# Scheme Pays Elections

April 2020

## Relevant for:

1. Participating employers in the Teachers' Pension Scheme.
2. Employer and member representatives.
3. Members concerned about the impact of the Annual Allowance.

## Introduction

The Annual Allowance charge was introduced in the Finance Act 2004 (section 227) and is a charge to income tax. This means that it is a personal tax matter.

It was introduced to limit the amount of tax relief that an individual could claim on their pension contributions, by placing an upper ceiling (known as the Annual Allowance Threshold) on the amount of Pension Savings that could be made in the period being assessed, known as the Pension Input Period. Any Pension Savings that were above the threshold would be subject to a personal tax charge at the member's highest marginal rate.

From its introduction in 2006 until 2011, the Annual Allowance threshold was relatively high, thus only a handful of higher earners and/or those with long pensionable service could potentially compromise the threshold and be subject to the Annual Allowance tax charge, which they had to pay (at that time) from their own resources.

The Finance Act 2011 (Schedule 17) reduced the Annual Allowance from £255,000 to £50,000 with effect from the 2011-12 tax year. The result of which was that the number of people affected increased.

In order to assist Scheme members who found themselves liable to a large one-off Annual Allowance tax charge (that could be difficult to manage from current income), the Act introduced two new mechanisms:

- A 'Scheme Pays' facility which allows a member, upon meeting certain conditions, to request that the pension Scheme pays the tax on their behalf, in exchange for a consequential reduction in the eventual benefits paid from the Scheme.
- A 'Carry forward' facility, to allow any unused Annual Allowance from the previous 3 preceding years, to be added to the current Annual Allowance threshold, to help to reduce/mitigate the current liability to an Annual Allowance tax charge.

In this Briefing Note we will focus on the Scheme Pays mechanism.

Teachers' Pensions

## What is a "Pension Input Period"?

These are time periods used to assess pension accrual in a given tax year against the Annual Allowance. Benefits in the Teachers' Pension Scheme and other Defined Benefit pension savings are valued for Annual Allowance purposes through measuring pension accrual over the Pension Input Period. Originally the legislation allowed the Scheme administrator for tax purposes to nominate the Pension Input Period end date. The Teachers' Pension Scheme nominated 31 March. However, in his summer budget of 2015, the Chancellor announced that, in future, all Pension Input Periods for registered pension schemes must accord with the tax year.

After this announcement on 8th July 2015 the Teachers' Pension Scheme immediately entered a transitional period during 2015/16, whereby we had to realign our Pension Input Period to the tax year with effect from the 6th April 2016. (For NPA 60 members, you must also add on the current value of your automatic lump sum entitlement, i.e. (Pension x 16) + Lump sum).

## What is a "Pension Input Amount"?

In a Defined Contribution scheme, the Pension Input Amount is the sum of any member and employer contributions paid during the Pension Input Period.

In a Defined Benefit scheme, such as the Teachers' Pension Scheme, the Pension Input Amount is calculated as the difference between the accrued pension at the end of the Pension Input Period and the accrued pension at the end of the previous Pension Input Period. The accrued pension at the end of the previous Pension Input Period is adjusted for inflation and the increase in the Accrued Pension is multiplied by a factor of 16.

## How do I know if I have an Annual Allowance tax charge?

Teachers' Pensions is required to issue a Pension Savings Statement by the later of 6 October following the end of the Pension Input Period in question, or within 3 months of receiving data from the employer whichever is the later, where we calculate that an individual will breach the Standard Annual Allowance threshold (please see our separate Briefing Notes for more information on the standard Annual Allowance and the Tapered Annual Allowance). This will notify the member of:

- The extent of their pension savings within the Teachers' Pension Scheme; and
- The amount of unused Annual Allowance that may be able to be carried forward from the previous three years, based on their pension accrual in the Teachers' Pension Scheme.

If a Pension Savings Statement is not automatically issued because the standard Annual Allowance has not been exceeded, a member has a right to request a statement, which must be provided by the later of three months following the date of receipt of the request for information, and
6 October following the end of the relevant tax year. This will assist members who singularly, may not have breached the Annual Allowance threshold within the Teachers' Pension Scheme, but due to pension savings they have made elsewhere, the combined figure from all sources* will put them over the Annual Allowance and a tax charge may have been triggered as a result. It is also helpful for those who may be subject to the Tapered Annual Allowance.

(*Please note that the Annual Allowance tax charge applies to pension savings in ALL registered pension Schemes. However, Teachers' Pensions can only report on the extent of pension savings that have accrued during the Pension Input Period in the Teachers' Pension Scheme).

## What do I do if I think I have a tax charge, but some information is missing?

If you do not have the information you require to notify HMRC of the growth in your pension savings by the 31 January following the relevant tax year, you must provide an estimate based on the information that you have available. The estimate must be included in your Self-Assessment Tax Return, which can be amended at a later date when all necessary information is available.

## Scheme Pays

The Finance Act 2004 was amended in 2011 to introduce a requirement by which, upon the meeting of certain conditions, a member can make a formal request to the Teachers' Pension Scheme to pay an Annual Allowance tax charge. In return, a corresponding debit will be applied to the eventual benefits paid out from the Teachers' Pension Scheme.

The tax charge that a Scheme can pay can only be in respect of the tax liability that has arisen with in that Scheme only. Scheme Pays requests cannot be accepted in respect of a liability that has arisen in another registered pension Scheme.

The Teachers' Pension Scheme has a statutory duty to accept a Scheme Pays election. This is known as a 'Mandatory' Scheme Pays election.

In the same year, further overriding legislation allowed a Scheme Pays election to be made on a 'Voluntary' basis, where none of the conditions are met. However, there is no statutory requirement for a Scheme to accept such an election.

'Mandatory' and 'Voluntary' Scheme pays mechanisms are discussed in more detail below:

**A. Mandatory Election**

As we have seen, the Finance Act (2011) introduced a 'Mandatory' Scheme Pays mechanism to allow a member, who, upon meeting certain conditions, could request that the Scheme administrator makes a payment from the Scheme, to immediately settle the tax charge due.

In return, an actuarially determined reduction would be made from the member's benefits when the member chooses to retire (known as a Scheme Pays Debit).

Before a member can elect for a Mandatory Scheme Pays election, four conditions must be met:

- i) The total Annual Allowance charge liability across all their pension Schemes for the tax year has exceeded £2,000, and;
- ii) The total amount of their pension savings in the pension Scheme in question for the same tax year has exceeded the standard Annual Allowance, and;
- iii) A member has made a written request (under section 237(b) of the Finance Act 2004) to instruct the Scheme to settle the tax due. Upon receipt of a qualifying Mandatory Election, the Scheme becomes jointly and severally liable to the Annual Allowance tax charge due.
- iv) The election has to be received by the Scheme no later than the 31 July in the year immediately following the Pension Input Period in which the tax liability arose. For example, the deadline would be 31 July 2020 for a tax liability that arose in the Pension Input Period for 6 April 2018 to 5 April 2019.

**Important** - Any Scheme Pays election must be received by Teachers' Pension Scheme prior to the payment of a retirement award, or the final tranche of a Phased Retirement award. Legislation prevents a Scheme Pays election being made after all of the member's benefit(s) is in payment.

For future tax years the deadlines are as follows:

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|---|---|
| 2018/19 | 31 July 2020 |
| 2019/20 | 31 July 2021 |
| 2020/21 | 31 July 2022 |

If you are unable to establish the exact amount of the Annual Allowance tax liability by the relevant 31 July, you may wish to estimate the charge and submit a Scheme Pays election in advance of the relevant deadline. This can be altered at a later date. If you miss the deadline, you will not be able to make a Scheme Pays election.

**B. Voluntary Election**

There is provision in overriding regulations for a Scheme to pay the member's Annual Allowance charge on a Voluntary basis. This is known as 'Voluntary Scheme Pays'. However, it must be noted that this is not 'as of right' and is purely granted at the Scheme Manager's discretion. The Department for Education made the decision to allow Voluntary Scheme pays elections from the 2016/17 tax year.

Unlike 'Mandatory Scheme Pays' the liability for the tax charge remains solely with the member at all times.

A 'Voluntary Scheme Pays election' will only be accepted if the tax charge has been accrued in the Teachers' Pension Scheme, the election is for the 2016/17 tax year or later, AND, Mandatory Scheme Pays has first been attempted.

**Interest on Voluntary Scheme Pays elections**

A payment made by any registered pension scheme on a Voluntary Scheme Pays basis need to be paid to the member's normal self assessment deadline, i.e. 31 January following the tax year end. Where the scheme is unable to make the payment to HM Revenue and Customs in advance of the relevant 31 January deadline, interest will accrue on the tax charge. Any interest is payable by the member as it remains their sole responsibility, it cannot be included on the Scheme Pays election form. Members will need to settle this directly with HMRC.

## Is there a minimum amount you can elect a Scheme to pay?

For Voluntary Scheme Pays no. For Mandatory Scheme Pays yes. The total tax payable (across all schemes) for Mandatory Scheme Pays must be more than £2,000. A tax charge below this amount would default to Voluntary Scheme Pays.

You can ask the Teachers' Pension Scheme to pay a proportion of the tax charge due, whilst remitting the remaining balance direct to HMRC.

## Can I make more than one election?

You can ask the Scheme to pay your tax charge each time your Pension Input Amount exceeds the Annual Allowance.

**You must make a new election every time**. An existing election only covers the tax charge in the year that it arose. Subsequent tax charges will need their own individual elections completing.

## Will a Scheme Pays debit reduce Family Benefits?

No.

The Annual Allowance debit(s) will not be applied to benefits that may become payable upon a member's death in respect of adult survivors and children's pensions.

## Amendments to a Scheme Pays Notice

A member may amend a 'Voluntary' or a 'Mandatory' Scheme Pays notice.

An amendment may be necessary, for example, where:

- An estimate has been provided previously.
- The amount of the tax charge has been wrongly assessed.

Where an amendment is required to the Scheme Pays notice, the Scheme administrator must receive the member's revised Scheme Pays election notice no later than the 31st July that follows the end of the period of four years from the end of the tax year to which the member's tax liability relates.

For example, if the member's Annual Allowance charge relates to the tax year 2018/19, their request to change the amount that they have already asked the pension Scheme to pay must be received by the Scheme no later than 31st July 2023.

However, it is important to note that the timescales in which you can amend your self-assessment tax return are substantially shorter.

You'll need to make your changes by:

- 31 January 2021 for the 2018/2019 tax year.
- 31 January 2022 for the 2019/2020 tax year.

If you miss the deadline, or if you need to make a change to your return for any other tax year, you'll need to contact HMRC.

If you no longer have an Annual Allowance charge, you should put "£0.00" on your amended Scheme Pays election form and separately confirm the reason for this in writing to us. This is because Scheme Pays elections are irrevocable, thus a 'nil' return must be made to achieve the desired outcome.

## Tapered Annual Allowance

If your earnings in any Pension Input Period exceed a Threshold Income of £110,000, and your Adjusted Income is between £150,000 and £210,000, then your individual Annual Allowance is "tapered". If your Adjusted Income is greater than £210,000, the Tapered Annual Allowance is £10,000.

The parameters for tapering changed on 6 April 2020.

If your earnings in any Pension Input Period exceed a Threshold Income of £200,000, and your Adjusted Income is between £240,000 and £300,000, then your individual Annual Allowance is "tapered". If your Adjusted Income is greater than £300,000, the Tapered Annual Allowance is £4,000.

## When you do not need to notify HMRC

If your **total** Pension Input Amount (in respect of all of your pension savings) has not exceeded your individual Annual Allowance (the lower of the standard Annual Allowance or Tapered Annual Allowance), then no further action is required by either you or the Scheme(s).

## Recovering the Annual Allowance charge

Section 237(E) of the Finance Act 2004 allows for the tax charge remitted by the Scheme to HMRC, on behalf of the member, to be recovered by a 'just and reasonable' deduction to be made from benefits.

The calculation must accord with standard actuarial practice.

For the avoidance of doubt, in respect of NPA 60 members in the Teachers' Pension Scheme, a deduction is made from both member's pension and the automatic lump sum entitlement.

The 'debit' is calculated at the 5th April in the Pension Input Period in question. It is then logged against the member's record. In the intervening period before retirement or transfer, it will be increased in line with Pension Increase factors published by HM Treasury. The increased debits will then be deducted from your benefits at the point of retirement or transfer from the Teachers' Pension Scheme.

For those members who ultimately apply for Phased Retirement, the debit(s) are revalued and deducted from the first tranche of benefits.

## Scheme Pays and subsequent Pension Input Amounts

When Teachers' Pensions measure your pension savings in subsequent years, any existing Scheme Pays debits must be revalued and allowed for in the calculations.

## When can a Scheme Pays election be declined by the pension Scheme?

A Scheme does not have to pay an Annual Allowance charge if:

- The election does not meet the Mandatory Scheme Pays conditions.
- A retirement award has already been put in to payment.
- The election has not been made on the requisite form.
- You do not have enough accrued benefits to make a deduction against.
- You are over age 75.
- You have transferred your benefit entitlement to another registered pension Scheme.
- You have taken a refund of contributions.

## Other pension schemes (including Additional Voluntary Contributions (AVC's)

If you have growth in another pension Scheme such as a personal pension scheme in the same Pension Input Period, any Annual Allowance liability associated with it must be met by that Scheme. Regulations stipulate that we can only pay a tax charge in relation to the extent of the liability arising in our Scheme only.

Teachers' Pensions can't accept a Scheme Pays Election that includes growth within other pension schemes. For example, any Scheme Pays liability involving the Teachers' AVC scheme must be dealt with by Prudential who administer the Scheme.

Tax charges attributable to other schemes must be dealt with by a separate election made exclusively with that Scheme or scheme.

## What happens if I transfer out of the Teachers' Pension Scheme?

Any existing Scheme debits will transfer with you and shall be applied from your retirement date with your new provider/employer. However, the transfer value paid will be net of the value of your debits and in so doing Teachers' Pensions will recover the tax they have paid to HMRC on your transfer.

If you move to a new employer and transfer your benefit entitlement to them within the current Pension Input Period, then it is your new employer who will be responsible for any new Scheme Pays election, if the relevant conditions are met.

## What happens if I am due to retire in the current Pension Input Period?

It is very important to be aware that, as soon as you are in receipt of your retirement benefits, you will lose the right to request a Scheme Pays election – however you can still amend an election which you made prior to retirement as long as it is within the four year period mentioned above.

Failure to make an election before retiring will mean that you would have to pay your tax charge from your personal resource. It is, therefore, important to measure the growth in your benefits up to the point of your retirement, in advance of your retirement, to discover whether you may have triggered an Annual Allowance tax charge.

If the usual conditions are met, a Scheme Pays election must be made prior to the payment date of your final award. The corresponding debit can then be calculated and applied to your benefits accordingly.

If you are taking your benefits by way of Phased Retirement, you are still eligible to make a Scheme Pays election in respect of the benefits that remain in the Teachers' Pension Scheme, assuming that they are sufficient to meet the amount of the debit to be applied.

## Money Purchase Annual Allowance

It is a statutory requirement that, where you also have money purchase (defined contribution) benefits that you have 'flexibly' accessed, you must provide us with a copy of your Flexible Access Statement. Teachers' Pensions will hold this information on your record but the Teachers' Pension Scheme will continue to notify you of your growth in benefits against the standard Annual Allowance only.

## Is there any further guidance available?

HMRC have a help sheet - HS345 'Pensions - tax charges on any excess over the Lifetime Allowance, Annual Allowance and on unauthorised payments' that contains further information and is primarily authored to assist you when completing your tax return.

**The information in this Briefing Note is based on our understanding of the tax and legal position and does not allow for any changes that may be communicated after the date of publication. This document is for reference purposes only and does not constitute financial advice. It is the member's responsibility to ensure that they pay any tax due on their pension savings. We recommend that you take independent financial advice from a registered individual, who can assess and quantify the extent of any tax liability that is due. You can find a list of independent financial advisers at www.unbiased.co.uk**