pays is only required to meet the charge arising from the element of pension input in the scheme over £40,000. However, due to HMRC introducing "tapering" of this £40,000 allowance for the 2016/17 tax year there are now circumstances where the firefighter doesn't have the right to make a mandatory scheme pays election for the tax relating to the difference between the "tapered" (a minimum of £10,000) allowance and the £40,000 previous allowance.

2.6 With the introduction of the 2015 Scheme, members of the 1992 Firefighters' Pension Scheme and 2006 Firefighters' Pension Scheme who have transferred into the 2015 Scheme on or after 1 April 2015 will effectively be members of two pension schemes and will see pension benefit growth in both schemes until retirement.

2.7 By virtue of accruing their pension growth across two, rather than one pension scheme, there is an increased likelihood that although the member's total annual pension growth across both schemes may exceed £40,000, the pension growth in any one of the schemes may fall short of the HMRC annual allowance limit. As such they will not be eligible to use mandatory scheme pays to pay the annual allowance tax charge.

2.8 In these circumstances the additional tax liability could be covered by a voluntary scheme pays arrangement. This is a relatively common practice in other pension schemes.

2.9 Voluntary scheme pays works in the same way as mandatory scheme pays where the tax liability is paid by the pension scheme and the cost recovered by a reduction in the individual's pension pot. Unlike mandatory scheme pays however, there will be no joint and several liability and the individual remains wholly liable for the tax.

2.10 Following the introduction of "tapering" by HMRC, the Home Office have responded and set out their proposed approach which would allow fire authorities to grant voluntary scheme pays under the firefighters' scheme rules. The Scheme Advisory Board, at their meeting in March 2017, indicated they were in favour of the proposed approach and the Home Office are now examining how these arrangements could work. The working assumption indicated by the Firefighters' Pension Adviser at the Local Government Association (LGA) at that time was that this would be introduced via an amendment to the pension scheme regulations.

## 3. Summary of LGA Legal Advice

3.1 The LGA has recently sought legal advice on whether a FRA may lawfully offer a voluntary scheme pays arrangement without the need for a change in the law.

3.2 Although the LGA has shared its advice with FRAs its legal adviser has made the point that the advice was prepared for the LGA and that individual authorities must satisfy themselves as to the lawfulness of establishing any voluntary scheme pays arrangement.

3.3 The legal advice provided to the LGA is that a combined fire and rescue authority such as DWFRA (and for other reasons a county with fire and rescue functions) has the legal powers to operate a voluntary scheme pays arrangement.

3.4 As a combined fire and rescue authority DWFRA has the legal power under 5A of the Fire and Rescue Services Act 2004 to do:

*1. (a) anything it considers appropriate for the purposes of the carrying-out of any of its functions (its "functional purposes"),*

*(b) anything it considers appropriate for purposes incidental to its functional purposes,*

*(c)* *anything it considers appropriate for purposes indirectly incidental to its functional purposes through any number of removes,*

*(d)* *anything it considers to be connected with:*

*(i) any of its functions, or*

*(ii) anything it may do under paragraph (a), (b) or (c), and*

*(e)* *for a commercial purpose anything which it may do under any of paragraphs (a) to (d) otherwise than for a commercial purpose.*

*2. A relevant fire and rescue authority's power under subsection (1) is in addition to, and is not limited by, the other powers of the authority.*

3.5 These are wide ranging powers, though not as wide ranging as a local authority's general power of competence under the Localism Act. The Monitoring Officer agrees with the advice provided to the LGA and that these powers do enable a combined fire and rescue authority both to operate a voluntary scheme pays arrangement and to adjust a scheme member's benefits to reflect the payment of a tax charge on behalf of the scheme member.

3.6 The advice also indicates that a FRA's powers must be exercised reasonably and that the introduction of a voluntary scheme pays arrangement would be reasonable in the following circumstances, (as proposed by the Home Office and agreed by the Scheme Advisory Board):

- where access to the Voluntary Scheme Pays arrangement for transitional members with service in one of the 1992 or 2006 Schemes and the 2015 Scheme would be the same as the access a protected 1992 or 2006 scheme member, or a member with service only in the 2015 Scheme, would have to the Mandatory Scheme Pays arrangement

- or where access to the Voluntary Scheme Pays arrangement is afforded to those Scheme members where the pension growth in one or more schemes is more than their own tapered annual allowance limit but less than the

  £40,000 annual allowance.

3.7 The legal advice goes on to state that any fire and rescue authority wishing to make a Voluntary Scheme Pays arrangement for reasons other than the two listed at paragraph 3.6 above should consider whether to do so would represent a reasonable exercise of powers.

3.8 Subsequently, the Police and Firefighters' Pension (Amendment) Regulations 2018 came into force on 8 October 2018 and those regulations do not include any amendments regarding Voluntary Scheme Pays as it was accepted that, in accordance with the advice set out in paragraphs above, Voluntary Scheme Pays arrangements could be introduced under the auspices of the Fire and Rescue Services Act 2004.

## 4. Summary

4.1 Changes to tax liabilities have adversely impacted on individuals who; through changes to pension schemes, have found themselves in two pension schemes.

4.2 Introducing voluntary scheme pays arrangements is considered to be lawful. It is also thought to be in line with future changes likely to be made to the legislative framework relating to firefighters' pay and pensions.

December 2018