Department of Health & Social Care

NHS Pension Scheme: pension flexibility

Consultation document

Published 11 September 2019

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Introduction

The NHS Pension Scheme is a highly valuable part of the package of pay, terms and conditions for NHS staff. It compares very favourably with pension schemes in other sectors. The scheme provides hard working and dedicated staff with financial security in retirement after decades of public service and patient care.

The Government provides tax incentives to encourage pension saving across society so that individuals have an income or funds throughout retirement. Pension scheme contributions can be made tax-free. However, the cost of providing this tax incentive is very substantial, at over £50bn, so Government places restrictions on the amount of pension saving that receives tax relief.

The relative generosity of the NHS Pension Scheme means that for some staff, mostly senior doctors, changes since 2010 to the way that wider pensions taxation works has resulted in their pension now growing to a level beyond their tax-free allowance. A tax charge is levied on the value of pension growth that exceeds the tax-free allowance. This is causing significant financial concerns to those doctors, with many now looking closely at whether it is in their financial interest to do extra work for the NHS. For some, the potential impact of the tax changes are prompting them to consider retirement or withdrawal from the NHS Pension Scheme.

The taxation regime affects different groups and different individuals in different ways. Initial concerns were focussed on the lifetime allowance as a factor that was leading General Practitioners (GPs) to retire earlier than they had planned. The British Medical Association (BMA) and NHS England agreed, as part of GP contract negotiations earlier this year, to ask the Government to consider a 50:50 option through which GPs could reduce both their pension contributions and their pensions accrual by 50%, to manage the growth in the size of their pension pot.

As this work developed to address issues principally in general practice, the interaction between the generosity of the NHS Pension Scheme and the tapered annual allowance, introduced in April 2016, on both GPs and senior consultants has become increasingly apparent. Both employers and the BMA have expressed concern about the need for wider flexibility to avoid perverse incentives which can cause senior medical staff to reconsider whether or not they can afford to provide additional patient care.

The Government had begun to consult on a 50:50 pension flexibility, where affected clinicians could choose to reduce their accrual by 50% and pay 50% fewer personal contributions. However it was clear from the early responses that a 50:50 option does not provide sufficiently broad flexibility for individuals to balance their pay, pension growth and tax liability.

The Secretary of State for Health and Social Care is determined to find an urgent solution that works for senior clinicians. The 50:50 consultation has therefore been withdrawn and this new consultation presents a package of new proposals that go significantly beyond the narrow 50:50 flexibility. Responses to the withdrawn 50:50 consultation will be considered alongside those received to this consultation.

These proposals offer very significant opportunities for senior clinicians to continue to provide additional care for the NHS by tailoring their pension accrual to the level they wish to achieve, taking into account desired pension growth and the tax implications. It also allows them to increase the level of accrual late in the scheme year, recognising that clinicians may not always know how much additional work they will do at the beginning of the scheme year. Where tax charges do occur, as is the case currently, the Scheme Pays facility means staff do not need to pay the tax charge upfront, instead the charge value plus interest can be taken off the individual's pension pot at retirement. The document proposes potential improvements to the way Scheme Pays operates in the NHS Pension Scheme so that staff can more clearly see the impact of using Scheme Pays on their pension at retirement. By tailoring accrual to manage annual allowance, it also enables easier management of the build up to the lifetime allowance limit.

The NHS Pension Scheme is a statutory scheme, so any changes require legislation and significant amendment to pension administration and payroll systems. Accordingly, the earliest changes can be made is in time for the next tax year. The Government recognises the urgency and asked NHS Employers to publish short-term guidance on possible local approaches that employers can consider taking to mitigate the impact of pension tax on their workforce this tax year.

The Government is listening to concerns about how the operation of the tapered annual allowance affects the delivery of public services. The Chancellor has announced that the Treasury will review how the tapered annual allowance operates in order to support the delivery of public services.

The Department recognises that, even with the important further flexibilities set out in this consultation, dealing with the complexities of the interaction between tax, pay, pensions and additional work for the NHS can be burdensome for hard working staff. The document therefore outlines plans to provide additional support that complements existing arrangements in helping individuals to navigate and manage this complexity.

The Government is committed to ensuring that hard-working clinicians who provide additional care for NHS patients do not find themselves considering reducing their work commitments, as a result of the interaction between their pay, their pension and the tax regime that surrounds this. The consultation therefore seeks views on how new important flexibilities in the way the NHS Pension Scheme operates can ensure that senior clinicians are rewarded properly for additional work whilst managing the impact on their pension and their tax liabilities in a fairer manner.

Executive Summary

The challenge of the tapering annual allowance

The NHS Pension Schemes are among the most generous pension schemes available and are a valuable part of the total reward package for NHS staff. However, for a relatively small but important group of staff, the interaction of the NHS Pension Schemes with the pension tax regime has created significant challenges. The evidence that the Department has demonstrates that the largest groups affected are high-earning consultants and GPs. The effect of this for some high earners is that pension tax could affect either the value of their take home pay or their final pension.

The Government provides tax incentives to encourage pension saving across society so that individuals have an income or funds throughout retirement. Pension scheme contributions can be made tax-free. The cost of providing this tax incentive is very substantial, at over £50 billion a year. Around 60% of the tax relief is claimed by higher and additional rate taxpayers. The Government has therefore sought to limit the amount of pension saving that receives tax relief so that the benefit is distributed fairly across society. Since 2010 there have been progressive restrictions on the amount that individuals can save into their pension tax-free. The Government applies two mechanisms to limit this: the Lifetime Allowance and the Annual Allowance.

The Lifetime Allowance limits the total amount of tax-free pension savings that an individual can make over their career. The allowance has reduced from £1.8m in 2011-12 to £1.055m currently. The current allowance level permits individuals in the older 1995 NHS Pension Scheme to build up with tax-free contributions, a pension worth £45,870 and a tax-free lump sum of £137,610. A tax charge is applied to pension savings above the lifetime allowance. The tax liability is assessed when the pension is drawn or transferred. Any tax charge is deducted from the value of the pension pot. Therefore, individuals do not pay a lifetime allowance tax charge in cash.

The Annual Allowance limits the amount by which an individual's pension savings can grow tax-free in the year. The allowance has reduced from £255,000 in 2010-11 to £40,000 currently unless a taper mechanism applies in which case it reduces further to potentially a £10,000 minimum. A tax charge is applied to pension savings above the individual's annual allowance.

The standard £40,000 allowance allows NHS staff to increase their pension by £2,500 before a tax charge is incurred. A member of the 2015 NHS Pension Scheme would increase their pension by £2,500 each year if they had pensionable earnings of £135,000. On average, consultants have pensionable earnings of around £90,000. This meant with a standard annual allowance of £40,000 far fewer doctors and other staff had pension

growth that exceeded the allowance limit. Tax charges arising from these allowances were relatively easy to predict and manage, because the tax calculation measured pension growth only which is related to the amount of pensionable earnings of individuals.

In April 2016, the Government introduced a mechanism to taper the annual allowance for those with the highest incomes. This applies to all individuals whose net income exceeds £110,000 and whose adjusted income (net income plus annual pension growth) exceeds £150,000. Net income is the taxable income shown on payslips - i.e. without pension contributions or other deductions made before income tax is applied. The taper mechanism reduces the amount of annual allowance by £1 for every £2 over £150,000. The taper stops at a minimum annual allowance of £10,000 which is reached where there is adjusted income over £210,000.

Individuals are able to carry-forward unused allowance from the previous three tax-years to absorb excess savings in the present tax-year. The current tax year (2019-20) is the fourth year since tapering was introduced meaning that for many affected staff any carry-forward reserves are likely to have been exhausted so the full force of the tax charge is now being felt.

Critically, the threshold income and adjusted income includes all sources of taxable income, including non-pensionable pay for additional sessions above full-time hours worked by many consultants. The result has been to bring increasing numbers of high earners in the NHS within the scope of pension tax charges.

Senior NHS clinicians, particularly consultants and GPs, have a significant degree of flexibility over their workloads and can vary their commitments in the course of the year. Consultants typically volunteer for additional non-pensionable sessions of work, often at short notice, to cover service pressures. This includes undertaking discretionary work to reduce waiting lists and deliver on-call services. GP partners are self-employed and will also take on additional work for instance supporting out of hours services.

In response to concerns about annual allowance tax charges, clinicians are seeking to control their income and pension growth by limiting or even reducing their NHS work to avoid breaching their annual allowance. NHS employers report that consultants are increasingly no longer willing to work additional sessions to reduce waiting lists, fill rota gaps or take on additional supervisory responsibilities. The lost capacity can be difficult to replace especially in clinical specialties where there are already shortages, and expensive as employers can pay a premium for locums to bridge the gap.

The Government recognises that the interaction between the NHS pension scheme and the pensions tax regime is driving a behavioural response from NHS clinicians to reduce their work commitments. The Government has also listened to concerns that this behavioural response is, in turn, impacting on frontline NHS service delivery and patient

care. In response, the proposals outlined in this consultation seek to address these issues by giving NHS clinicians facing these much greater pension flexibilities.

The taper can create some cliff edges, though this depends on an individual's circumstances. Some commentators argue that the operation of the taper is difficult to predict, particularly when a senior clinician is unsure what level of income that they will earn within a tax year. This uncertainty means that tax charges can occur unexpectedly for individuals. Around a third of NHS consultants and GP practice partners have earnings from the NHS that could potentially lead to them being affected by the tapering annual allowance.

The Government is listening to concerns about how the design of the tapered annual allowance affects the delivery of public services. The Chancellor has announced that the Treasury will review how the tapered annual allowance operates in order to support the delivery of public services. Should changes to the tax system be introduced the Department may revisit the need for flexibility within the NHS Pension Scheme.

Paying annual allowance tax charges

HM Revenue & Customs require pension schemes to provide a Scheme Pays facility, through which some individuals can meet their annual allowance tax charges by choosing to have it deducted (plus interest) from their pension pot at retirement.

The Department has maximised the availability of Scheme Pays facility by extending it so that it can be used to settle any annual allowance charge of any value. This is beyond the statutory minimum requirement for Scheme Pays coverage. This means that no one needs to find money up front to pay their pension tax bill.

Under NHS Scheme Pays the pension scheme pays the tax charge on behalf of the member directly to HMRC. This creates a debt that is repaid at retirement where the charge value plus interest is deducted from the member's pension before it is put into payment. Scheme Pays is available to all members of the NHS Pension Scheme.

Staff who are high-earners early in their career may incur annual allowance tax charges frequently throughout their career. Whether staff pay their annual allowance charges by using Scheme Pays or in cash upfront will be an individual decision and is likely to depend on their circumstances including whether they have the resources to pay the tax charge up front. Central to this decision is a clear understanding of how at retirement the size of a Scheme Pays deduction from the pension compares with the final value of the pension growth that led to the tax charge.

However, the current way that the NHS Pension Scheme operates Scheme Pays may not allow a clear insight on how it affects member pensions. The consultation proposes an

alternative method that seeks to provide greater transparency for members. This would involve annual member benefit statements showing the Scheme Pays deduction as a pension debit so that they can see the adjustment to their pension at retirement as it increases with interest each year and compare this with how the accrued pension also increases over time though annual pot revaluation or salary increase.

However, whilst Scheme Pays is an important method for paying tax charges, it does not allow high-earners to manage their pension accrual, and any associated annual allowance charges, in the first place.

Proposed scheme flexibility

Some private sector pension schemes offer members the flexibility to tailor the rate at which their pension builds (accrual rate). At present the NHS Pension Scheme does not allow any such flexibility. Instead, in response to concerns about annual allowance tax charges, some clinicians are choosing to reduce their NHS income through declining the additional discretionary work and responsibilities that the NHS relies upon, reducing their hours or opting out of the NHS Pension Scheme.

The Department is therefore consulting on proposals to introduce new flexibilities within the NHS Pension Scheme for clinicians whose work patterns mean they have a reasonable prospect of incurring an annual allowance tax charge.

The new proposals offer options that go significantly beyond the previous 50:50 proposal that the BMA and NHS England had originally asked Government to consider but that is now viewed as providing insufficient flexibility. Discussions with the medical profession and employers have highlighted the need for wide-ranging pension flexibility, that would offer clinicians the tools to control the amount of tax-free pension saving they build up so that they can manage their tax liability without needing to reduce their workload. Tailoring pension accrual helps manage both the annual and lifetime allowance liability, as slowing down pension growth allows individuals to reach the lifetime allowance limit at a point in time that matches their target retirement age.

The proposed changes to the Scheme would allow such clinicians to:

- Choose before the start of each scheme year (1 April) a personal accrual level and pay correspondingly lower employee contributions. The accrual level chosen would be a percentage of the normal scheme accrual level in 10% increments. For example, 50% accrual with 50% contributions, 30%:30% or 70%:70%.

- Fine tune their pension growth towards the end of the scheme year by updating their chosen accrual level when they are clearer on total earnings. For example, go from 50%:50% to 60%:60%. The updated accrual level would be higher than

initial level and have retrospective effect from the start of the scheme year. Contribution arrears from the higher accrual level would be payable by the member and employer before the end of the scheme year.

Where clinicians use the flexibilities to choose a lower accrual level than the full rate, the employer will also pay lower contributions. Employers have the discretion to pay to the member unused employer contributions in these circumstances, although this would be a decision for individual employers. Unused employer contributions could be paid by non-recurrent lump sum at the end of the scheme year after any updating of the chosen accrual level for that year.

To note, for 2019-20 NHS Employers has issued short-term guidance on possible local approaches that employers can consider taking to mitigate the impact of pension tax on their workforce this tax year; this includes consideration of recycling unused employer contribution into salary. The Government's response to this consultation will provide clarity around such approaches after flexibilities are introduced.

One-off substantial increases in pensionable pay can create a spike in pension growth and a higher annual allowance tax charge that is not replicated in the subsequent years. The NHS Pension Scheme Advisory Board have suggested that the amount by which the new pay level contributes towards member pensions could be gradually increased over a number of years to smooth such spikes. The Department proposes to consult on the principle of phasing the 'pensionability' of large pay increases for high-earners and invites views on potential ways to give effect to this.

The Department is concerned that the complex interaction of tax, pay and pensions can take considerable amounts of individual time and resources to manage. To complement the introduction of new pensions flexibilities, the Department will work with employers and staff representatives to ensure that all clinicians affected by pensions tax issues or concerns have access to high quality education and information to understand their tax liability and how these new flexibilities can be best used to support individual circumstances and preferences. Guidance and modellers commissioned by the Department do not constitute financial advice.

Building on what is already available, the Department is planning to commission a modeller to help individuals assess options for using these flexibilities tailored to their personal circumstances. The intention is to support affected clinicians and their employers to agree programmed activities and other contractual commitments equipped with a clear understanding of their pension tax liability and how the flexibilities can be best deployed to deliver the right balance of incentives.

The Department intends that this support will be available from the end of this calendar year in good time, subject to the outcome of this consultation, for the introduction of the new pension flexibilities.

The NHS Pension Scheme remains one of the most generous pension schemes on offer and will continue to be an important part of the reward offer for all staff, including high-earners. The proposals set out in this consultation document are intended to offer clinicians flexibility to tailor their pension growth, so they are not unfairly impacted by performing the extra work that the NHS needs. Where tax is incurred, the proposed changes to Scheme Pays will provide increased transparency as well as flexibility in how the liability is met.

Consultation purpose and process

The NHS Pension Schemes provide generous pension benefit accrual for members. The Department understands this means many senior clinicians are exceeding their annual allowance for tax-free pension saving, producing a tax charge. In response, there is evidence that high-earning clinicians, particularly consultants and GPs, are managing their annual allowance tax liability by reducing their workload, turning down extra responsibilities and/or retiring early. Consequently, there is a reduction in NHS service capacity and patient care is adversely affected.

The first two chapters of this consultation document explain the issue, describe the impact as understood by the Department, and proposes introduction of a targeted pension flexibility. Currently, the Department is proposing to target flexibility at clinicians, provided that doing so is reasonable and proportionate.

Chapter 3 sets out the proposed new flexibility and invites views. Chapter 4 explains how the Scheme Pays facility, a mechanism that members can use to settle their tax charges, works in the NHS Pension Scheme and proposes a potential improvement to improve transparency.

Consultation questions

The Department would like to receive responses on the following consultation questions, including evidence (where available) to support the response:

The case for pension flexibility

1. Who do you think pension flexibility should be available to?

- *NHS GPs and consultants who may be affected by the annual allowance tax charge*
- *Other NHS clinicians who may be affected by the annual allowance tax charge*
- *Non-clinicians in the NHS who may be affected by the annual allowance tax charge*
- *All members of the NHS workforce, regardless of their tax position*
- *Other group*
- *None of the above*

Please provide evidence to support your views

Proposed pension flexibility

2. Do you think the proposal for a more tailored approach to pension accrual is flexible enough for senior clinicians to balance their income, pension growth and tax liability? *Please set out the reasons for your answer.*

3. If not, in what ways could the proposals be developed further?

4. We're proposing that large pay increases for high-earning staff should only be included in their pensionable income gradually. Do you agree or disagree with this proposal? *Please set out the reasons for your answer.*

Improving Scheme Pays

5. Currently, the NHS Pension Scheme has a notional defined contribution pot (NDC) approach to Scheme Pays deductions. We're proposing to replace this with the debit method. Do you agree or disagree with this? *Please set out the reasons for your answer.*

Equality Impact Assessment

6. What impact, if any, do you think the following will have on people with one or more protected characteristics:

a) The proposal to target the flexibility to clinicians who have a reasonable prospect of an annual allowance tax charge

b) The proposal to provide flexible accrual to clinicians who have a reasonable prospect of an annual allowance tax charge

c) Other proposals in the consultation document *e.g. phasing pensionable pay increases and/or commissioning a modeller to help individuals understand their tax liability and flexibility options*

d) Adopting the debit method for scheme pays

7. Are there any further equality considerations that the Department should be aware of from groups outside the data set?

How to respond

Comments on the proposals can be submitted online at the gov.uk website

By email to:
NHSPSconsultations@dhsc.gov.uk

Or by post:
NHS Pensions Policy Team
Department of Health and Social Care
2NE Quarry House
Quarry Hill
Leeds LS2 7UE

The consultation will close on 1 November 2019.

Confidentiality of information

We manage the information you provide in response to this consultation in accordance with the Department of Health and Social Care's Personal Information Charter.

Any information received, including personal information, may be published or disclosed in accordance with the access to information regimes (primarily the Freedom of Information Act 2000 ("FOIA"), the Data Protection Act 2018 (the "DPA 2018") and the Environmental Information Regulations 2004).

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you would explain to us why you regard the information that you have provided as confidential. If we receive a request for disclosure of the information you have provided we will take full account of your explanation, but we cannot give an assurance that confidentiality will be maintained in all circumstances.

An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

The Department will process your personal data in accordance with the DPA 2018 and in most circumstances, this will mean that your personal data will not be disclosed to third parties.

1. Context: the NHS Pension Scheme and tax incentives for pension saving

The NHS Pension Scheme for England & Wales

1.1 The NHS Pension Schemes for England & Wales (the "Scheme") are provided to staff working in the NHS and other approved organisations who deliver certain services or functions that support the NHS. There are two separate Schemes: the 2015 Scheme[i] and an earlier Scheme comprising a 1995 Section[ii] and a 2008 Section[iii].

1.2 The 2015 Scheme provides pension benefits calculated on a career average revalued earnings basis. The 2015 Scheme replaced the earlier 1995/2008 NHS Pension Scheme which is closed to new entrants. The 1995/2008 Scheme provides pension benefits based on final salary for employees, or career average earnings for General Practitioners and General Dental Practitioners.

1.3 Transitional arrangements following introduction of the 2015 scheme mean that many NHS staff have benefits accrued in both the 1995/2008 Scheme and the 2015 Scheme. However, a recent judgment by the Court of Appeal in the cases of McCloud and Sargeant found that transitional arrangements gave rise to unlawful discrimination. Whilst the judgment found against the Judges' and Firefighters' pension schemes, the Government announced on 15 July 2019 that it accepts the judgment applies to other public service pension schemes, including the NHS, and will remedy the discrimination in all the schemes.

1.4 Around 90% of NHS staff participate in the NHS Pension Scheme. The Scheme is administered by the NHS Business Services Authority (the "BSA") on behalf of the Secretary of State for Health and Social Care. There are around 1.5 million actively contributing members, 650,000 people who have left the scheme but not yet claimed their pension, and 900,000 pensioners. At 31 March 2018 there were 8,674 participating employers, the majority of whom are GP practices though most scheme members are employed by NHS Trusts and Foundation Trusts.

1.5 The NHS Pension Scheme is a valuable and valued component of the reward package for NHS staff, helping employers recruit and retain their workforces. The NHS Pension Scheme is high quality, providing generous retirement and life assurance benefits including a retirement lump sum (optional in some cases), an annual pension and benefits for a surviving partner and dependants. Benefits accrue at a rate of 1/80th pensionable pay (1995 Section), 1/60th (2008 Section) or 1/54th with annual revaluation by the rate of CPI + 1.5% (2015 Scheme). The

normal pension age at which benefits become payable is 60 (1995 Section), 65 (2008 Section) or the member's state pension age (2015 Scheme). The BSA's website provides further detail of the benefits provided.

1.6 Each member contributes a percentage of their pensionable pay towards the cost of their pension benefits. The percentage rate is based on the level of a member's pensionable pay, and ranges between 5% and 14.5% (before tax relief). Employers also contribute to the cost of providing pension benefits at a rate of 20.6%, plus a scheme administration levy of 0.08%.

1.7 The table below shows the size of average annual pensions paid at retirement[iv].

Staff type	Average annual pension at retirement
GP	£44,000
Consultant	£40,000
Nurse, midwife & physiotherapist	£11,500
All NHS staff, excluding GPs & consultants	£6,400

Funding model for the NHS Pension Scheme

1.8 The NHS Pension Schemes are statutory unfunded, defined benefit ("DB") occupational pension schemes backed by the Exchequer. In DB schemes the benefits received at retirement are calculated according to a pre-set formula determined by the scheme rules. It is not dependent on the level of contributions made. DB schemes need to predict contribution income when pricing the level of contributions required to deliver the pre-set benefits. DB schemes are therefore inherently less flexible and do not usually allow their members to vary the amount that they contribute to the scheme.

1.9 Many private-sector pension schemes are defined contribution ("DC") pension schemes. Members of DC schemes usually have more flexibility over the amount they contribute towards their pension pot. Both the member and employer contributions are invested to grow the pot, which can be used to buy a pension annuity or drawn down at retirement. Pension growth is therefore directly linked to the level of contributions made.

1.10 In common with other major public service pension schemes, except the Local Government Pension Scheme, the NHS Scheme is 'unfunded' and does not manage a pool of assets out of which pensions are paid. It is instead financed by the Exchequer on a ‘pay as you go’ basis. This means the Exchequer pays

pension liabilities as they fall due and uses contribution income from employers and staff to defray the cost of pensions already in payment. An actuarial valuation is conducted every four years to ensure the level of contributions made by staff and employers meet the full cost of their pension rights as they accrue them. The Exchequer meets the cost of any shortfall in the cashflow between pensions paid and contributions received and would also retain any surplus.

1.11 Membership of the NHS Pension Scheme for eligible members is automatic and the NHS Pension Scheme currently has 1.5m actively contributing members. Where individuals withdraw from the Scheme (opt-out), this reduces the amount that the Scheme expects to receive in contribution income but also reduces long-term liabilities in the form of membership benefits being bought that will subsequently be paid to retired members in the future.

1.12 In the financial year 2019-20, the Scheme expects to receive contribution income of £10.1 billion from employers and £4.8 billion from members. The Government Actuary's Department have valued the pension liabilities of the Scheme at £526.1 billion as at 31 March 2018.

1.13 The fiscal framework within which the NHS Pension Scheme operates is therefore an important consideration when changing scheme rules. Any changes that have a significant effect on contribution income, such as flexibility that leads to a lower level of contributions being paid, produces an immediate fiscal impact for the Exchequer. The Government must therefore balance the benefit of changes with the corresponding cost risk to the Exchequer.

Tax incentives for pension saving

1.14 The Government wishes to encourage pension saving to help people ensure they have an income or funds throughout retirement. It is for this reason that pension contributions are tax-free for the majority of savers.

1.15 Pension tax relief works on the principle that pension contributions and any investment growth are exempt from income tax, but the pension is then taxable when paid. Pension contributions are usually paid out of pre-tax salary, so tax relief is received at the individual’s marginal tax rate.

1.16 However, tax relief on pension contributions is one of the most expensive reliefs in the personal tax system. In 2017-18, income tax relief and employer National Insurance Contributions relief cost the Exchequer over £50 billion, with around 60% of the relief claimed by higher and additional rate income taxpayers.

1.17 In view of this cost, the Annual and Lifetime allowance tax policies were introduced to limit the amount of pension savings that can be built up with tax-free contributions. Reforms made to these allowances in the previous two Parliaments are expected to save over £7 billion this year and are necessary to deliver a fair system and to protect public finances. These measures affect those on the highest incomes with significant pension accruals: 95% of people currently approaching retirement have a pension pot worth less than the current lifetime allowance limit of £1.055m, while the median pension pot for individuals approaching retirement is around £170,000.

1.18 The Government keeps its lifetime and annual allowance tax policies under review. The 2018 Autumn Budget confirmed that the lifetime allowance would rise from £1.03m to £1.055m in April 2019, in line with the Consumer Prices Index ("CPI") to ensure the benefit is not eroded. The standard annual allowance remains at £40,000, although it can taper down to a minimum of £10,000 for those on the highest incomes.

1.19 The taper applies to all individuals whose net income exceeds £110,000 and whose adjusted income (net income plus annual pension growth) exceeds £150,000. Net income is the taxable income shown on payslips - i.e. without pension contributions or other deductions made before income tax is applied. The taper mechanism reduces the standard £40,000 annual allowance by £1 for every £2 of adjusted income over £150,000. The taper stops at a minimum annual allowance is £10,000 which is reached where there is adjusted income over £210,000.

1.20 The Lifetime Allowance and Annual Allowance measures allow individuals to make significant amounts of pension savings tax-free, whilst ensuring incentives to save are targeted across society.

1.21 To put the allowances in context, members of the 1995 final salary section of the NHS Pension Scheme who use up the full £40,000 annual allowance would see their annual pension increase by around £2,500. Members who build up pension benefits worth the current lifetime allowance of £1.055m can expect an annual pension of around £46,000 a year plus a tax-free lump sum on retirement of £138,000. Pensions of this size provide substantial financial security in retirement, and it is right that the Government takes steps to limit tax incentives for those who benefit disproportionately from them.

1.22 These allowances apply to all pension savers, working in both public and private sectors. Tax charges are incurred by individuals where the growth in pension benefits breaches their lifetime or annual allowances. The lifetime allowance tax charge depends on how the value of benefits in excess of the limit are paid to the member: 25% for annual pension, 55% for lump sum. The tax charge is deducted

from the pension benefits upon crystallisation, usually when the pension is claimed or transferred to another scheme. The annual allowance charge is typically taxed at 40% or 45% and is the marginal rate of income tax that the member would be charged if their taxable income was added to the amount of pension saving in excess of their annual allowance.

1.23 The NHS Pension Scheme operates a Scheme Pays facility, through which individuals can meet their annual allowance tax charges by choosing to have it deducted (plus interest) from their pension pot at retirement. This means that no-one needs to find money up front to pay their pension tax bill.

1.24 The Department has maximised the availability of the Scheme Pays facility by extending it so that it can be used to settle any annual allowance charge of any value. This is beyond the statutory minimum requirement for Scheme Pays coverage.

1.25 Under Scheme Pays the pension scheme pays the tax charge on behalf of the member directly to HMRC. This creates a debt that is repaid at retirement where the charge value plus interest is deducted from the member's pension before it is put into payment. Scheme Pays is available to all members of the NHS Pension Scheme.

1.26 Staff who are high-earners early in their career may incur annual allowance tax charges frequently throughout their career. Whether staff pay their annual allowance charges by using Scheme Pays or in cash upfront will be an individual decision and is likely to depend on their circumstances. Central to this decision is a clear understanding of how at retirement the size of a Scheme Pays deduction from the pension compares with the final value of the pension growth that led to the tax charge.

1.27 However, the current way that Scheme Pays operates in the NHS Pension Scheme may not allow members to easily assess how it affects their pension. An alternative method is proposed in Chapter 4 that may provide greater transparency for members. This would result in annual benefit statements showing the Scheme Pays deduction as a pension debit so that members can see the adjustment to their pension at retirement as it increases with interest each year and compare this with how the pension growth that gave rise to the tax charge also increases annually.

2. The case for pension flexibility

2.1 Across all public service workforces, the Government looks at remuneration in the round and takes action where required to ensure delivery of first-class public services. Where there is evidence that the delivery of services is being impacted, the Government is prepared to take appropriate action to address this.

The impact of pension tax

2.2 The Government is listening to concerns raised by senior doctors and their employers that annual allowance tax charges are discouraging them from performing extra work for patients or maintaining their current level of commitments. The increased income from this work could trigger their annual allowance to taper downwards thereby increasing the annual allowance tax charge arising from growth in their NHS pension beyond the tax-free limit. The prospect of a large annual allowance tax charge could decrease the financial attractiveness of undertaking the additional work.

2.3 Consultants perform relatively high amounts of discretionary work which is mainly non-pensionable. Many offer further sessions to deliver waiting list initiatives and will also take on additional responsibilities such as clinical director roles. The taper assesses all taxable income, therefore non-pensionable income contributes to reducing the annual allowance where the individual crosses the £110,000 threshold limit and has adjusted income above £150,000. However, the point at which an annual allowance charge emerges will vary between individuals according to their income plus the amount and type of pension already accrued.

Example 1 - average pensionable pay

A consultant with an average[v] basic pay (pensionable) of £91,532, increased by 2% from the previous year, 14 years' service in the final salary 1995 section and £5,300 of accrued CARE[vi] pension in the 2015 scheme. That consultant would need to have non-pensionable earnings of at least £62,800 before an annual allowance charge is incurred. Therefore, a lower amount of non-pensionable earnings would not result in an annual allowance charge and non-pensionable earnings of £70,000 would incur an annual allowance charge of £1,579.

Example 2 - higher pensionable pay

If the consultant instead had pensionable pay of £153,000, increasing by 2% from the previous year, and £8,000 of accrued CARE pension in the 2015 scheme together with 14 years' service in the 1995 section. Without any extra non-pensionable work, there would be an annual allowance charge of £9,691. If the consultant utilises Scheme Pays to pay the annual allowance tax charge, then they will accrue £3,090 of annual pension[vii]. If the consultant chooses to pay their tax charge up front, then they will accrue £3,738 of annual pension[viii].

The annual allowance tax charge would be increased by almost £5,500 if the consultant earned an extra £20,000 through non-pensionable work because the total annual allowance tax charge would increase to £15,150. If the consultant utilises Scheme Pays to pay the annual allowance tax charge, then they will accrue £2,726 of annual pension[ix]. Again, if the consultant chooses to pay their tax charge up front, then they will accrue £3,738 of annual pension[x].

2.4 Example 1 demonstrates that many consultants, particularly in the earlier years of their consultant career when pensionable pay is lower, are unlikely to receive large regular annual allowance charges, however example 2 shows that at higher levels of pensionable pay there is greater potential for significant regular annual allowance tax charges. It also demonstrates the impact on their pension of using Scheme Pays to meet the tax charge compared to paying it in cash up front.

2.5 Examples 3 and 4 below show how large increases in pensionable pay or long service in the final salary 1995/2008 Scheme can lead to higher annual allowance charges, as these factors substantially affect pension growth. As with the other examples, the impact of using Scheme Pays on pension benefits is shown. The consultant receives a pay rise which is above-inflation which results in an increase to the retirement lump sum. To demonstrate this and the impact utilising Scheme Pays will have on the lump sum, lump sum figures are included in the examples.

Example 3 - large increase in pensionable pay

A consultant has pensionable pay of £112,200, increased by 10% from the previous year, with £55,000 in non-pensionable income, producing total pay of £167,200. The consultant has £5,300 of accrued CARE pension in the 2015 scheme together with 14 years' service in the 1995 section.

In this scenario, the consultant would incur an annual allowance tax charge of £23,765. If the consultant utilises Scheme Pays to pay the annual allowance tax charge, then they will accrue £2,973 of annual pension and grow their lump sum by £4,076[xi]. If the consultant chooses to pay their tax charge up front, then they will accrue £4,121 of annual pension and grow their lump sum by £5,355[xii].

Example 4 - long service in the final salary scheme

The consultant in example 4 is older and is a transitionally protected member with 30 years' service in the 1995 section and no CARE pension in the 2015 Scheme. With all other circumstances the same as example 3, the consultant would incur an annual allowance tax charge of £32,783.

If the consultant utilises Scheme Pays to pay the annual allowance tax charge, then they will accrue £3,764 of annual pension and grow their lump sum by £11,293[xiii]. If the consultant pays their annual allowance tax charge upfront then they will grow their pension by £5,100 a year and add £15,300 to their retirement lump sum[xiv].

2.6 The Government recognises that the action some members are taking in response to their concerns about, or direct experience of, annual allowance tax charges is impacting the delivery of NHS services and patient care. NHS employers report that consultants are increasingly no longer willing to work additional sessions to reduce waiting lists, fill rota gaps or take on additional supervisory responsibilities. The lost capacity can be difficult to replace especially in clinical specialties where there are already shortages, and expensive as employers can pay a premium for locums to bridge the gap.

2.7 An independent review[xv] of the GP partnership model on behalf of the Department found pension tax to be a factor in decisions by GPs to reduce their NHS commitments or retire prematurely. 57% of GPs who retired in 2018-19 took early retirement, a total of 610.

2.8 The pension tax system supports individuals to save for their later life. Reforms in the last two Parliaments to support fiscal sustainability have limited the benefit of income-tax relief on pension contributions for the highest earners in society who benefit most from this relief. Clinicians are rightly well remunerated for their work. Outside the public service, some employers may adjust benefit packages to enable high-earning employees to target a lower level of pension saving and so reduce the potential for large regular annual allowance tax charges. In most DC pension schemes, the member can reduce the rate at which contributions are made to their pension.

2.9 The NHS Pension Scheme does not currently allow any flexibility over benefit accrual or the level of contributions. Where an individual chooses to participate in the scheme for an employment, all regular earnings from that employment must be pensionable unless excluded by the Scheme rules. The Government takes the view that it is important to ensure a good level of pension saving and reward packages are set on that basis. The total reward package for NHS staff is kept under review by Government with recommendations made by the pay review bodies taken into consideration.

2.10 However senior clinicians, particularly consultants and GPs, have a unique degree of flexibility over their workloads and can vary their commitments. Consultants can reduce or increase the number of additional sessions undertaken, and many GPs are self-employed. This can create perverse incentives for clinicians to seek to control their income and pension growth by limiting or even reducing their NHS work to avoid breaching their annual allowance.

2.11 Additionally, as highlighted in example 3 above, a one-off substantial increase in pensionable pay can lead to a large spike in pension growth for that year and a higher annual allowance tax charge that is not replicated in the subsequent years. In some cases, the carry forward of up to three years of previous unused annual allowance may help minimise the tax impacts of such an increase.

Targeting the flexibility

2.12 Retaining and maximising the contribution of our highly-skilled clinical workforce is crucial to delivery of the ambitions for patient care set out in the Long-Term Plan for the NHS. The Government recognises that the fixed structure of the NHS Pension Scheme combined with measures in the pension tax system to limit the relief available to those on the highest incomes, could create unintended consequences for NHS service capacity and the delivery of patient care.

2.13 Accordingly, the Government proposes making the NHS Pension Scheme more flexible to create the right balance of incentives for clinicians to deliver the services

that the NHS needs. The Government is proposing to target these measures to ensure changes maintain the capacity of the NHS to deliver excellent clinical services. There is clear evidence that the interaction of pension tax with the NHS Pension scheme is leading to senior clinicians refusing to do extra work, reducing their hours or retiring early. In line with the Government's principles for public sector pay and pension policy, any flexibility must be affordable, targeted at affected staff and drive productivity.

2.14 Whilst the evidence of service impact is strongest for consultants and GPs, the Department understands that other clinicians such as senior nurses and dentists can also incur annual allowance tax charges, particularly those with long service in the NHS Pension Scheme, and that they also may have the flexibility in their roles such that they can choose to work fewer hours or not take on additional duties in response. Consequently, there is the potential for a similar impact on NHS service capacity and the delivery of patient care as that evidenced for senior doctors. The Department invites evidence to test and confirm this position. If such evidence does not exist and annual allowance tax charges do not appear to affect clinicians other than doctors in a way that leads to a reduction in NHS service capacity and impacts patient care, then the Department will reconsider this position.

2.15 There is a less clear case that annual allowance tax charges are creating similar retention and productivity issues in the non-clinical NHS workforce. Whilst non-clinical staff may exceed their annual allowance, the Department has not yet seen evidence that it has the same impact on the capacity of NHS services and patient care. This might be because the nature of these roles provides less or no scope to vary or reduce their working commitments or substantially increase their income through additional tasks and responsibilities. The Department is open-minded on the issue and invites respondents to submit evidence that non-clinical staff exceeding the annual allowance is leading to a reduction in NHS capacity and impacts patient care.

2.16 Lower earners are unlikely to be affected by annual allowance tax charges, particular as a result of the tapering rules. Accordingly, it is anticipated that the annual allowance tax charges are unlikely to impact the retention and productivity of these staff. Offering a general pension flexibility to all staff is therefore not under consideration at present. The Government keeps the impact of public sector pay and pensions policies under review, taking account of total reward and fiscal considerations. The reward package for NHS staff, is independently assessed by relevant Pay Review Bodies. The Government takes review body recommendations into consideration.

2.17 To summarise, the Department is proposing that subject to the outcome of this consultation, eligibility for the flexible accrual facility set out in the next chapter is

targeted at individuals who are registered health care professionals and can demonstrate a reasonable expectation that their prospective NHS commitments would result in pension growth exceeding their annual allowance.

Consultation questions

1. Who do you think pension flexibility should be available to?

- *NHS GPs and consultants who may be affected by the annual allowance tax charge*
- *Other NHS clinicians who may be affected by the annual allowance tax charge*
- *Non-clinicians in the NHS who may be affected by the annual allowance tax charge*
- *All members of the NHS workforce, regardless of their tax position*
- *Other group*
- *None of the above*

Please provide evidence to support your views

3. Proposed pension flexibility

3.1 The Department recognises that some staff are already taking steps to reduce their exposure to annual allowance tax charges.

3.2 Some clinicians are, or are considering, reducing their NHS workload or declining additional duties. Others are engaging in a practice of continually opting-out and opting-in of the Scheme. This is where the member chooses to opt-out from the scheme part way through the year at a point where pension growth from further membership would lead to an annual allowance charge. The same member subsequently re-joins at the start of the next tax year. A drawback for the member is the loss of 'death-in-service' life assurance and ill-health retirement cover which are only available with active membership. Whilst the optimal point to opt-out may be difficult to predict, it does allow members to control their pension accrual.

3.3 Where members choose to opt-out of the scheme because of annual allowance tax charges, some employers are considering paying to them the value of the unused employer contribution. This already happens for GP partners who retain within the practice the employer contribution that is included in the payment received for performing their primary care contract. The Department is committed to the NHS Pension Scheme remaining a cornerstone of the reward package for all staff. However, it is recognised that unlike scheme members who do not pay annual allowance tax charges, the incentive for these individuals to maintain contributions to their pension may be less and so alternative reward options could be appropriate.

3.4 Whilst practices such as the opt-in/opt-out approach can provide flexibility for individuals to manage their pension growth, the Department recognises that going beyond this to offer a more structural option within the Scheme is appropriate.

3.5 At present there is no flexibility within the NHS Pension Scheme to scale pension saving to fit within tax free allowances. Instead, in response to annual allowance tax charges, some clinicians are choosing to manage their tax liability by reducing their NHS income by declining additional discretionary work and responsibilities or reducing their hours. The Department therefore proposes to introduce greater pension flexibility. The purpose is to give clinicians the tools to balance their pay, pension growth and tax liability without having to change their NHS commitments.

3.6 It should be borne in mind that pension scheme flexibility does not set aside the pension tax system. Measures that reduce pension tax exposure necessarily present a trade-off. An individual choosing to reduce their pension growth to fit within tax-free allowances will accrue a lower pension at retirement but at the

same time might make a saving from making fewer pension contributions and not incurring a tax charge.

3.7 The NHS Pension Scheme Advisory Board[xvi] is exploring the case and potential options for pension flexibility in the context of the impact that the NHS Pension Scheme has on the recruitment, retention and productivity of NHS staff. The Board is expected to make recommendations to the Secretary of State in September. This work is important, and the recommendations will be considered together with the other responses received through this consultation.

Proposals: flexible accrual

3.8 The previous consultation presented a 50:50 flexibility that allows clinicians to voluntarily reduce their NHS Pension Scheme accrual by 50% and correspondingly pay 50% fewer contributions.

3.9 Discussions with the medical profession and employers have highlighted the need for flexibility that provides a far more tailored approach to pension accrual. Tailoring pension accrual helps to manage both annual and lifetime allowance liabilities, as slowing down pension growth allows individuals to reach the lifetime allowance limit at a point in time that matches their target retirement age.

3.10 The Department therefore proposes to amend NHS Pension Scheme rules to provide a new 'flexible accrual' facility. This will allow eligible members to:

- Choose before the start of each scheme year a personal accrual level in 10% increments and pay correspondingly fewer employee contributions. For example, 50% accrual with 50% contributions, 30%:30% or 70%:70%. Based on their income expectations for the year ahead and the amount of pension already built up from previous years, clinicians can set their accrual at a personal 'safe' level that is unlikely to lead to a tax charge.

- Fine tune their pension growth towards the end of the scheme year by updating their chosen accrual level when they are clearer on total earnings. For example, go from 50%:50% to 60%:60%. The updated accrual level would be higher than initial level and have retrospective effect from the start of the scheme year. Contribution arrears from the higher accrual level would be payable by the member and employer before the end of the scheme year.

3.11 Ancillary benefits such as 'death in service' life assurance and survivor benefits would continue to be provided in full, together with ill-health retirement cover.

Contributions

3.12 Where clinicians choose a lower level of accrual and pay correspondingly fewer contributions, the employer will also pay fewer contributions. However, it is important to be clear that the flexibility relates to the cost of accruing the pension benefit, for example 40% accrual and 40% contributions. There is a cost to providing full ancillary benefits (death in service lump sum, survivor pension, ill-health retirement cover). In addition, part of the employer contribution relates to recovering a shortfall in the meeting the cost of past benefit accrual as identified through actuarial valuation of the scheme.

3.13 The employer contribution required under flexible accrual will factor both the cost of pension benefit accrual, ancillary benefits, and shortfall recovery. Accordingly, the employer contribution will be higher than that made by the member, so more than 40% in the example above. The precise contribution rates payable at each of the 10% accrual increments will be determined based on the final policy design following consultation.

3.14 Where the member has elected to increase their accrual level later in the year, both the member and employer are required to pay the associated higher contribution rate. As the increased accrual level is backdated to the start of the scheme year, so too would be the higher contribution rate. This will create arrears of both member and employer and member contributions that must be paid by the end of the scheme year for the higher accrual level to apply during that year.

3.15 Employers would have the discretion to consider paying any unused employer contributions where members take up flexible accrual. A purpose of the flexible accrual proposal is to enable almost all high-earners to participate in the NHS Pension Scheme. Given the design of the flexible accrual facility, it is considered that if employers decide to add the value of unused employer contributions to staff pay, they would pay the balance as a non-recurrent lump sum at the end of the year. Such a payment will contribute toward the member's threshold income for the purpose of assessing their annual allowance. Contribution rates are subject to change following future scheme valuations and therefore the amount available as unused employer contributions could go up or down in future.

3.16 The case for paying unused employer contributions to members who are affected by annual allowance and consequently access pension flexibility is very different to offering a general flexibility and providing unused contributions to all staff. The Government's response to this consultation will set out the circumstances in which employers may wish to provide unused contributions from the next scheme year to staff who take up flexible accrual. The Department is clear that decisions on paying unused employer contributions will remain a matter for individual employers to take.

3.17 NHS Employers has issued short-term guidance on possible local approaches that employers can consider taking to mitigate the impact of pension tax on their workforce this tax year. Such approaches can include consideration of recycling unused employer contribution into salary. In making their decision, employers will need to consider any equality and affordability issues.

'Zero accrual' option

3.18 Some stakeholders have suggested that a 'zero accrual' option should be provided for members who have reached their lifetime allowance limit and do not want to accrue any further pension benefits but wish to continue active membership to remain eligible for ancillary benefits such as 'death in service' life assurance and ill-health retirement cover.

3.19 Without pension accrual taking place, it would be inappropriate for tax-relieved contributions to purchase insurance products. Such benefits are provided ancillary to the main purpose of participating in a pension scheme, which is to build up pension benefits. Therefore the need for the member to accrue some pension means it is impossible to offer a genuine zero accrual option.

3.20 The flexible accrual facility proposed above would allow clinicians to select a 10%:10% level for those who wish to reduce their accrual to a minimal level. With a 10% accrual, a new member of the 2015 scheme with no past service who has had their annual allowance tapered to the £10,000 minimum would need to have pensionable pay of around £340,000 before a small tax charge is incurred that year. Alternatively a large increase in pensionable pay may be anticipated and a lower level of accrual desired to provide allowance headroom. However the option to phase the 'pensionability' of large pay increases, discussed at paragraph 3.22 onwards, could mitigate the annual allowance impact of such increases.

3.21 Accordingly, the Department currently does not consider there to be a compelling need to provide an 'almost zero' accrual option that is below the proposed 10%:10% minimum accrual level. However views are invited on the circumstances where a 10% accrual, in conjunction with the option to phase the 'pensionability' of large pay increases, would give rise to a significant annual allowance tax charge for some clinicians that may in turn lead to a reduction in NHS service capacity and impacts patient care.

Phasing the 'pensionability' of large pay increases

3.22 One-off substantial increases in pensionable pay can create a spike in pension growth and a higher annual allowance tax charge that is not replicated in the subsequent years.

3.23 Large pensionable pay increases can occur as a consequence of contractual pay increments, promotions or taking on new significant duties such as a medical directorship. Consultants receive increments every five years from years 9 to 19 of their consultant career of around £6,000 that create spikes in the increase in pension value, particularly where the member has significant service in a final salary scheme. Payments for additional responsibilities are a local matter and pensionability is also considered locally but a medical director typically receives an allowance of £40,000 to £60,000.

3.24 The Department therefore proposes to consult on the principle of phasing the 'pensionability' of large pay increases for high-earners. 'Pensionability' is the amount by which the new pay level contributes towards the pension. The portion of the pay increase that is pensionable could be gradually increased (phased) to smooth pension growth spikes. For example, a 10% pay rise might be 50%, 75% and 100% pensionable over a three-year period.

3.25 Phased pensionability is likely to be more helpful for higher earners who are seeking to manage their annual allowance tax liability. However, lower earners may prefer that their pension is calculated based on the full amount of their pay straightaway, in particular where accrual is based on a career-average method as is the case for the 2015 NHS Pension Scheme. This would indicate that a phased approach should be applied to high-earning staff only.

3.26 The Department invites views on potential ways to give effect to phasing pensionable pay for high-earning staff, should it be considered desirable following consultation. For example, the NHS Pension Scheme regulations defines what counts as pensionable pay. One way of providing for phased pensionability could be to apply a formula that regulates the amount of pay that is permissible as pensionable once a member earns above a threshold level and the pay increase is above a set percentage.

3.27 The formula could apply to members with pre-increase pensionable pay of at least £90,000 and experience a pensionable pay increase above CPI inflation of at least 5%. Where this test is met, to apply a three-year smoothing of pensionability, the pay increase amount is divided by the number of years over which phasing is to take place ("the phasing period") less the number of years since the pay increase occurred. This calculation would be done annually during the phasing period to provide an amount of pensionable pay that is then added to the pre-increase pensionable pay. The pre-increase pensionable pay would continue to increase during the phasing period as the result of any uplifts.

3.28 The desirability of this approach will depend on the amount of final salary service that the member has. For members with CARE benefits only (or limited final salary benefits) it is possible that this option would not be beneficial and potentially leave

them worse off than accruing their standard benefits with an associated annual allowance tax charge. Furthermore, it may be the case that flexible accrual is a more suitable option for members with CARE benefits to consider for managing their annual allowance position.

3.29 The implications of phasing pensionable pay on benefits for a member who leaves mid-way through the phasing period, including what should count as a final salary when determining benefits should be considered. This should also be considered for death-in-service benefits during the phasing period, as well as ill-health benefits coming into payment during a member's phasing period. The benefit of this option will also depend on the availability of surplus annual allowance from previous tax years for members to carry-forward into the tax year in which the large pay increase occurs. Views are also therefore invited on whether this should be a member choice option.

Support for individuals to understand their tax liability and use the new pensions flexibilities

3.30 The Department recognises that for some NHS staff the complex interaction of tax, pay and pensions can take considerable amounts of individual time and resources to manage.

3.31 To complement the introduction of new pensions flexibilities, the Department will work with employers and staff representatives to ensure that all clinicians affected by pensions tax issues or concerns have access to high quality education and information to understand their tax liability and how these new flexibilities can be best used to support individual circumstances and preferences.

3.32 Building on what is already available, the Department is planning to commission a modeller to help individuals assess options for using these flexibilities tailored to their personal circumstances. This modeller does not constitute financial advice. It will support affected clinicians and their employers to agree programmed activities and other contractual commitments equipped with a clear understanding of their pension tax liability and how the flexibilities can be best deployed to deliver the right balance of incentives.

3.33 The aim of this new modeller service will be to enable clinicians, with the right information and help, to apply the flexibilities so that they can take on additional clinical work and responsibilities while continuing to accrue pension benefits in a way that reflects their specific circumstances. The Government is committed to ensuring that hard working staff who provide additional care for NHS patients do not find themselves considering reducing their work commitments, as a result of the interaction between their pay, their pension and the tax regime that surrounds this.

3.34 The Department intends that this support will be available from the end of this calendar year in good time, subject to the outcome of this consultation, for the introduction of the new pension flexibilities. The Department would expect employers to wish to provide additional tailored support to high earning clinicians to help them make informed decisions about levels of pension accrual.

The effect of flexible accrual

3.35 The new flexible accrual facility, with elections before the start and towards the end of the scheme year, allows clinicians to target their own personalised level of pension growth and contributions. It should allow individuals to maximise their accrual rate whilst reducing or eliminating their annual allowance exposure by having a wider range of options, for example 70% employee pension contributions for 70% accrual or 20% employee pension contributions for 20% accrual.

3.36 The potential benefit is that compared to full-rate pension growth, the annual allowance tax charge is reduced or eliminated due to lower pension accrual. In addition to the tax charge savings, clinicians would pay fewer member contributions thereby increasing take home pay (earnings will be subject to income tax in the usual way). Ancillary benefits remain payable in full with cover for the whole year, unlike the opt-in/opt-out approach where there is no cover during the period of opt-out.

3.37 This section contains a series of examples to show the potential effect of flexible accrual. These examples are illustrative, with the outcomes subject to final decisions following this consultation and any subsequent changes to scheme rules.

3.38 The table below shows the effect of 50:50, 80:80 and 90:90 at both the start and the end of year elections for a 45-year old consultant with pensionable pay of £102,000 which had increased by 2% from the previous year, and £55,000 of non-pensionable income. The consultant has 14 years of service in the final salary 1995 Section and already accrued annual pension of £5,300 in the CARE 2015 Scheme.

Description	Full accrual	90:90	80:80	50:50
Amount of annual pension accrued over the year (2015 scheme)	£1,889	£1,700	£1,511	£944
Employee contributions (gross)	£13,770	£12,393	£11,016	£6,885
Annual allowance tax charge	£2,177	£576	£0	£0
Reduction to annual pension if Scheme Pays used to pay the annual allowance tax charge (existing method, in current terms)	£145	£38	N/A	N/A
Total increase in annual pension over the year (before Scheme Pays, for members who meet AA charge directly)[xvii]	£2,491	£2,295	£2,100	£1,513
Total amount of annual pension accrued (following utilising Scheme Pays)[xviii]	£2,345	£2,257	£2,100	£1,513

3.39 For some clinicians wanting to eliminate an annual allowance tax charge entirely, a lower level of accrual may be preferable. The table below shows the effect of taking up 50:50 or 40:40 at both the start and the end of year elections on the consultant from example 2 at paragraph 2.3. The consultant has pensionable pay of £153,000, increasing by 2% from the previous year, plus £20,000 of non-pensionable income, £8,000 of accrued annual pension in the 2015 CARE scheme together with 14 years of service in the 1995 section.

Description	Full accrual	50:50	40:40
Amount of annual pension accrued over the year (2015 scheme)	£2,833	£1,417	£1,133
Employee contributions (gross)	£22,185	£11,093	£8.874
Annual allowance tax charge	£15,150	£1,811	£0
Reduction to annual pension if Scheme Pays used to pay the annual allowance tax charge (existing method, in current terms)	£1,012	£121	£0
Total increase in annual pension over the year (before Scheme Pays, for members who meet AA charge directly)[xix]	£3,738	£2,271	£1,978
Total amount of annual pension accrued (following utilising Scheme Pays)[xx]	£2,726	£2,150	£1,978

3.40 The nature of their earnings mean that some clinicians may not know exactly how much they will earn at the start of the year. Consequently, they may be unsure what the best level of flexible pension accrual will be for them. If a clinician actually earns less then they expect to earn throughout the year (for example due to taking on less additional work than expected, dropping to part-time hours or an extended leave of absence such a sabbatical or maternity leave), and would like to top-up their pension accrual once their financial circumstances become clearer then towards the end of the scheme year they can elect to increase their accrual level for the year.

3.41 As described above, a clinician's actual earnings may be lower than their expected earnings. In the following example, the member earns £102,000 pensionable pay which is an increase of 2% from the previous year. The member expected to earn £55,000 non-pensionable pay at the start of the year and therefore could have expected to accrue at 80% without incurring an annual allowance tax charge. As a safety margin, the member elected for 60%:60% before the start of the year. The member actually earned £45,000 in non-pensionable during the year and therefore decided to update their flexible accrual election to increase their accrual level to 90% and so maximise their pension growth for the year without incurring an annual allowance tax charge.

Member aged 45	Expected earnings 100% accrual	Expected earnings 80% accrual	Expected earnings 60% accrual	Actual earnings 60% accrual	Actual earnings 90% accrual
Election before start of year	100%	80%	60%	60%	60%
Election before end of year	N/A	N/A	N/A	60%	90%
Amount of annual pension accrued over the year (2015 scheme)	£1,889	£1,511	£1,133	£1,133	£1,700
Annual allowance tax charge	£2,177	£0	£0	£0	£0

3.42 Alternatively, a clinician may earn more throughout the year than they originally expected. For example, the clinician above might earn £65,000 in non-pensionable pay, an increase of £10,000 compared to their expected earnings of £55,000. The table below illustrates the impact that this additional income would have on the clinician's tax position. Again, they could have expected to be able to accrue at an 80% level but elected for 60%:60% to leave a margin. This clinician could still fine tune their accrual by choosing to increase their flexible accrual election to 70%.

Member aged 45	Expected earnings 100% accrual	Expected earnings 80% accrual	Expected earnings 60% accrual	Actual earnings 60% accrual	Actual earnings 70% accrual
Election before start of year	100%	80%	60%	60%	60%
Election before end of year	N/A	N/A	N/A	60%	70%
Amount of annual pension accrued over the year (2015 scheme)	£1,889	£1,511	£1,133	£1,133	£1,322
Annual allowance tax charge	£2,177	£0	£0	£0	£0

3.43 Taken together, the above examples demonstrate how a clinician can set a lower accrual level at the start of the year and then fine tune their final accrual towards the end of the year. Clinicians who are unsure of their likely earnings may find this a useful method of managing their pension accrual.

Establishing eligibility and using the flexible accrual facility

3.44 The previous chapter set out the rationale for targeting pension flexibility at clinicians who are likely to incur an annual allowance tax charge. The Government Actuary's Department advise that it is impractical to set an earnings threshold beyond which annual allowance charges uniquely emerge. This is because of the wide variation between individuals in their level of accrued pension (past service) and non-pensionable income.

3.45 Instead the Department proposes that eligibility for the flexible accrual facility be contingent on meeting two tests. The individual must:

- be employed in a role that requires registration with an appropriate healthcare regulatory body; and
- demonstrate a reasonable expectation that their prospective NHS commitments would result in pension growth exceeding their annual allowance.

3.46 As scheme administrator, the NHS Business Services Authority will need to be satisfied that the member has a reasonable expectation of a tax charge. To complete the process of taking up the option an election form is submitted specifying the chosen accrual level, with the employer certifying that the member meets the eligibility test. The NHS Business Services Authority will issue guidance

to employers about such certification. Results from the modeller referred to in paragraph 3.32 could provide the necessary evidence for employers. The modeller can estimate whether there is a reasonable expectation of an annual allowance tax charge based on the member's projected earnings and their pension accrued from past service. However the modeller should not be considered as financial advice.

3.47 The Department proposes that eligible members make their flexible accrual election before the start of the scheme year in which it is to have effect. Once made the election would remain in place for the whole year, with appropriate exceptions made where member income is reduced, for example due to extended periods of leave or moving to part-time hours. This is to ensure the pension scheme administration effort for flexible accrual is proportionate and predictable.

3.48 Should these proposals proceed, implementation would require substantial preparation in terms of changes to legislation, payroll and pension administration systems, together with communication of the new flexible accrual facility to members and employers. The Department expects it would be available by March 2020, ready for the start of the next tax year.

Consultation questions

2. Do you think the proposal for a more tailored approach to pension accrual is flexible enough for senior clinicians to balance their income, pension growth and tax liability? *Please set out the reasons for your answer.*

3. If not, in what ways could the proposals be developed further?

4. We're proposing that large pay increases for high-earning staff should only be included in their pensionable income gradually. Do you agree or disagree with this proposal? *Please set out the reasons for your answer.*

4. Improving Scheme Pays

Scheme Pays

4.1 The 'Scheme Pays' facility allows individuals to settle their tax charge without needing to find funds upfront. Scheme members can choose for the NHS Pension Scheme to pay their annual allowance tax charge to HMRC on their behalf. It is available to all members and provides a straightforward way for staff to settle tax charges without to pay cash up front, whilst also benefitting from income tax relief on their pension contributions. The facility can also help reduce Lifetime Allowance charges as the pension is assessed against the Lifetime Allowance after the Scheme Pays deduction is applied.

4.2 Under Scheme Pays the pension scheme pays the tax charge on behalf of the member directly to HM Revenue & Customs. This creates a debt that is repaid at retirement where the charge value plus interest is deducted from the member's pension before it is put into payment.

4.3 The Department is keen to make the facility as useful as possible for staff. We have already maximised the availability of Scheme Pays facility by extending it beyond the statutory minimum requirement so that from tax year 2017-18 it can be used to settle any annual allowance charge of any value.

Making and amending a Scheme Pays election

4.4 To help members assess their annual allowance liability, the NHS Business Services Authority (the "BSA") as scheme administrator provides members with a Pension Saving Statement if their pension growth within the scheme exceeds the annual allowance in a tax year.

4.5 The BSA must issue mandatory statements by the later of 6th October following the end of the relevant tax year, or within three months of all the relevant information being received such as their pensionable pay from their employer. Accordingly, the BSA ask employers to provide the information required to calculate a member’s pension growth by 6 July following the end of the tax year. A member who does not exceed the annual allowance based on pension growth within the NHS Pension Scheme, can request a voluntary statement which must be provided by the BSA within the same timescales as mandatory statements.

4.6 The deadline for a member to make a Scheme Pays election is 31 July of the year following the relevant tax year. The Department wishes to highlight that where a

statement is unavailable before the election deadline, this does not mean the member misses the opportunity to use Scheme Pays for that tax year.

4.7 Members can make an election using their own estimate of the annual allowance charge. The estimate can be revised at any point for up to four years into the future. For example, members have until 31 July 2022 to change their 2017-18 Scheme Pays election. This practice is acceptable to HM Revenue & Customs.

4.8 This flexibility provides members with the latitude to reassess their tax liability and mitigates instances where there is delay or timing issues in BSA receiving the information necessary to produce a statement in good time for the election deadline.

Deducting a Scheme Pays charge from pension benefits

4.9 Tax legislation requires that if a defined benefit pension scheme, such as the NHS scheme, pays an annual allowance tax charge there must be an adjustment to the member's accrued pension benefits. The adjustment must be just and reasonable, having regard to normal actuarial practice.

4.10 Upon retirement, the accumulated tax charge is converted into a debit and deducted from a member's scheme benefits. Interest is applied to the tax charge during the period between charge payment and member retirement. The interest rate is set at the scheme discount rate.

4.11 The discount rate used to value this reduction for public service pension schemes is the SCAPE discount rate plus CPI. The SCAPE discount rate reflects the Office for Budget Responsibility's forecasts for long-term GDP growth, in line with established methodology. Due to recent changes to the SCAPE rate and CPI, the Scheme Pays discount rate has fallen this year to 4.8%.

4.12 The interest rate therefore corresponds to the rate of return foregone by the Scheme on the money it had paid to HMRC on behalf of the member. It is important that Scheme Pays is cost neutral to the NHS Pension Scheme, otherwise members and employers subsidise the tax charges of high-earning individuals.

Effect of using Scheme Pays

4.13 Staff who are high-earners early in their career may incur annual allowance tax charges frequently throughout their career. Whether staff pay their annual allowance charges by using Scheme Pays or in cash upfront will be an individual

decision and is likely to depend on their circumstances. Central to this decision is a clear understanding of how at retirement the size of a Scheme Pays deduction from the pension compares with the final value of the pension growth that led to the tax charge. In other words, does the credit outweigh the debit?

4.14 To illustrate the effect of using Scheme Pays to settle an annual allowance tax charge, the table shows the pension value of the Scheme Pays deduction compared to the pension accrued that year. The deduction is presented as a debit in current terms relative to the pension accrued that year (credit). The following table is based on pensionable pay of 153,000, non-pensionable pay of £20,000 and pensionable pay of £150,000 in the previous year.

Member aged 45	Full benefits	50:50 option	40:40 option
Amount of annual pension accrued over the year (2015 scheme)	£2,833	£1,417	£1,133
Employee Contributions	£22,185	£11,093	£8,874
Annual Allowance position (total)			
Pension Input Amount value	£48,840	£25,380	£20,688
Threshold Income	£150,815	£161,908	£164,126
Adjusted Income	£199,655	£187,288	£184,814
Tapered Annual Allowance	£15,173	£21,356	£22,593
Annual Allowance tax charge	£15,150	£1,811	£0
Scheme pays debit in current terms (pension pa)	£1,012	£121	£0
Pension accrued over year including in-service revaluation and salary link			
Before Scheme Pays debit	£3,738	£2,271	£1,978
After Scheme Pays debit	£2,726	£2,150	£1,978

CARE pension accrued over year (credit)	£2,933	£1,466	£1,173
Scheme pays reduction incurred over the year in current terms (debit)	£1,012	£121	£0
Scheme pays debit as a proportion of pension accrued	34.5%	8.2%	0.0%

4.15 The debit is revalued (increased) each year by the scheme discount rate of currently 2.4% plus CPI. The annual 2015 Scheme pension is also revalued (increased) by 1.5% plus CPI whilst the member is in active service. The net increase in annual pension over the year is also shown, after the Scheme Pays charge has been deducted. As well as the amount of annual pension accrued over the year, this increase allows for the impact of the revaluation on the CARE pension and the increase in final salary due to the rise in pensionable pay.

4.16 Some commentators suggest that the headline compound interest rate (2.4% plus CPI) and for Scheme Pays is unattractive. However, the example above illustrates that the accrued pension that created the tax charge will also increase in value over time. When the rate by which the accrued 2015 pension increases is offset against the rate by which the Scheme Pays deduction increases, **the effective interest rate of the Scheme Pays 'loan' is 0.9% for pension under the 2015 Scheme**. It is worth noting that the above comparison between pension revaluation increases and scheme pays interest only applies to members remaining in-service until retirement, as the example assumes an active service revaluation rate.

4.17 A similar offsetting is expected to occur for final salary benefits in the 1995 and 2008 Section, as typically salaries and hence pensions are assumed to increase by at least CPI over the longer term. However, the comparison is more difficult due to the nature of differing individual circumstances, for example promotional salary increases and the number of years to retirement.

4.18 Clinicians will need to make their own personal assessment on what approach best serves their financial interests. For some it may be a sound financial decision to accumulate pension above their tax-free allowance and use the Scheme Pays facility to deduct the tax charge from their pension pot at retirement rather than paying cash upfront. Others may prefer to take advantage of new flexibility to minimise their tax exposure. Equally, a balanced combination of both approaches may be desired. It depends on individual circumstances and preferences.

4.19 However, the current way that Scheme Pays operates in the NHS Pension Scheme may not allow members to assess clearly how it interacts with the overall growth of their pension.

Improving Scheme Pays transparency

4.20 All public service pension schemes have a Scheme Pays facility. However, schemes have the option to decide which Scheme Pays approach they implement. There are two methods used across public sector schemes: the ‘notional defined contribution pot’ (the "NDC") method, and the 'debit' method.

4.21 The NHS Pension Scheme uses the NDC method. This is where the Scheme meets the cost of the annual allowance tax charge in the scheme year it occurs. There is no immediate adjustment to the value of a member’s pension benefits, but the value of the annual allowance tax charge (plus the compounding interest) is converted to a pension amount at retirement. At that stage the amount is deducted from the value of the member’s pension at retirement.

4.22 Alternatively, the ‘debit’ method is used by other public sector pension schemes. The calculation involved in this method is similar to the way the NHS Pension Scheme calculates a partitioning of pension rights upon divorce. Under this method, the pension value of the annual allowance tax charge is deducted from the value of the member’s pension in the year it occurs, rather than at retirement, using a conversion factor reflecting the Scheme Pays discount rate. The debit is increased by the rate specified in Pension Increase Orders (typically the rate of CPI) each year to retirement and members are able see the value of their pension minus Scheme Pays deductions on their annual benefit statements.

4.23 When the Scheme Pays facility was first introduced, it was concluded that the NDC method was the most suitable for the NHS Pension Scheme given the high number of NHS Pension Scheme members affected by the annual allowance who could request Scheme Pays, and the burden this would place on the scheme administrator. The NHS Pension Scheme is the largest of all the public service pension schemes and has the greatest number of higher earners who are likely to be within scope of an annual allowance tax charge. It also simplified the IT requirements around Scheme Pays at a time when the scheme administrator was under pressure to provide IT functionality to calculate the pension input amounts for all scheme members.

4.24 The Department is listening to concerns that some members are unaware of the impact that Scheme Pays charges and the compounding interest will have on their pension benefits at retirement. The debit approach would allow members to see the effect 'in real time', delivering greater transparency over their pension benefits

and pending Scheme Pays charges. The expectation is that this clarity would support better informed financial planning and decision-making by members.

4.25 The Department is therefore considering changing the method of Scheme Pays charge deduction from the current NDC approach to the debit method. This would bring the NHS Pension Scheme into line with other public sector pension schemes and make deductions more transparent and easier to understand. However, there is a marginal difference between the two methods in terms of the likely size of Scheme Pays deduction at retirement. The Government Actuary's Department calculate that the current NDC method might be expected to produce an overall Scheme Pays deduction at retirement age around 2% lower than the debit approach. The difference can vary depending on a member's individual circumstances, such as age when the debit arises and retirement date.

4.26 The difference arises from the timing for applying the SCAPE discount rate and the deferred revaluations under the two approaches. For example, under the current NDC approach, the interest only applies from the January following receipt of the Scheme Pays election (e.g. January 2021 for the 2018-19 tax year), whereas under the debit approach, the interest is built into the factor which is calculated at the end of the tax year.

4.27 To illustrate, a 40-year old member incurs annual allowance tax charges in 2018-19 of £10,000 arising from their 1995 Section service and a further £10,000 charge for the 2015 Scheme service. The member elects to meet both charges through Scheme Pays. The member retires at age 60 drawing benefits from both schemes, with an early retirement reduction applying to their 2015 Scheme benefits.

4.28 The table below shows the Scheme Pays deductions to the annual pensions. A deduction of three times the pension deduction would also apply to the 1995 Section lump sum under both the debit and the NDC approach.

Scheme pays deduction to annual pension at assumed retirement age	1995 Section	2015 Scheme	Total
Debit approach	£942	£1,062	£2,005
NDC approach (current)	£914	£1,046	£1,960
Difference	£28	£17	£45

4.29 This example assumes that there are no changes in SCAPE rate or the factors between incurring the charge and the member retiring at age 60. Any such changes would affect the Scheme Pays deduction through the current NDC approach but not through the debit approach. Accordingly, the two approaches might be considered to deliver a similar reduction at retirement.

4.30 The Department invites views on the merits and desirability of changing the approach to Scheme Pays deductions implemented in the NHS Pension Scheme.

Consultation question

5. Currently, the NHS Pension Scheme has a notional defined contribution pot (NDC) approach to Scheme Pays deductions. We're proposing to replace this with the debit method. Do you agree or disagree with this? *Please set out the reasons for your answer.*

5. Equality Impact Assessment

The equality duty

5.1 The public sector equality that is set out in the Equality Act 2010[xxi] requires public authorities, in the exercise of their functions, to have due regard to the need to:

(a) Eliminate unlawful discrimination, harassment and victimisation and other conduct prohibited by the Act.

(b) Advance equality of opportunity between people who share a protected characteristic and those who do not.

(c) Foster good relations between people who share a protected characteristic and those who do not.

5.2 This chapter sets out the Department's initial assessment of the proposals and its consideration of the public sector equality duty. This preliminary assessment will be kept under review and the Department invites comments and evidence that are relevant to the public sector equality duty so that further analysis of equality issues can be undertaken.

5.3 The data used in this chapter is included at Annex A and details the annual earnings of Hospital and Community Health Service ("HCHS") staff between January and December 2018 split to under £90,000 and £90,000 or more, partitioned to staff group and protected characteristics as at 31 December 2018, in NHS Trusts and CCGs in England. The data is taken from the Electronic Staff Record system and is broken down by age, disability, ethnicity, religious beliefs, sex and sexual orientation.

5.4 The data considered in this chapter does not include staff who are working in Wales or for employers other than NHS Trusts and CCGs. Notably, the data does not include GPs or dental practitioners, as primary care organisations tend not to participate in the national Electronic Staff Record system from where the data is drawn.

5.5 The Department invites views on issues relevant to the public sector equality duty, including views and evidence that are outside the data set.

Targeting

5.6 The aim of introducing pension flexibility into the NHS Pension Scheme is to give members an option to reduce the likelihood that they will incur large, regular annual allowance tax charges without requiring them to reduce their hours, not take on extra responsibilities or leave the pension scheme. The aim of the policy is to prevent the reduction of capacity in the NHS due to highly qualified clinicians leaving the workforce, turning down additional responsibilities or reducing their commitment to the NHS in order to manage their tax exposure.

5.7 The NHS Pension Scheme is an important means of retaining staff in NHS service and the Department understands that high-earning clinicians are reducing their hours, declining extra sessions or retiring early in preference to incurring an annual allowance tax charge. The aim of providing flexibility is not to advantage high earning members but instead it is to neutralise or mitigate a disadvantage of continuing current working patterns or taking on further work whilst remaining a member of the NHS Pension Scheme.

Targeting high-earners with a reasonable expectation of incurring an annual allowance tax charge

5.8 As explained in Chapter 3, lower earners would be unlikely to incur an annual allowance tax charge and therefore do not fall within the scope of the Department's policy aim: preserving NHS capacity by attenuating the disincentive to perform the services that the NHS needs because of their tax position. Whilst lower earners would be unable to pay reduced contributions for a reduced pension benefit and consequently benefit from increasing their take-home pay, this is not the aim of the policy. Instead, the ability to increase take-home pay is an effect of members utilising flexible accrual to manage their annual allowance tax exposure. As noted in Chapter 3, employers have the option to decide how to use any unused employer contributions and whether to recycle them back to the employee. If the employer decides to give the employee the residual employer contributions as take-home pay then this would further increase the member's take-home pay. Whilst this is not the aim of the policy, given that, under a targeted approach, low earners will not be able to increase their take-home pay in a similar manner, the Department is considering the equality implications of restricting flexible accrual to members with a reasonable expectation of incurring an annual allowance tax charge.

5.9 The data set uses £90,000 as the start of the salary ranges that are considered more likely to contain members affected by the annual allowance. It is considered that a threshold of £90,000 allows for some headroom for non-pensionable pay that will affect annual allowance calculations once the taper threshold of £110,000

has been passed. Whilst it will not reflect every member identified, it gives the Department an indication of the groups of staff that are more likely to be affected.

5.10 High earners are statistically more likely to be older members of the NHS Pension Scheme and therefore issues of age discrimination should be considered, for example 75% of HCHS doctors aged 50-54 earn over £90,000 compared to 2% of HCHS doctors aged 30-34. This is reflected, although not quite as severely, across the rest of the workforce. 6.24% of staff aged 50-54 earn over £90,000 compared to only 0.28% of staff aged 30-34. Consequently, the annual allowance tax charge is more likely to affect older staff because they are more likely to be high earners. The aim of the proposals is to provide flexibility to those members who have a reasonable expectation of receiving an annual allowance tax charge, regardless of their age.

5.11 Additionally, high-earners are also statistically more likely to be male, with 12.7% of male HCHS staff earning over £90,000 as at 31 December 2018, compared to 1.7% of female staff. High-earners are also less likely to be disabled, with 1.1% of disabled staff earning over £90,000. The Department also notes that 13% of Chinese and 12.8% of Asian or Asian British members of staff in NHS Trusts and CCGs in England earn over £90,000. 19.7%, 19.2%, 12% and 9.4% of members of staff who state their religion is Hinduism, Jainism, Judaism and Islam, respectively, earn over £90.000.

5.12 Therefore, if one of the conditions of being able to take up any flexible accrual options is a reasonable expectation of receiving an annual allowance tax charge by virtue of their high-earnings, then these groups of staff are more likely to fall within the scope of the proposed flexibility than other groups. This is because, using staff earning over £90,000 as an indication of the likely groups of staff that will receive annual allowance tax charges, more male staff then female staff earn over £90,000 and therefore are more likely to build up pensions at a rate which exceed their annual allowance. It is noted that a higher proportion of Chinese or Asian British staff are likely to earn over £90,000. Additionally, a higher proportion of staff who believe in Hinduism, Jainism, Judaism and Islam earn over £90,000 than staff with other or no religious beliefs.

5.13 The aim of the policy is to mitigate the impact of the annual allowance on NHS capacity, not to advantage specific groups. On the information currently available, the Department considers that it is reasonable and proportionate to the aim to target flexibility to high-earners only as they are the group affected by the annual allowance tax.

5.14 More detailed breakdowns of staff in CCGs and NHS Trusts in England, who earn more than £90,000 is contained in the Annex to this consultation document. The data is broken down by age, disability, ethnicity, religious beliefs, sex and sexual

orientation. Similar data is not currently available for other NHS staff groups, for example GPs or NHS staff working in Wales.

Targeting clinicians

5.15 The aim of the policy is to preserve NHS capacity by attenuating the disincentive for staff to perform the services that the NHS needs because of their tax position. Providing high-earning clinical staff with the ability to accrue pension benefits more slowly and therefore help manage their annual allowance tax exposure would strengthen the incentive for them to remain within the workforce, deliver extra work and take on further responsibilities.

5.16 Clinical staff made up 53.6% of the workforce in NHS Trusts and CCGs in England on 31 December 2018. This information does not include other NHS workforce groups, such as staff working in the Welsh NHS or primary care. Younger members of the workforce in NHS Trusts and CCGs in England are more likely to work in clinical roles. On 31 December 2018, 43% of 25-year olds in the workforce held a clinical role. However, this sharply increases and is likely to be related to medical training. In the 25-29 age bracket, 62.8% held clinical roles.

5.17 Older members of the workforce are also statistically less likely than average to work in clinical roles; 44.2% of 55-59-year olds, 35.7% of 60-64-year olds and 30.2% of over 65s are in clinical roles. Therefore, members of staff working for NHS Trusts and CCGs who are over 55 are more likely to work in non-clinical roles and would not qualify for flexibility under the current proposal. However, one reason for there being less clinicians over 55 could be due to clinicians retiring earlier than their normal pension age and therefore leaving the NHS workforce. As discussed earlier in the consultation document, regularly exceeding pension tax thresholds has been highlighted as a factor in decisions to retire early. By enabling this group to build up their pension benefits more slowly, it may be that more clinicians are retained within the workforce and increase NHS capacity.

5.18 The proportion of staff in clinical roles also varies by ethnicity, with 79% of Chinese staff, 70.4% of staff from ethnic groups other than those available for the equality data and 66.7% of Asian or Asian British staff holding clinical roles. For staff with religious beliefs, 73% of staff who believe in Judaism, 70.6% of staff who believe in Jainism and 69.3% of staff who believe in Hinduism work in clinical roles.

5.19 The Department's initial assessment is that it is reasonable and proportionate to the aim to restrict the flexibility to clinical roles unless evidence is provided that the tax position of non-clinical staff members is leading to a reduction in NHS service capacity.

5.20 More detailed breakdowns of clinical and non-clinical staff in CCGs and NHS Trusts in England is contained in the Annex to this consultation document. The data is broken down by age, disability, ethnicity, religious beliefs, sex and sexual orientation. Similar data is not currently available for other NHS staff groups, for example GPs or NHS staff working in Wales.

Targeting clinicians with a reasonable expectation of incurring an annual allowance tax charge

5.21 Whilst the analysis above considers members with annual allowance tax exposure and clinicians separately, it is also important to understand the implications of targeting clinicians who have a reasonable expectation of incurring an annual allowance tax charge. Again, earnings of over £90,000 have been used as an indication of staff groups that are most likely to have the potential to exceed their annual allowance. Over the total staff working within NHS Trusts and CCGs in England, 3.9% are clinicians earning over £90,000.

5.22 The proportion of male staff who work in clinical roles and earn over £90,000 is 12%, which is higher than average. Conversely, only 1.47% of women working in the NHS Trusts and CCGs are in clinical roles and earn over £90,000.

5.23 Disabled members of the workforce are less likely to be in clinical roles earning over £90,000 as only 0.96% of disabled members of staff in the data set earn over £90,000 in a clinical role.

5.24 Similar to the earlier analysis, younger members of the workforce are less likely to be in clinical roles earning over £90,000, with 0% of under 25s, 0.01% of 25-29-year olds and 0.25% of 30-34 year-olds in clinical roles earning over £90,000. Again, this can be partly explained due to the career progression and medical training expectations highlighted above.

5.25 Chinese and Asian or Asian British members of staff are more likely to earn over £90,000 in clinical roles as 12.93% and 12.65%, respectively, are in clinical roles and earn over £90,000. Conversely, Black or Black British and White members of staff in the data set were less likely to earn over £90,000 in clinical roles as only 2.19% of Black or Black British and 2.79% of White staff members were in clinical roles and earning over £90,000.

5.26 Whether staff are more likely to be in high-earning clinical roles also varies by religious belief. Staff who state their religious beliefs to be Hinduism, Jainism, Judaism and Islam are more likely to be in clinical roles earning over £90,000, with 19.61%, 18.77%, 11.33% and 9.27%, respectively, of those groups employed in clinical roles earning over £90,000.

5.27 These groups are more likely to be working in clinical roles and earn £90,000. Consequently, they are more to incur an annual allowance tax charge and therefore the Department is considering providing them with flexible accrual options. As explained above, it is not intended that there will be a general flexibility for all senior clinicians earning over £90,000 but the current proposal is that flexible accrual options would be available to clinicians with a reasonable expectation of incurring an annual allowance tax charge. The Department's initial assessment is that this is reasonable and proportionate given that these groups are particularly likely to have the ability to reduce their hours, turn down extra responsibilities or retire early in order to manage their tax liability.

5.28 More detailed breakdowns of staff in CCGs and NHS Trusts in England, who earn more than £90,000 is contained in the Annex to this consultation document. The data is broken down by age, disability, ethnicity, religious beliefs, sex and sexual orientation. Similar data is not currently available for other NHS staff groups, for example GPs or NHS staff working in Wales.

Flexible accrual option

5.29 One of the aims of the public sector equality duty is to advance equality of opportunity between those who share a protected characteristic and those who do not. The nature of the proposed flexibility is that high earning clinicians will pay a reduced rate of contributions in exchange for accruing a reduced pension benefit. Whilst the aim of the policy is not to advantage high earning members but instead it is to attenuate the disincentive to perform the services that the NHS needs because of their tax position, a consequence of this is that their take-home pay will increase. Given that lower earners are more likely to be constituted from groups with protected characteristics (for example, younger members, women, disabled staff, staff with certain religious beliefs or are part of particular ethnic groups), the Department would like to further consider the fact that, by offering flexible accrual to high earners only, the difference in take-home pay between low and high earning members is likely to increase.

5.30 As noted in Chapter 3, employers have the option to decide how to use any unused employer contributions and whether to recycle them back to the employee. If the employer decides to give the employee the residual employer contributions as take-home pay then this would further increase the member's take-home pay. There is a potential argument that this increases the potential take-home pay gap between members from groups with protected characteristics and other members. However, this is balanced against the fact that high earners would be purchasing a lower pension and therefore the gap in pension income for these two groups is likely to reduce.

5.31 Whilst not central to the policy aim of the flexibility, lower earners are a group that may benefit from the ability to opt for flexible accrual, reducing their pension contributions and therefore increasing their take-home pay (without opting out of the pension scheme entirely) and making membership of the pension scheme more affordable. However, these changes should be considered within the scheme architecture as a whole and it is established policy that lower earners receive a reduction in their contribution rate in order to make pension contributions more affordable. The contribution rate is 5% of earnings for the lowest earning members and the average contribution rate required across the scheme is 9.8% and the rate for the highest earning members is currently 14.5%. This is established pension policy and seeks to make the scheme more affordable to NHS employees with lower incomes.

5.32 Should the Department not make the proposed amendments to the NHS Pension Scheme, the maintenance of the status quo will impact on those with protected characteristics identified above, particularly men, older members, those with certain religious beliefs or that are part of particular ethnic groups. Consequently, there is a risk that these groups are likely to face annual allowance tax charges and thus choose to leave the NHS workforce.

5.33 Therefore, the Department's initial assessment is that flexible accrual is a measure which is reasonable and proportionate to the aim, although it will continue to consider any potential equality impacts that arise through consultation and further analysis.

Phasing the 'pensionability' of pay increases

5.34 Phasing the 'pensionability' of pay increases may have an impact on groups with protected characteristics, depending on how it is implemented, and the Department is keen to explore this further.

5.35 The ability to phase pensionable pay is likely to be more helpful for higher earners who are seeking to manage their annual allowance tax liability. However, lower earners who are unaffected by pension tax may prefer that their pension is calculated based on the full amount of their pay straightaway, as this would maximise their pension growth. This would indicate that it would be appropriate and proportionate that a phased approach should be available to high-earning staff only.

5.36 However the desirability of phasing is likely to vary between members, with the benefit of doing so dependent upon the nature of their pension accrual method (final salary or CARE) and the availability of any carry-forward of unused annual allowance from previous tax years. Accordingly the Department suggests that

phasing be optional for members. If available as an option rather than mandatory, this would reduce the potential for phasing to create disadvantage amongst and between groups.

5.37 This proposal is in the early stages of consideration. The Department would like to invite correspondents to highlight any equality concerns that they have about this approach, if any.

Support for individuals to understand their tax liability and use the new pension flexibilities

5.38 The Department is considering commissioning a modeller to help individuals assess the flexibility options. This is in order to help those individuals who are likely to exceed their tax-free allowances and have the option to use the proposed flexibilities. Therefore, by its nature, it will not assist all members of the NHS Pension Scheme because it would not be relevant to those members who are unlikely to experience pension tax charges.

Scheme Pays

5.39 The Department's initial assessment is that a move to the debit method would not impact on any protected characteristics. However, the Department invites evidence of any impact that such a change might have in this regard.

Consultation questions

6. What impact, if any, do you think the following will have on people with one or more protected characteristics:

a) The proposal to target the flexibility to clinicians who have a reasonable prospect of an annual allowance tax charge

b) The proposal to provide flexible accrual to clinicians who have a reasonable prospect of an annual allowance tax charge

c) Other proposals in the consultation document *e.g. phasing pensionable pay increases and/or commissioning a modeller to help individuals understand their tax liability and flexibility options*

d) Adopting the debit method for scheme pays

7. Are there any further equality considerations that the Department should be aware of from groups outside the data set?

6. Conclusion

6.1 The Government understands that some members of the NHS workforce are taking action to reduce their tax liability in response to exceeding their annual allowance for tax-free pension saving. The Government is concerned that high-earning clinicians are reducing their workload, turning down extra work and responsibilities or retiring early which has a consequential impact on NHS capacity and delivery of NHS services.

6.2 Whilst there are informal ways in which affected members can reduce their tax liability (for example, opting-in and out of the NHS Pension Scheme), these have disadvantages for members and the Department recognises the benefit of providing a more structural approach within the scheme rules.

6.3 The Government is prepared to change the rules of the NHS Pension Scheme to make it more flexible for clinicians who are likely to incur an annual allowance tax charge. The consultation proposes a flexible model through which clinicians can reduce their pension accrual in 10% increments and pay correspondingly lower contributions.

6.4 Clinicians would be able to choose a personal accrual level before the start of the scheme year, and have an opportunity to fine tune their pension growth towards the end of the scheme year by updating their chosen accrual level when they are clearer on total earnings.

6.5 In parallel, the Chancellor has announced that the Treasury will review the operation of the annual allowance taper to support the delivery of public services. The financing model for the Scheme means any flexibility which reduces contribution income has an immediate fiscal impact on the Exchequer, meaning flexibility must be balanced with affordability.

6.6 A further proposal to phase the 'pensionability' of pay increases has also been included in the consultation document and the Department welcomes views on this proposal and whether it should be given further consideration.

6.7 The Department recognises that some clinicians may continue to experience annual allowance tax charges even with the option to reduce their accrual. In that scenario, such individuals may use Scheme Pays to settle the annual allowance tax charge. In order to ensure that Scheme Pays operates with as much clarity and transparency as possible, this consultation document explains the two different methods of calculating Scheme Pays charges. The Department welcomes views on this, particularly in relation to ensuring the Scheme Pays facility is clear and transparent for affected members and their financial advisors.

Next steps

6.8 The Department invites responses to the consultation questions set out in this document.

6.9 Following the conclusion of the consultation period, the Department will review and consider the responses to the consultation document. As part of this, the Department will also take into consideration recommendations made by the Scheme Advisory Board. A consultation response will be published which will respond to views received and set out how Government will proceed.

6.10 Should legislative amendments be required to implement any pension flexibility that is pursued following this consultation, there will be a further consultation period for stakeholders and the public to consider and comment on the detailed specific legislative changes proposed.

Annex

Data contained in this annex is for staff working in NHS Trusts and CCGs in England as at 31 December 2018. Similar data is not currently available for other NHS staff groups, for example GPs or NHS staff working in Wales.

The data is taken from the Electronic Staff Record system and is broken down by age, disability, ethnicity, religious beliefs, sex and sexual orientation. Data for other protected characteristics has not been available for the purpose of this consultation document.

Summary tables

The overall percentage of staff in the data set earning over £90,000 is 4.22%.

The overall percentage of clinical staff in the data set is 53.6%.

The overall percentage of staff that are in clinical roles and earning over £90,000 is 3.90%

Age	Proportion earning over £90,000	Proportion that are clinical staff	Proportion that are clinical staff earning over £90,000
Under 25	0.00%	43.01%	0.00%
25-29	0.01%	62.81%	0.01%
30-34	0.28%	61.66%	0.25%
35-39	2.93%	59.62%	2.78%
40-44	6.56%	61.64%	6.27%
45-49	6.78%	55.76%	6.30%
50-54	6.24%	51.09%	5.59%
55-59	5.42%	44.18%	4.90%
60-64	3.96%	35.67%	3.71%
Over 65	4.16%	30.23%	4.10%

Disability	Proportion earning over £90,000	Proportion that are clinical staff	Proportion that are clinical staff earning over £90,000
Disabled	1.12%	49.4%	0.96%
Not Disabled	3.66%	53.9%	3.35%
Not Disclosed	6.17%	53.0%	5.80%
Unknown	5.85%	53.4%	5.56%

Ethnicity	Proportion earning over £90,000	Proportion that are clinical staff	Proportion that are clinical staff earning over £90,000
White	3.15%	51.2%	2.79%
Mixed	5.61%	56.3%	5.41%
Asian or Asian British	12.77%	66.7%	12.65%
Black or Black British	2.27%	55.1%	2.19%
Chinese	13.05%	79.1%	12.93%
Any Other Ethnic Group	6.82%	70.4%	6.8%
Not Stated	5.85%	55.4%	5.32%
Unknown	3.79%	54.1%	3.12%
Discontinued codes	8.39%	66.8%	8.39%

Religious beliefs	Proportion earning over £90,000	Proportion that are clinical staff	Proportion that are clinical staff earning over £90,000
Atheism	3.14%	57.7%	2.78%
Buddhism	6.85%	63.4%	6.66%
Christianity	2.31%	53.0%	2.02%
Hinduism	19.75%	69.3%	19.61%
Islam	9.39%	59.8%	9.27%
Jainism	19.17%	70.6%	18.77%
Judaism	11.98%	73.0%	11.33%
Sikhism	4.56%	44.8%	4.32%
Other	1.47%	46.8%	1.30%
Not Disclosed	5.78%	53.2%	5.38%
Unknown	6.59%	52.3%	6.25%

Sex	Proportion earning over £90,000	Proportion that are clinical staff	Proportion that are clinical staff earning over £90,000
Male	12.70%	54.0%	12.00%
Female	1.67%	53.5%	1.47%

Sexual orientation	Proportion earning over £90,000	Proportion that are clinical staff	Proportion that are clinical staff earning over £90,000
Bisexual	1.59%	53.2%	1.49%
Gay or Lesbian	3.00%	57.1%	2.29%
Heterosexual or Straight	3.23%	53.8%	2.94%
Not Stated	6.22%	53.6%	5.85%
Other sexual orientation	0.00%	60.0%	0.00%
Undecided	0.00%	64.6%	0.00%
Unknown	6.61%	52.3%	6.27%

Endnotes

[i] Under the National Health Service Pension Scheme Regulations 2015

[ii] Under the National Health Service Pension Scheme Regulations 1995

[iii] Under the National Health Service Pension Regulations 2008

[iv] These figures were calculated using data as at 31 March 2015 with the intention of demonstrating the pensions that would be coming into payment. The figures are an estimate of likely retirements based on 1995 Section active members aged 59 and over, and 2008 active members aged 64 and over.

[v] Mean annual basic pay per Consultant FTE. NHS Staff Earnings Estimates - December 2018 (Provisional Statistics)

[vi] CARE: Career Average Revalued Earnings

[vii] Including in-service re-valuation and salary link

[viii] See endnote iv

[ix] See endnote iv

[x] See endnote iv

[xi] Including in-service re-valuation and salary link. The an above-inflation pay rise results in an increase to the consultant's lump sum and therefore lump sum figures have also been provided for clarity

[xii] See endnote iv

[xiii] Including in-service re-valuation and salary link. The an above-inflation pay rise results in an increase to the consultant's lump sum and therefore lump sum figures have also been provided for clarity

[xiv] See endnote iv

[xv] GP Partnership Review: Final Report

[xvi] The Scheme Advisory Board is a statutory board, comprising representatives from NHS trade unions and employers, that advises the Secretary of State for Health and Social Care on the desirability of making changes to the NHS Pension Scheme.

[xvii] This figure includes the revaluation on the CARE pension and the increase in the final salary pension benefits due to the rise in pensionable pay.

[xviii] See endnote xv

[xix] See endnote xv

[xx] See endnote xv

[xxi] Equality Act 2010, section 149

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