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Dear

CONSULTATION DOCUMENT: PROPOSED AMENDMENTS TO ARMED FORCES PENSION PROVISION

1. At the Central Advisory Committee meeting on 10 December I outlined changes we were having to make to ensure that Service personnel could continue to take Resettlement Commutation (RC). The following provides more detail about what we are doing and I would welcome your comments or suggestions about this and an error in the re-employment rules that has just come to light. As before, if any member would like to discuss any of the proposals I am happy to field questions by telephone, letter or email.

Issue

2. Amendments are proposed to the Armed Forces Pension Scheme 1975 (AFPS 75). These amendments relate to the rules on RC and the rules on re-employment

Timing

3. The Central Advisory Committee are invited to consider the attached amendments out of committee and to submit comments or observations by 4 February 2009.

Background

4. AFPS 75 is a non-contributory, final salary-related pension scheme which closed to new entrants on 6 April 2005 when two new schemes (AFPS 05 and RFPS) were introduced. AFPS 75 rules are contained in prerogative instruments and amendment is by Royal Prerogative.

5. Members of AFPS 75 who were in service on that date and still in service on 6 April 2006 were given an offer to transfer (OTT) to AFPS 05. In the event about 8% of those eligible opted to transfer to the new schemes.

6. Amendment to RC provisions: The RC provisions as originally drafted allow AFPS 75 members who leave at or after the Immediate Pension point, but before age 55, to realise an additional tax-free lump sum equal to the difference between the Terminal Grant (TG) they received and the TG they could have received if they had served for a full career (34 years for an officer or 37 years for an other rank). The lump sum realised is recovered from the pension between retirement and age 55. At age 55 the pension is restored to its original level. The size of the lump sum is limited so that this recovery does not take the pension below 50% of its original value. Members could take RC at any time during the first 12 months of their retirement.

7. Her Majesty's Revenue and Customs (HMRC) rules on tax-privileged pension schemes changed on 6 April 2006. These Pension Tax Simplification rules contained provisions which prevented:

- a member's pension being reduced once it was in payment; and
- the payment of a lump sum greater than 25% of the pension pot or the Life Time Allowance (LTA).

If a scheme allows either of these things to happen, the pension becomes an unauthorised payment and both the scheme and the member becomes subject to significant tax charges.

8. We had understood from HMRC that RC would not be caught by these rules as the right to RC existed before 6 April 2006 and AFPS 75 was, at that date, closed to new entrants. Subsequently HMRC informed us that they had advised us wrongly on the non-application of the 25% limit and that we had misunderstood their advice in respect of the window during which the decision could be made.

9. Since this unwelcome discovery, we have been working with HMRC on what might be done to allow Service personnel to continue to enjoy RC while observing the new rules. We are having to move RC out of the pension scheme in order that the 25% limit on lump sums should not bite and we are issuing a notice instructing that the decision to take RC must be made before leaving the Armed Forces.

10. HMRC has given us until the end of the financial year to make the necessary legislative changes.

11. Re-employment rules: AFPS 75 closed to new entrants on 6 April 2005 and those in service on that date and still in service on 6 April 2006 were given the opportunity to take part in the OTT exercise. During this exercise, concern was expressed by the Special Forces (SF) that their recruiting from the Royal Navy and the Royal Air Force could be affected if we did not make provision for someone who opted to stay in AFPS 75 to join the SF without having to change pension scheme. For these people, joining the SF means discharge from their original Service one day and joining the Army the next. Those who opted to stay in AFPS 75 did so because they believed that it was the right decision for them and the prospect of having to transfer to AFPS 05 could have been a deterrent to joining the SF.

12. We allayed their fears by explaining each prerogative instrument contained a rule which said that, unless the break in service was more than one month, service would be considered to be continuous. What has just been discovered is that the drafting of the closure of AFPS 75 was done in such a way as to make the rule applicable only to re-employment before the scheme's closure.

13. The proposed change adjusts the re-employment rules to achieve the original policy intent and safeguard SF recruitment.

Conclusion

14. These proposed amendments serve to:

- preserve the ability of Service personnel to raise an extra lump sum by way of temporary commutation; and
- safeguard the pension position of Royal Navy and Royal Air Force personnel who wish to join the SF.

If you have any comments on the attached proposals I would be very happy to received them. I should be grateful if you let me have them by 4 February 2009.

Yours sincerely,