

Armed Forces Pension Scheme: Retrospective Remedy

Tax: Annual Allowance, Lifetime Allowance and Income Tax

07 September 2023



© Crown copyright 2023

This publication is licenced under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit <u>www.nationalarchives.gov.uk/doc/open-government-licence/version/3</u> or write to the Information Policy Team, The National Archives, Kew, London, TW9 4DU, or email psi@nationalarchives.gov.uk

Pension Taxation

Introduction

- 1.1. This guide is for eligible members¹ of the 2015 remedy. It provides detail on the approach to Annual Allowance (AA) and Lifetime Allowance (LTA), as well some general guidance on income tax. If you are not affected by the 2015 remedy the detail within this guide will not apply to you and you should refer to the existing MOD Pension Tax Booklet [here] and MOD Tax Booklet [here]. As in all cases, tax remains an individual responsibility and at the Annex you will find links and details to further resource. MOD cannot provide tax advice and you may wish to seek external financial support.
- 1.2. As part of the 2015 pension remedy, eligible members will be returned ('rolled back') into their relevant legacy pension scheme for the remedy period. For active and deferred² members this will happen automatically on 1 Oct 23. For pensioner³ members their benefits will only change after an election is made. Members will be given a choice of either legacy pension benefits, or the equivalent AFPS 15 scheme benefits, for the remedy period of 1 Apr 15 31 Mar 22 when their pension becomes payable. As a result of this, members may face changes to their individual tax situation. The remedy may impact a member's AA, LTA and any benefits in payment.
- 1.3. For most members no tax adjustment will be required. This is because the amounts they will be entitled to will be below AA and LTA thresholds throughout the remedy period. If, however, a member has previously been issued a Pension Savings Statement (PSS) for service in the remedy period or been subject to an LTA tax charge there may be action for them to take. For Pension Savings Tax, members are generally not required to submit Self-Assessment tax Returns for Tax Year (TY) 2022/23 but see para 1.31

¹ To be eligible for remedy you had to be in pensionable service under a public sector pension scheme on or before 31 Mar 12 and on or after 1 Apr 15, without a break in that service exceeding 5 years.

² An active member is someone still serving, a deferred member has left the Armed Forces but is not in receipt of any pension benefits ³ A pensioner member is someone who is in receipt of pension benefits, this could include an EDP.

The Annual Allowance

Pension Saving Statements (PSS)

1.4. The distribution of Pension Savings Statements (PSS) for members eligible for pension remedy differs depending on whether you are a transitionally protected member⁴, and if you are an immediate⁵ or deferred⁶ choice member.

Transitional Protection

1.5. If you had transitional protection (referred to as a protected member), irrespective of whether you are an immediate or deferred choice member, you would have been in your legacy scheme for the remedy period. Therefore roll back (see para 1.2) will not have an effect on your tax position and it does not need to be re-assessed. As such, you will be issued with a PSS for TY 2022/23 on 6 Oct 23 in the normal manner. See paragraphs 1.11 to 1.14 for details about what happens when you make your remedy choice.

Deferred Choice

 For unprotected members with a deferred choice, the deadline for the provision of a PSS for TY 2022/23 has been extended by 12 months to 6 Oct 24.

Immediate Choice

- 1.7. For all members (or their representatives in the event the member has died) who are given an immediate choice election the deadline to provide an updated PSS is the sooner of 6 months after an election has been made, or 6 months after the end of the election period⁷.
- 1.8. For example, a pensioner member who receives their Remediable Service Statement (RSS) on 1 Feb 24 and makes their election by 1 Jul 24 can expect DBS to provide them with a PSS by 1 Jan 25.

⁴ Transitionally protected means you did not transition to AFPS 15 on 1 Apr 15.

⁵ Immediate choice members are members who left the service prior to 1 Oct 23 with pension benefits, including EDP, in payment.

⁶ Deferred choice members are those still serving, or who have left the service but with a deferred pension award.

⁷ For immediate choice the election period ends one year after the date of issue of the RSS.



Pension input amounts

- 1.9. The Annual Allowance is the maximum amount of tax-privileged pension savings an individual can make each year to a registered pension scheme. For defined benefit schemes, such as the AFPS, the amount of tax-privileged savings is deemed to be the overall increase of the value of the member's pension during the course of the year. Members may be required to pay an annual tax allowance charge (AATC) on any **Pension Input Amount** (**PIA**) in excess of their AA.
- 1.10. The remedy operates differently depending on whether you have transitional protection and are an active, deferred or pensioner member, though it is designed to deliver similar effect. The table below provides a brief summary of what will happen for each cohort of members.

Group	What happens automatically ⁸ at 2023 rollback	What happens when remedy period benefits are chosen
Active and deferred	No change	Deferred Choice
protected members		Choose legacy ⁹ : no change
		Choose AFPS 15: any extra
		pension arrives at single point at
		retirement – new tax rules apply –
		see Paragraph 1.14
Active and deferred	Receive legacy accrual with	Deferred Choice
unprotected	retrospective effect – potential	Choose legacy: no change
members	AATC adjustments for past	Choose AFPS 15: any extra
	years.	pension arrives at single point at
		retirement – new tax rules apply –
		see Paragraph 1.18.

⁸ i.e., without the member exercising a choice.

⁹ Choose legacy means member/beneficiary does not make a new scheme benefits election.

Protected pensioner	No change	Immediate Choice
and deceased		Choose legacy: no change
members		Choose AFPS 15: any extra
		pension arrives at single point at
		retirement/ death if they died before
		retirement (in past) – new tax rules
		apply – see para 1.12
Unprotected	No change	Immediate Choice
pensioner and		Choose legacy - given legacy
deceased members.		benefits with retrospective effect –
		potential AATC adjustments for past
		years – 1.16
		Choose AFPS 15: no change –
		Compensation available – see 1.15

Protected Members

- 1.11. Immediate Choice. For those members who have started to take their pension benefits or died before roll back comes into force, their (or their Eligible Decision Maker's¹⁰ (EDM)) immediate choice may change the amount of their pension benefits during remedy period years. If the member retains their legacy benefits, there will be no change in their pension input amounts.
- 1.12. In the case where a member (or EDM) makes an election for AFPS 15 equivalent benefits, the member's AA will be based on legacy scheme PIAs unless AFPS 15 PIAs are lower for remedy period years. There will be no additional tax liability associated with making an election for AFPS 15 equivalent benefits.
- 1.13. **Deferred Choice**. For those members who have not started to take their benefits, member's pension input amounts will not change at rollback. When a member's pension becomes payable, if the member retains legacy benefits there will be no change in their pension input amounts.

¹⁰ Eligible decision makers are representatives of deceased members who are eligible for remedy, they will be offered the same choice as members.

1.14. In the case where a member (or EDM) makes an election for AFPS 15 equivalent benefits, the member's AA will be based on legacy scheme PIAs unless AFPS 15 PIAs are lower for remedy period years. There will be no tax liability associated with making an election for AFPS 15 equivalent benefits.

Unprotected Members

- 1.15. Immediate Choice: Where pension benefits are already in payment before roll back occurs, an election for AFPS 15 benefits will not change pension input amounts for tax purposes.
 However, if the PIA would have been lower if based on legacy scheme accrual, resulting in a reduced AATC, then they can claim compensation for the difference.
- 1.16. For those members who have started to take their pension benefits or died before roll back comes into force and choose legacy scheme benefits, member's pension input amounts will change as they will be recalculated based on legacy accrual for the remedy period. The amount of the member's benefits will change from immediately before they started to take their pension. There may be pensions tax liabilities associated with this choice, but it is likely that, due to the higher accrual rates in AFPS 15, these members will not face a tax liability electing for legacy scheme benefits.
- 1.17. **Deferred Choice**. For those members who have not started to take their benefits before roll back comes into force, there will be a change in their pension input amounts for all pensionable service in the remedy period. The pension input amounts for these years will need to be recalculated, based on legacy accrual, with the change effective from the date 'roll back' comes into force. There may be pensions tax liabilities when the member rolls back, but it is likely that, due to the higher accrual rates in AFPS 15, these members will not face a tax liability on rollback.
- 1.18. In the case where a member makes an election for AFPS 15 equivalent benefits at Deferred Choice point, the member's AA will be based on legacy scheme PIAs unless AFPS 15 PIAs are lower for remedy period years i.e., there will be no tax liability associated with making an election for AFPS 15 equivalent benefits.

In Scope and Out of Scope Tax years

1.19. In scope and out of scope years have been frozen in the latest HMRC regulations. Therefore, the timing of a PSS in relation to remedy will not have an adverse effect on the member in respect to retrospective adjustment. The TY 2019/20, 2020/21, 2021/22 and 2022/23 are in scope years and tax years before this are out of scope.

Effect on Annual Allowance for In Scope and Out of Scope Tax Years

- 1.20. The re-assessment of PIAs for members may lead to the following scenarios for in scope and out of scope tax years:
 - Underpaid AATC for an in-scope year. Where a member has underpaid an AATC, they will be required to pay the additional charge to HMRC. This can be done via scheme pays or directly to HMRC.
 - Underpaid AATC for an out-of-scope year. Where a member has underpaid the AATC for an out-of-scope year, the additional amount owed will not be collected.
 - Overpaid AATC for an in-scope year. Where a member has overpaid the AATC for an in-scope year following reassessment of their benefits, they will be able to claim back the overpaid tax. This will either be from HMRC or AFPS depending on how the original tax charge was paid. Individuals who paid the AATC direct to HMRC will receive cash compensation; where it has been paid via scheme pays, benefits will be uplifted by the relevant amount. For an in-scope year, individuals will need to report their revised position to HMRC through the self-assessment process.
 - Overpaid AATC for an out-of-scope year. Where a member has overpaid the AATC for an out-of-scope year following reassessment of their benefits, they will be able to claim back the overpaid tax from the AFPS. Where an individual has paid the AATC direct to HMRC, they will receive cash compensation and where it has been paid via scheme pays their benefits will be uplifted by the relevant amount.
- 1.21. Where AATC has been overpaid in an **out-of-scope year**, each out-of-scope year will be considered separately. This means that where a member has an overpayment in an out-of-scope year, they will receive compensation equal to this value. Where a member has an

underpayment, no tax will be collected, and no reduction will be made to compensation due for other years. There will be **no netting off** across schemes and members will be required to make separate compensation claims for each scheme they were a member of. For example.

 If the first four years of the remedy period are out of scope and the individual has; overpaid AATC in the first year by £1,000, underpaid in the second year by £1,500, overpaid in the third year by £2,000, and overpaid in the fourth year by £1,000, then they will be able to claim £4,000 in compensation for overpaid AA.

Lifetime Allowance

- 1.22. The Lifetime Allowance applies to the total amount of pension benefits an individual has built up over the course of their life and if breached a tax charge is applied. It is only applied when those pension benefits come into payment, this is known as a Benefit Crystallisation Event (BCE).
- 1.23. In Mar 23 the Chancellor announced in his Spring Budget that the Lifetime Allowance tax charge would be removed on 6 Apr 23 and abolished in a future finance bill. Members may still be subject to a tax charge at their marginal rate on a pension tax free lump sum if the lump sum exceeds 25% of the LTA limit, which is currently £1,073,100 i.e. the lump sum exceeds £268,275. If the member holds any LTA protection or has already been paid a lump sum from another pension, this may alter that limit. HMRC will publish more detailed policy on this in due course.
- 1.24. For the 2015 pension remedy, the LTA only impacts those members who have an immediate choice. As with AA, the LTA is also subject to in and out of scope tax years as detailed in 1.19.
- 1.25. Where an immediate choice **increases** the value of a member's benefits, the increase in LTA value is then subject to a further Lifetime Allowance Tax Charge (LTAC). If the BCE falls in an in-scope year, this is automatically paid from within the scheme. The test is conducted against the LTA limit that was applicable at the time. Historic LTA rates are available at

<u>Pension schemes rates - GOV.UK (www.gov.uk)</u>¹¹. For an out-of-scope year, any additional LTAC is not recovered.

- 1.26. For deceased members, the AFPS scheme will not pay the additional LTA charge and the member's estate would be solely liable.
- 1.27. If an immediate choice **reduces** the value of a member's benefits, then the member will receive compensation via an unwinding of their scheme pays debit. Any changes to your LTA will need to be reported through self-assessment in the normal manner.

Income tax

- 1.28. If you make an election that results in lower overall benefits, which means you owe money to the scheme, then you may have overpaid income tax. The amount owed to the scheme will be reduced by an amount to reflect the income tax you paid on this amount.
- 1.29. If you make an election that results in higher benefits, then you may be owed arrears of pension or lump sum. Where these are taxable (if the lump sum was previously tax free any lump sum top up will also be tax free), members will receive the amount net of tax, the tax being calculated using their current marginal rate. A member will be able to request a schedule of their pension payments if they wish to contact HMRC if they believe they have overpaid income tax as a result of this arrangement.
- 1.30. All members should note that any election which results in higher benefits, will likely lead to a higher tax liability on the pension income going forward in the same way any increase in pension or salary is subject to tax.

Self-Assessment Tax Returns

- 1.31. There will be no requirement to enter any pension information in a SATR for TY 2022/23 in respect to a deferred PSS. Tax returns for TY 2022/23 and returns for remedy years will not be re-opened – a new special format will apply.
- 1.32. The special format for individuals to report an AA tax charge for the 2022 to 2023 tax year will be available in an electronic form and further guidance on the form will be published in

¹¹ https://www.gov.uk/government/publications/rates-and-allowances-pension-schemes/pension-schemes-rates

due course. Generally, the deadline for reporting these charges will be 31 January 2025 for those who are still building up pension rights (active members) or are no longer building up rights but have not yet taken a pension (deferred members). For all others with an AA tax charge who are impacted by the remedy, the deadline for reporting will be 31 January 2027.

1.33. This does not preclude members from submitting a TY 2022/23 SATR if they ordinarily do so or have other relevant information to report, including pension information from schemes not affected by remedy.

Next Steps

- 1.34. No action is required now on behalf of members, further information will follow to aid members in correcting their tax position, this will include:
 - Details from HMRC on the HMRC tax calculator
 - Further information on PSSs (including scheme pays)
 - User guides and walkthroughs, similar to existing material.

Annex A – further guidance

The MOD does not provide tax advice or financial advice but there are a number of charitable organisations who will be able to assist.

Forces Pension Society – <u>memsec@forpen.co.uk</u> White Ensign Society – <u>office@whiteensign.co.uk</u> Army Families Federation – <u>contact@aff.org.uk</u> SIIAP – <u>chairman@siiap.org</u>

War Widows Association - info@warwidows.org.uk

Annex B – definitions

	The limit on what can be added each tax
Annual Allowance (AA)	
	year to the value of the pension without tax
	charge. The rule is that, when added
	together, the increase in the value of an
	individual's pension savings in any input
	period may not exceed the Annual
	Allowance. Any amount over the Annual
	Allowance is taxed either at 40% if a
	member's excess over the AA, plus salary
	is less than 150k. If it is over 150k it is
	taxed at 45%. Both are due as a lump sum
	when the tax liability is calculated.
Deferred Choice	The choice (or election) made by active or
	deferred members at the point when
	pension benefits, including Early Departure
	Payments, are due to come into payment.
	Covered under Section 10 of the Act
Immediate choice	Under Section 6 of the Act members who
	already have benefits in payment or who
	have died by the time the remedy is
	implemented (as entitlement to the
	payment of benefits in relation to
	remediable service will have occurred) will
	be provided with an immediate choice.
Lifetime allowance	The lifetime allowance is the maximum
	amount of pension savings that you can
	have without paying extra tax. The limit is
	set by the government and applies to all of
	your pension schemes. The standard
	lifetime allowance is £1,073,100. If you
	exceed the allowance, you will pay a tax

	charge of 25% or 55% depending on how
	you take the excess
Pension commencement lump sum	More commonly referred to as 'the lump
	sum', this is a tax-free amount of money
	automatically paid to the member when
	they start to take benefits.
Pensions saving statement	This is a statement of the amount of
	pension saving in the pension scheme for
	a tax year. Members can use this
	information when submitting their Self-
	Assessment return
Remediable service statement	A Remediable Service Statement is a
	document which will clearly show the value
	of pension scheme benefits available
	under the election. Among other
	information, it will show the default
	entitlement as the value of legacy pension
	benefits up to 31 Mar 22 (or end of service
	if earlier) and then AFPS 15 from that point
	forward (if there was service after Apr 22).
	The alternative will show legacy pension
	benefits up to and including 31 Mar 15 and
	then AFPS 15 / EDP 15 benefits from that
	point forward.
Self-assessment	This is the process for member's paying
	tax to HMRC, pensions growth only makes
	up a part of a member's Self-Assessment
	return.