Home Office

Home Office Circular 029/2015

Police pension schemes (England & Wales)

Introduction

1. This circular provides an update to circular 020/2008 and sets out the current position in relation to lifetime allowance and annual allowance charges. Police forces are required to note the information provided below, and take action where necessary. This circular has been produced in accordance with our best understanding of the Pensions Tax legislation. Administrators should check for any updates to the legislation or take further advice as necessary when carrying out any calculations.

2. This circular should be read in conjunction, where appropriate, with the following Government Actuary's Department's (GAD) guidance on "Tax charge debits":

- Police pension schemes (England & Wales): 1987 scheme: Tax charge debits: Factors and guidance, dated 7 May 2015
- Police pension schemes (England & Wales): 2006 scheme: Tax charge debits: Factors and guidance, dated 7 May 2015
- Police pension schemes (England & Wales): 2015 scheme: Tax charge debits: Factors and guidance, dated 11 June 2015

The above documents are those in force at the time of writing, but are subject to review. Administrators should refer to the most up to date versions of the GAD documents when carrying out calculations.

3. Contact details are provided at the end of the circular if further clarification is required.

4. The guidance below applies to the 1987, 2006 and 2015 police pension schemes.

5. This circular contains references to the Registered Pension Schemes Manual (RPSM) which is to be replaced by the Pensions Tax Manual. HMRC have released a draft version of the Pension Tax Manual prior to release of the final version, however, not all of the required references are available at this stage.

Lifetime Allowance

Calculation of lifetime allowance charges

6. Where an officer's total pension savings exceed the HM Revenue & Customs (HMRC) lifetime allowance (LTA) an additional tax charge may fall due. It can be paid by the officer, through the police force, at the time that the pension commences or it could be paid by the scheme administrator on the officer's behalf. If paid by the scheme administrator, the officer's ongoing police pension scheme benefits (and any lump sum benefit if it also exceeds the LTA) must be reduced so as to recoup the tax charge.

7. Regulations 84 and 85 of the Police Pensions Regulations 2006 and regulations 221 and 222 of the Police Pensions Regulations 2015 describe this. A similar rule will be inserted into the consolidation of the Police Pensions Regulations 1987, with backdated effect from 6 April 2011.

8. Example calculations of the LTA charge to apply are set out in **Annexes A, B and C.** Example calculations of any reduction to the officer's pension and lump sum are set out in the GAD guidance notes.

Meeting the lifetime allowance tax charge

9. In order to calculate the incidence of the charge, it is necessary to determine how much of the lump sum and the annual pension are above and below the LTA. This depends on whether or not the benefits are eligible for protection.

10. This guidance does not apply to a Benefit Crystallisation Event (BCE) where Enhanced Protection (EP) applies, because no LTA charge will be payable. However, this guidance might apply to officers who originally registered for EP but where that status no longer applies. This could be because they have chosen to split their BCEs so that EP applies to only the first BCE. In that case this guidance would apply to any subsequent BCEs, where the available LTA will be zero.

11. For officers not covered by Primary Protection (PP), the amount of the lump sum above the limit is the total lump sum entitlement in excess of one-quarter of the available LTA. In this case, the available LTA will depend on what type of protection, if any, the officer is covered by. Further details are set out in the section below titled 'Methods of Protection'. If the lump sum entitlement is smaller than one-quarter of the available LTA, then none of the lump sum is liable for a tax charge.

The amount of the pension above the limit is the post-commutation pension minus one-twentieth of the residual LTA after the tax-free lump sum has been deducted. In cases where the lump sum attracts a tax charge the residual LTA will be 75% of the prevailing LTA. In other cases the residual LTA will be the prevailing LTA less the lump sum paid. **See examples 1 and 2 in Annex B.**

12. For officers covered by Primary Protection the amount of the lump sum above the limit is whatever remains once any tax free lump sum has been subtracted from the total lump sum entitlement. The level of lump sum that can be taken tax free should be calculated in accordance with HMRC guidance as it applies to officers with PP, taking account of any rights to a lump sum of more than £375,000 on 5 April 2006. The amount of the pension above the limit is the post-commutation pension minus one-twentieth of the residual LTA after the tax-free lump sum has been deducted.

13. The tax charge in respect of ongoing pension is 25% of the excess of the HMRC valuation of ongoing pension benefits over the available lifetime allowance. HMRC uses a set factor of 20 to determine the overall valuation of post-commutation pension benefits. In addition, any lump sum over the limit is charged at 55%. (These two charging rates are equivalent if allowance is made for income tax at a rate of 40% on the pension element.)

14. The charge is paid by the scheme administrator to HMRC and can be financed in the following ways:

- by the officer paying the amount of the LTA charge to the police force for onwards transmission to HMRC or

- by the officer’s lump sum being reduced by the amount of the LTA charge, or
- by a reduction to the officer’s ongoing pension and any lump sum payable (see paragraph 2 which details the guidance covering these reductions)

15. A combination of the financing mechanisms could be used to meet the charge. The reduction in lump sum/ongoing pension is the default arrangement. If an officer does not wish to incur this reduction, and wishes instead to pay the LTA charge straight away via the police force, he/she must submit a request in writing to the police force and must pay the police force the full amount in question prior to the relevant benefit crystallisation event.

16. The LTA charge should be reported on the Accounting for Tax form APSS 302, whilst the tax itself is due at the same time that the form is due to be submitted to HMRC, i.e. 45 days after the quarter of the year in which the benefits are paid. HMRC does not need to issue an assessment to tax for this purpose. For more information see HMRC’s Scheme Administrator Page - RPSM11300055.

Lifetime allowances

17. The LTA is the amount within which an individual’s total pension benefits will not be subject to an additional tax charge. The LTA has been set for current and future tax years as follows:

2015-16 - £1.25m

2016 onwards - currently set to be £1m (due to be indexed by CPI from April 2018).

18. For the 1987, 2006 and 2015 police pension schemes, the value of retirement benefits coming into payment, as assessed for LTA purposes, is calculated as 20 times the annual pension plus any lump sum.

19. The LTA covers benefits in all pension schemes. At the benefit crystallisation event (BCE), that is the point when benefits come into payment, officers must inform the police force of any other benefits already in payment, providing the amount of LTA that has already been used by benefits that crystallised on or after 6 April 2006 and the level of benefits in payment at 5 April 2006 for benefits that crystallised before that date. The administrators can then determine the amount of LTA that remains. However, to prevent unnecessary delays to the process, officers should notify police forces of the amount of LTA that has already been used when advising of their intention to split their BCEs under the police pension schemes.

Methods of protection

20. The table below outlines the various methods of protection HMRC have made available for individuals who had already built up high levels of pension savings both at the introduction of the LTA on 6 April 2006 and at later stages where the LTA has been lowered. Further details can be found below the table.

Table 1 – Lifetime allowance protections

Protection name	Eligibility requirements	Personal LTA	Deadline for application
Enhanced Protection	Open to all	Pension rights value on 5 April 2006 as subsequently increase in line with HMRC guidelines (see below)	5 April 2009

Primary Protection	Pension rights value at 5 April 2006 exceeds £1.5m	Exceeds standard LTA by same proportion by which pension rights valued at 5 April 2006 exceeded £1.5m	5 April 2009
Fixed Protection 2012	Pension rights value on or after 6 April 2012 expected to exceed £1.5m Individual currently has no Enhanced or Primary Protection	Higher of standard LTA or £1.8m	5 April 2012
Fixed Protection 2014	Pension rights value on or after 6 April 2014 expected to exceed £1.25m Individual currently has no Enhanced, Primary or Fixed Protection	Higher of standard LTA or £1.5m	5 April 2014
Individual Protection 2014	Pension rights value on 5 April 2014 exceeds £1.25m Individual currently has no Primary Protection	Pension rights value on 5 April 2014 (subject to maximum of £1.5m)	5 April 2017

Additional information for Enhanced Protection

21. Enhanced Protection (EP): EP is lost if relevant benefit accrual occurs, i.e. when the value of the benefits crystallised exceeds the EP appropriate limit.

22. The EP appropriate limit is calculated as the greater of the value of pension rights on 5 April 2006 adjusted in the following two ways:

- Increased by the greater of 5% per year or the Retail Prices Index since 5 April 2006
- Recalculated using final pensionable pay at the BCE, i.e. allowing for the increase in pension value resulting from an increase in salary, not from further accrual of service, since 5 April 2006. This is known as the earnings recalculation amount. (Although it is of general application this is particularly important for officers in the 1987 scheme with 30 years' service by 5 April 2006, who expect that their salary will rise between 6 April 2006 and retirement, whose police pension rights can be fully protected from LTA charges. The officer must keep paying contributions towards the pension scheme in order to maintain the link between their pension and their current salary).

23. If the EP appropriate limit is exceeded at the BCE, then EP is lost. Benefits will be subject to the standard LTA, or personal LTA if the officer has PP. If the EP appropriate limit is the earnings recalculation limit and the officer has accrued additional years of service after 5 April 2006, then in most cases, the value of benefits at retirement will exceed the EP appropriate limit and EP will be lost if all benefits are crystallised in a single event.

24. EP can be lost by relevant benefit accrual only at the point when benefits actually come into payment. EP can also be lost in other circumstances, for example if an individual, or employer, makes contributions to a money purchase arrangement (such as a stakeholder pension or additional voluntary contribution fund) after 5 April 2006. It is the individual officer's responsibility to notify HMRC if EP is lost.

25. It is not possible for an officer to waive their entitlement to the part of the pension that would cause the EP appropriate limit to be exceeded. The Department for Work and Pensions has

stated that this would be an illegal practice. It is also intended to discontinue the option for officers to allocate part of their pension to increase the level of benefits payable to a dependant upon their death. This does not mean that existing allocations will be revoked; officers will simply now not have the ability to make new allocations. However, the removal of this ability to allocate can only be implemented once the relevant amendments to the regulations have been made - police forces are advised not to change their approach to allocation until further notice of the required regulation amendment.

Additional information for Primary Protection

26. Following the reduction in the standard LTA in 2012 and 2014 (and the planned reduction for 2016), individuals with primary protection will continue to measure their personal LTA with reference to the previous standard LTA of £1.8 million.

27. Where a pension becomes subject to a pension debit on divorce, the value of the pension rights under PP needs to be recalculated. The officer should be provided with an amended factor which is to be applied to the standard LTA to calculate their personal LTA when benefits are crystallised. An officer will lose their Primary Protection where the pension debit reduces the officer's protected pension rights to a value below £1.5m. For more information see HMRC's Technical Page – RPSM03102040.

Additional information for Fixed Protection

28. Officers cannot give up Fixed Protection but will lose Fixed Protection 2012 or Fixed Protection 2014 if, from 5 April 2012 and 5 April 2014 respectively, they:

- have a contribution paid to any of their money purchase pension pots
- build up new benefits in a defined benefits or cash balance pension pot above the relevant percentage. In a given tax year, the relevant percentage for the police pension schemes is the percentage by which the CPI increased in the year ending in September of the previous tax year. If there is no increase, or a fall in CPI in this period, then the relevant percentage rate is nil.
- join a new pension scheme - unless they are only transferring pension savings from one of their existing schemes into the new scheme
- start saving in a new pension pot either under an existing pension scheme or a new pension scheme
- Have a transfer that is not a permitted transfer

It is the individual officer's responsibility to notify HMRC if they lose Fixed Protection.

29. More information on fixed protection can be found on the HMRC's Technical Page - RPSM11101500.

Future Protection

30. From 6 April 2016 the standard lifetime allowance is to be reduced from £1.25 million to £1 million.

31. A new form of transitional protection which follows a similar approach as described above for the 2014 changes is expected to be put in place, although no details have currently been announced.

32. Further explanation of these protection measures may be found in HMRC's Registered Pension Schemes Manual.

Splitting the benefit crystallisation event

33. An arrangement is in place to allow officers to use EP to its maximum effect so as to limit the tax payable. Officers in the police pension schemes are permitted to receive their pension benefits upon retirement in stages, a practice known as splitting the benefit crystallisation event.

34. Under this guidance all officers, not solely those who have high levels of pension savings, are able to choose to split their benefit crystallisation events, regardless of whether their benefits exceed the LTA or not. However, the advantages of doing so in the case where benefits do not exceed the LTA are not clear, therefore officers are strongly advised to seek independent financial advice before making such a decision, as police forces are not permitted to give individual guidance.

35. This will be of particular benefit to an officer in the 1987 scheme who has built up further 60ths accrual since 5 April 2006 and would exceed his or her EP limit if all the pension benefits were crystallised in a single event. At the first stage, benefits up to the EP limit would be brought into payment, thus not breaching EP.

The officer would then receive his or her remaining benefits in the second stage (and any further stages). The second stage would result in relevant benefit accrual and trigger the loss of EP. Benefits taken at this stage (and any further stages) would then be subject to the standard LTA (or personal LTA if PP applies).

Crucially however, the portion of benefits between the standard LTA and the EP limit would not be subject to the lifetime allowance charge because, at the benefit crystallisation event in the first stage, EP is still valid. Each police force pensions administrator is responsible for conducting the relevant benefit accrual test, and will calculate the tax accordingly.

36. Officers must notify their police force in writing within four months prior to their retirement, and no later than their last day of service, with their request to split their BCE. Police forces may exercise discretion to allow officers to give notification of their request earlier than four months before their last day of service.

The officer must also specify at this time the amount that he or she wishes to receive as pension and the amount to be commuted for a lump sum at each separate stage. The total lifetime allowance charge payable and the remaining pension and lump sum will depend on whether pension is commuted at the first or subsequent BCEs (or the split between the two if commutation occurs at both events).

37. There are no limitations on the sequence of BCEs, apart from the fact that the Pension Commencement Lump Sum BCE must always occur immediately before the BCE of the associated pension. Police forces should be aware that according to HMRC guidance, the payment of a retirement lump sum and the payment of a retirement pension should be seen as separate BCEs.

38. Benefits received at the second stage (and any further stages) can occur on the same day as the initial BCE, although the police force may exercise discretion in allowing later payments as and when requested. Police forces are reminded that pensions administrators must have in place suitable mechanisms so that, for audit purposes, each BCE can be distinguished from one another.

HMRC have advised that there is no set method that pensions administrators must adhere to. Police forces are therefore recommended to develop local procedures to ensure compliance with HMRC rules. In addition, each officer's decision to split their BCEs should be set out in a written agreement with the police force. Police forces should seek legal advice on such an agreement to ensure it is enforceable.

39. There may be cases where individuals have previously registered for both PP and EP, and retain dormant PP whilst their EP is still valid. If EP is lost or surrendered, the individual is still entitled to rely on his/her PP and the associated personal lifetime allowance.

The individual must notify HMRC, who will issue the individual's PP certificate as proof of protection. There is nothing to prevent administrators from paying further BCEs on the officer's word that he/she has PP before receiving this certificate (i.e. on the same day as the other BCEs and the loss of EP), but administrators would risk being liable for a scheme sanction charge if HMRC later confirmed that the officer in fact did not have PP, and that there was an overdue tax charge payable.
We would strongly advise that any further BCEs should not take place until the pensions administrator has received the certificate. In these circumstances, police forces must ensure that officers are aware that all BCEs may not occur on the same day.

40. If EP is lost, and the police force pays the lifetime allowance charge on the officer's behalf, the pensions administrator must account for and pay it under the next quarterly Accounting for Tax return. Payment of the tax due should be made at the same time as the Accounting for Tax return is submitted. Further information may be found at HMRC's Registered Pension Schemes Manual.

41. Forces may exercise their discretion when considering how many extra crystallisation events an officer may request. Forces must bear in mind the administrative time and costs that would be incurred if an officer requests more than two payment stages, and should consider each case accordingly.

42. Officers must be aware that the police force bears no liability for any loss of income as a result of staging payment of the pension. Police forces are not empowered to give individual officers financial advice; therefore officers are strongly recommended to seek independent financial advice before making a decision.

Annual allowance

Calculation of annual allowance charges

43. Where an officer's total pension savings in any tax year exceed the HMRC Annual Allowance (AA) an additional tax charge may fall due.

44. In order to calculate the incidence of the charge, it is necessary to determine how much the annual pension savings in each tax year are above the AA limit.

45. The value of all pension savings is measured over a pension input period (PIP). This period usually covers 12 months and the PIP for the police pension schemes has historically been 1 April to 31 March. Legislation following the July 2015 Budget requires alignment of PIPs with the tax year. The PIP which started on 1 April 2015 will end on 8 July 2015. A new PIP will start on 9 July 2015 and run up to 5 April 2016. Pension savings accrued in both of these PIPs will be

assessed against the AA for the 2015/16 tax year only. All subsequent PIPs will be aligned with the tax year.

46. Due to the alignment of PIPs there is a transitional AA for savings made during the 2015/16 tax year of £80,000 (with “carry forward” provisions applying as usual), with a maximum allowance of £40,000 for the period between 9 July 2015 and 5 April 2016. **An example calculation is shown in Annex D.**

47. The pension savings in any tax year are the total from any PIPs that ended in that tax year.

48. The amount of an officer’s total pension savings in any one year should be calculated as the increase in the value of the individual’s benefits over the PIP. The increase is the difference between the opening value (the value of benefits at the start of the PIP i.e. 1 April) and the closing value (the value of the benefits at the end of the PIP i.e. 31 March).

49. The opening value can be found by multiplying the officer’s accrued pension calculated at the start of the period by 16, adding any separate lump sum amount and increasing this total by the 12 month increase in the Consumer Price Index (CPI) to the September before the start of the tax year. The closing value is found by multiplying the annual pension calculated at the end of the period by 16 and adding any separate lump sum amount. The pension input during this period is found by subtracting the opening value from the closing value. The pension input amount will be nil if this figure is negative. For more information see HMRC’s Technical Page - RPSM06105000. (There is a section below which covers how the officer’s accrued pension should be calculated for those with 1987 scheme service.)

If the pension savings over the year exceed the AA available to the officer then a tax charge will fall due. An officer’s AA in a given tax year (see the AA table below) can be topped up (under the “carry forward” provisions) with any unused AA from the previous three tax years.

50. The taxable amount will be the excess of the pension savings over the AA available to the officer (including any carry forward). The tax charge in respect of the AA charge will be at the officer's marginal tax rate.[1]

51. The charge may be paid by the officer or under certain circumstances they may request that the scheme administrator pay on their behalf.

52. The officer has a right to request the scheme pays their AA charge if:

- the AA charge for the tax year exceeds £2,000
- the total amount of pension savings in the scheme exceeds the AA for that tax year

If the officer meets the conditions above and requests that the administrator pays the charge on their behalf, the scheme becomes jointly and severally liable to pay the annual allowance charge with the officer. When considering whether the second condition is met, please note that the three police pension schemes are separate legal entities.

<u>For officers who do not meet the conditions above, legislation allows schemes to voluntarily pay the tax charge on the officer’s behalf. We are awaiting legal advice on whether the current police pension scheme regulations require amendment to allow such payments. Until this advice is</u>

[1] Note that for Scottish residents this marginal tax rate should refer to the Scottish Rate of Income Tax from the 2016/17 financial year onwards.

obtained, administrators should only pay charges in respect of officers who meet the conditions above.

53. Details on AA charges being paid by police forces are not currently set out in the Police Pensions Regulations 1987 or the Police Pensions Regulations 2006, however, the Police Pensions Regulations 2015 do set out details on the AA charges. These state that where an AA charge has been paid by the scheme on behalf of an officer, the officer's benefits will be reduced by an amount which reflects the amount of the tax charge paid. Overarching legislation requires that the officer's ongoing police pension scheme benefits (and any lump sum benefit) from the 1987 or 2006 schemes must be reduced so as to recoup any tax charge paid by the scheme administrator.

54. Example calculations of any reduction to the officer's pension and lump sum are set out in the GAD guidance notes.

Annual allowances

55. The annual allowance has been set for a series of tax years as follows:

2012/13 - £50,000

2013/14 - £50,000

2014/15 - £40,000

2015/16 – £80,000 (this is the transitional AA, and is subject to a maximum of £40,000 pension savings between 9 July 2015 and 5 April 2016)

2016 onwards – £40,000[2] (see below for high earners).

56. The AA covers benefits in all pension schemes. It is the officer's responsibility to review the annual pension input amounts for all pension schemes they have benefits in to calculate if a charge is to apply.

Annual allowances for high earners from April 2016

57. An AA taper will be introduced for high earners with effect from April 2016, reducing the AA down, incrementally depending on your income, to a minimum of £10,000.

58. The tapered AA will come into effect for officers with adjusted income (see below) over £150,000. For every £2 someone earns over this amount, their AA will reduce by £1 to a minimum of £10,000. An officer with an adjusted income of £210,000 or more will have an AA of £10,000.

59. Adjusted income is an officer's net income plus the value of any pension savings. These are defined as follows:

- Net income is the normal calculation of an officer's income for tax purposes, i.e. all of their taxable income, less any reliefs that they are entitled to, including relief on charitable contributions. Taxable income should include all of the officer's taxable

[2] The annual allowance is expected to increase in line with CPI from April 2018.

earnings from employment, plus all taxable income from other sources (for example rental income).

- Pension savings include the value of both the officer's and the employer's pension contributions.

60. One easement to the above, is that officers with net income of £110,000 or less will not be affected by the tapered AA, regardless of their adjusted income. For these officers the standard AA will apply. **An example calculation is shown in Annex E.**

Accrual in the 1987 scheme

61. The double accrual provisions of the 1987 scheme mean that some officers may have different accrual rates applying over a PIP. The pension input amount should be calculated using the officer's accrued service at the start and the end of this period, and should make allowance for the accrual actually awarded at those points in time.

62. As an example, take a protected 1987 scheme officer with 20 years of 1987 scheme service at the start of the PIP. The opening value should be calculated using an accrued pension of 20/60 times average pensionable pay. Provided that the officer remains in the 1987 scheme throughout the PIP, the closing balance (based on 21 years of service) should be calculated using an accrued pension of 21/57.273 times average pensionable pay (where 21/57.273 =20/60 + 1/30).

63. For unprotected officers, the accrued pension in the 1987 scheme at the start of the PIP should be calculated using the weighted accrual that would apply to the officer's pension if they retired at the start of the PIP (based on continuous service to that date). The 1987 scheme benefits at the end of the PIP should be calculated using the weighted accrual that would apply to the officer's pension if they retired at the end of the PIP. As a result, any change in the weighted accrual over a year is recognised for the purpose of the AA charge.

To illustrate this, consider an unprotected officer who has 15 years of 1987 scheme service and has been in the 2015 scheme for 10 years at the start of the PIP (i.e. 25 years of continuous service at the start of the PIP). The officer's 1987 scheme pension at the start of the PIP should be calculated using an accrued pension of 15/50 times average pensionable pay at the start of the PIP (where the 50ths accrual rate comes from the weighted accrual table in Annex A to the 2015 scheme guide, for 25 years of continuous service). The officer's 1987 scheme pension at the end of the PIP should be calculated using a pension of 15/48.75 times average pensionable pay at the end of the PIP (again, the accrual rate of 48.75 comes from Annex A of the 2015 scheme guide).

64. For more information see the variable accrual section of HMRC's Technical Page – RPSM06107100.

Officers with mixed police pension scheme service

65. For officers with service in both the 2015 scheme and a pre-2015 police pension scheme, the pension input amounts required to assess an officer's pension savings can be calculated separately for each scheme. However, these amounts should then be combined for assessment against the annual allowance.

66. Officers with tapered protection who move into the 2015 scheme at some point over the PIP can be processed in a similar manner to others with mixed police pension scheme service. Please note however that the opening value for the 2015 scheme pension input amount should

be set to zero and the closing value for the pre-2015 scheme pension input amount should include any service accrued up to the point of transition into the 2015 scheme.

Reduction of scheme benefits

Reduction to officer's pension in respect of lifetime allowance or annual allowance charges

67. Formulae for calculating the reduction applicable to the officer's annual pension and lump sum (where relevant) are set out in the GAD guidance notes referred to in paragraph 2.

68. The reduction to the officer's pension is permanent: it continues for as long as the pension continues to be paid, i.e. for the life of the officer.

Reduction to survivor's pension

69. No reductions, in respect of LTA or AA charges, will be made to the benefits payable to any surviving spouse, civil partner or children.

Officers with service in multiple schemes

70. For officers with benefits in multiple schemes there are currently no regulations on how scheme administrators should deal with cases where officer meet the criteria outlined in paragraph 52 in aggregate across multiple schemes but do not meet this criteria for any individual scheme. Further information will be made available as and when an approach is finalised.

For further enquiries on any of the issues covered in this Home Office circular, please contact:

Police Pension Team
Police Workforce and Capability Unit
police.pensions@homeoffice.gsi.gov.uk