Voluntary Scheme Pays Elections
– a detailed guide (including worked examples)

Relevant for:

1. Members who are affected by a tapering of the standard Annual Allowance
2. Annual Allowance tax liability in the Teachers' Pension Scheme from 2016/17 PIP onwards

Introduction

The Annual Allowance tax (AA) charge was introduced in the Finance Act 2004 (the 'Act') and became effective from 6 April 2006.

It is a mechanism which recovers tax relief where the growth in pension benefits is deemed to be excessive. This additional levy is applied via an extra charge against personal income tax.

Up until 2012, it was only higher earners who came within the scope of this additional tax charge.

However, the Finance Act 2011 introduced a significant reduction in the standard AA with effect from 6 April 2012. In order to avert a 'cliff edge' scenario for the majority of members suddenly brought within scope of the lower level, members are able to carry forward unused AA from the three previous tax years. In addition, the 'Act' also introduced a 'Mandatory' Scheme Pays mechanism, enabling a pension scheme to pay the charge on a member's behalf.

This meant that members affected by the reduction in the standard AA could, upon meeting three prescribed conditions, mitigate the tax charge arising by requesting their 'scheme' to pay the charge.

If a member opts for a Mandatory Scheme Pays, their pension scheme becomes jointly and severally liable to the tax charge until it has been paid to HMRC.

In return for paying the tax charge, the pension scheme will apply a reduction to the member's pension benefits when they reach retirement.

For those members who had a tax charge liability arising, but did not meet the conditions that allowed them to make a 'Mandatory' Scheme Pays Election, the Modification Regulations (2011) introduced legislation that allows a scheme such as the Teachers' Pension Scheme to accept a Scheme Pays election on a 'Voluntary' basis. It is for the Teachers' Pension Scheme to decide whether it will accept or reject a voluntary election in these circumstances.

Because a 'Voluntary' Scheme Pays election does not come under the Finance Act 2004, there are no qualifying conditions to be satisfied before an election can be accepted.

If a member opts for, and the pension scheme accepts a Voluntary Scheme Pays election, the scheme does not become jointly and severally liable to the tax charge, but it will meet the tax charge at the member's request subject to an actuarial reduction in the member's benefits at retirement. The liability however, remains the sole responsibility of the member at all times.

Please note that further changes made to primary legislation (Finance Act 2019/20) tapers (reduces) the standard AA threshold further for higher earners.

Please see:

1. Briefing Note 6 for how to measure your income to work out if you will be affected, and if so, how much of a reduction will be applied to the standard AA.

The current situation

Teachers' Pensions is required under s237(b) of the Finance Act 2004 to accept a 'Mandatory' Scheme Pays election if the member meets certain qualifying conditions specified in the Act. These conditions are:

1. The tax charge in the Teachers' Pension Scheme must be £2,000 or more, and
2. The member has exceeded the standard AA threshold in the Teachers' Pension Scheme and;
3. The member has made a valid 'Election' before the statutory deadline.*

(*This is 31 July in the subsequent year following the period that the excessive pension savings were made. For example 31 July 2018, for the Pension Input Period 6 April 2016 to 5 April 2017).

Upon receipt of a valid 'Mandatory' Scheme Pays Election, Teachers' Pensions will become jointly and severally liable to the tax charge.

An individual should report any AA tax liability to HMRC through a self-assessment tax return and confirm to HMRC that they intend to meet the tax charge using the Scheme Pays mechanism.

A separate Scheme Pays election is needed for each year that the AA tax charge liability arises. However, the above conditions need to be satisfied each year in order for the 'Mandatory' Scheme Pays election to be accepted.

A member can request that their pension scheme pays their AA tax charge in any Pension Input Period (PIP) where the standard AA threshold has been exceeded and the member has met the 3 prescribed conditions mentioned above.

As noted earlier, the Modification Regulations (2011) introduced an overriding provision for a pension scheme to allow an election to be made on a 'Voluntary' basis, if accepted by the scheme administrator.

If we allow a 'Voluntary' Scheme Pays Election to be made, at no point are Teachers' Pensions jointly or severally liable to the tax charge, the liability rests with the member at all times.

Until further notice, Teachers' Pensions will accept Voluntary Scheme Pays elections for any tax liability arising in respect of the 2016/17 tax year and beyond.

Please note that late payment of the tax charge will incur penalties and/or late payment interest. Neither the Teachers' Pension Scheme nor Teachers' Pensions will not accept liability for any such payments. These payments cannot be included in the tax charge to be mitigated by any Scheme Pays election. Therefore, the member must pay these from their own personal resources.

Tapered Annual Allowance (TAA) – discretion to accept 'Voluntary' elections

As we have noted earlier, there are 3 principal conditions which are contained within section 237(b) of the Finance Act 2004, which must be satisfied before a pension scheme can accept a Mandatory Scheme Pays election.

However, a member who is subject to a TAA, (i.e. has had their standard AA reduced), would find that unless the pension scheme is willing to adopt the 'Modification Rules', they would find that they will have to pay part of the tax charge from their own resources.

For example, a final salary member with an 'Adjusted Income' of £260,000 will have a TAA of £30,000.

If we assume that they had a Pension Input Amount (PIA) of £60,000 and that their highest marginal rate of tax was 40%, utilising a Mandatory Scheme pays election alone, the following outcome would arise.

1. The amount of pension savings subject to an AA charge liability is:
    - PIA less the minimum of either the standard AA or the TAA.
    - In our example this would be: £60,000 - £30,000 = £30,000
2. The tax that would need to be paid is: £30,000 x 40% = £12,000
3. A Mandatory Scheme Pays election can only pay a tax charge in respect of an AA tax liability that has exceeded the standard AA threshold.

Therefore, the pension scheme can only accept a Mandatory Scheme Pays election in respect of:
(£60,000 (PIA) - £40,000 (standard AA)) x 40% = £8,000

This is the total extent of the liability that the pension scheme can accept in these circumstances. Unless a Voluntary Scheme Pays election is accepted, the £4,000 tax charge that is not covered by the Mandatory Scheme Pays election must be paid by the member, directly to HMRC.

Therefore, without a change of approach by the Scheme, this member would need to pay £4,000 of the tax liability from their own resources.

After discussions with the Department for Education, Teachers' Pensions do accept 'Voluntary' Scheme Pays elections from any member making such an application in respect of the 2016/17 tax year onwards.

Therefore, the revised outcome for this particular member would be that they can now ask Teachers' Pensions to pay all their tax charge. Members simply need to complete one Scheme Pays election form and Teachers' Pensions will calculate what needs to be paid on a mandatory and a voluntary basis.

Teachers' Pensions

Worked Examples

There follows a number of Worked Examples which explore the position for a number of different member situations.

Worked Example 1 – Protected Member (final salary only)

For the purposes of this example, let us assume that:

1. A teacher has a Pension Input Amount of £60,000.
2. They have Adjusted Income over £300,000 and therefore a Tapered Annual Allowance of £4,000.
3. Their highest marginal rate of income tax is 45%.
4. There is no carry forward of unused relief available from the previous 3 years.

Step 1 – Calculate the excess Pension Input Amount

The total Pension Input Amount is:	£60,000
Less	
The Annual Allowance threshold*	
(including any available carry forward)	£4,000
Taxable 'excessive' pension savings	£56,000

(*this is the lesser of the standard Annual Allowance or the Tapered Annual Allowance).

Step 2 – Calculate the tax charge due

Taxable 'excessive' pension savings	£56,000
Multiplied by	
Highest marginal rate of tax	45%
Tax charge payable	£25,200

Step 3 – What can be covered by 'Mandatory' Scheme Pays?
'Mandatory' Scheme Pays can only meet the tax liability arising on the level of pension savings that exceed the standard AA threshold.

The total Pension Input Amount is:	£60,000
Less	
The standard Annual Allowance threshold:	£40,000
Excess above the standard threshold	£20,000
Multiplied by	
Highest marginal rate of tax	45%
The member can elect the Teachers' Pension Scheme to pay	£9,000

Under a 'Mandatory' election, Teachers' Pensions will become jointly and severally liable for this amount of tax, until it has been paid to HMRC.

However, the total tax charge was for £25,200; how do we account for the remaining balance?

Step 4 – What can be covered by 'Voluntary' Scheme Pays?

Tax charge payable	£25,200
Less	
The 'Mandatory' amount the Teachers' Pension Scheme can pay (if you elect for the Teachers' Pension Scheme to pay this amount)	£9,000
Balance of tax payable to HMRC	£16,200

This amount can, if the member chooses not to pay it from their own personal funds, can be met via a 'Voluntary' Scheme Pays election. Members, however, simply need to complete one Scheme Pays election form and Teachers' Pensions will calculate what needs to be paid on a mandatory and a voluntary basis.

Summary

Election	Scheme	Tax	Balance of tax remaining
Mandatory	final salary	£9,000	£16,200
Voluntary	final salary	£16,200	£0
Total		**£25,200**	

Worked Example 2 – Protected Member (final salary only)

For the purposes of this example, let us assume that:

1. A teacher has a Pension Input Amount of £80,000.
2. They have Adjusted Income of £250,000 and therefore a Tapered Annual Allowance of £35,000.
3. Their highest marginal rate of income tax is 45%.
4. There is no carry forward of unused relief available from the previous 3 years.

Step 1 – Calculate the excess Pension Input Amount

The total Pension Input Amount is:	£80,000
Less	
The Annual Allowance threshold* (including any available carry forward where applicable)	£35,000
Taxable 'excessive' pension savings	£45,000

(*this is the lesser of the standard Annual Allowance or the Tapered Annual Allowance).

Step 2 – Calculate the tax charge due

Taxable 'excessive' pension savings	£45,000
Multiplied by	
Highest marginal rate of tax	45%
Tax charge payable	£20,250

Step 3 – What can be covered by 'Mandatory' Scheme Pays?
'Mandatory' Scheme Pays can only meet the tax liability arising on the level of pension savings that exceed the standard Annual Allowance threshold.

The total Pension Input Amount is:	£80,000
Less	
The standard Annual Allowance threshold:	£40,000
Excess above the standard threshold	£40,000
Multiplied by	
Highest marginal rate of tax	45%
The member can elect the Scheme to pay	£18,000

Under a valid 'Mandatory' Election, Teachers' Pensions will become jointly and severally liable for this amount of tax, until it has been paid to HMRC.

However, the total tax charge payable was £25,200; how do we account for the remaining balance?

Step 4 – What can be covered by 'Voluntary' Scheme Pays?

Tax charge payable	£20,250
Less	
The 'Mandatory' amount the Teachers' Pension Scheme can pay (if you elect for the Teachers' Pension Scheme to pay this amount)	£18,000
Balance of tax to pay to HMRC	£2,250

This amount can, if the member chooses not to pay it from their own personal funds, can be met via 'Voluntary' Scheme Pays.

Summary

Election	Scheme	Tax	Balance of tax remaining
Mandatory	final salary	£18,000	£2,250
Voluntary	final salary	£2,250	£0
Total		**£20,250**	

Worked Example 3 – Transitional Member (final salary and career average)

This example illustrates the position regarding a member who has moved into the career average scheme, but there is still a potential for pension savings arising under both the final salary and the career average schemes. This is because the member in this example still has a final salary link in respect of their final salary benefits. Therefore, increases to pensionable salary can cause a 'relevant accrual event' under the final salary scheme, even though ongoing pensionable service is now completed in the career average scheme.

HMRC guidance (PTM056300) states that a Scheme Pays election can only meet the extent of the liability arising in each scheme;

"Where the individual is a member of more than one scheme they cannot elect to require just one scheme to pay all of their liability or simply divide the liability equally between all of the schemes that they are a member of. The maximum amount a member can require a scheme to pay is based on the amount of their pension savings that exceeded the annual allowance in that scheme alone."

This statement is true for all members who have transitioned in to the career average scheme.
For the purposes of this example, let us assume that:

1. A teacher has a Pension Input Amount of
   - 1.1 final salary £14,000 (20%)
   - 1.2 career average <u>£56,000</u> (80%)
   - 1.3 Total <u>£70,000</u>
2. They have Adjusted Income of £280,000 and therefore a Tapered Annual Allowance of £20,000.
3. Their highest marginal rate of income tax is 45%.
4. There is no carry forward of unused relief available from the previous 3 years.

Step 1 – Calculate the excess Pension Input Amount

The total Pension Input Amount is:	£70,000
Less	
The Annual Allowance threshold*	
(including any available carry forward)	£20,000
Taxable 'excessive' pension savings	£50,000
(*this is the lesser of the standard Annual Allowance or the Tapered Annual Allowance).	

Step 2 – Calculate the tax charge due

Taxable 'excessive' pension savings	£50,000
Multiplied by	
Highest marginal rate of tax	45%
Tax charge payable	£22,500

Step 3 – What can be covered by 'Mandatory' Scheme Pays?
'Mandatory' Scheme Pays can meet the tax liability arising on the level of pension savings that exceed the standard Annual Allowance threshold in each scheme.

Only the career average scheme had excessive pension savings above the standard Annual Allowance threshold.

Therefore mandatory Scheme Pays would meet:

career average pension input amount =	£56,000
Less	
Standard annual allowance =	£40,000
	£16,000

As the highest marginal rate of tax is 45%, this means that £7,200 (£16,000 x 45%) of the total tax can be paid via 'Mandatory' Scheme Pays

However, there is still a tax charge remaining for £15,300; how do we account for this?

Step 4 – What can be covered by 'Voluntary' Scheme Pays?
Because the PIA in respect of the final salary scheme (£14,000) is less than the standard AA threshold (£40,000), none of the tax charge in this scheme can be dealt with via 'Mandatory' Scheme Pays.

Therefore, 'Voluntary' Scheme Pays would need to meet the remaining tax charge of £15,300.

We will apportion this between the career average and final salary schemes in accordance with your PIA in each scheme.

This means that:

Tax to be paid using Voluntary Scheme Pays in the career average scheme = Total tax to be paid by Teachers' Pensions multiplied by the proportion of PIA that accrued in the career average scheme less any tax met by Mandatory Scheme Pays in the career average scheme = 22,500 x 56,000 / 70,000 – 7,200 = £10,800

Tax to be paid using Voluntary Scheme Pays in the final salary scheme = Total tax to be paid by Teachers' Pensions less any tax met by Mandatory Scheme Pays less any tax met by Voluntary Scheme Pays in the career average scheme = 22,500 – 7,200 – 10,800 = £4,500.

Summary

Election	Scheme	Tax	Balance of tax remaining
Mandatory	career average	£7,200	£15,300
Voluntary	career average	£10,800	£4,500
Voluntary	final salary	£4,500	£0
Total		**£22,500**	

Worked Example 4 – New member (career average scheme only)

For the purposes of this example, let us assume that:

1. A teacher has a Pension Input Amount of £45,000.
2. They have Adjusted Income of £255,000 and therefore a Tapered Annual Allowance of £32,500.
3. Their highest marginal rate of income tax is 45%.
4. There is no carry forward of unused relief available from the previous 3 years.

Step 1 – Calculate the excess Pension Input Amount

The total Pension Input Amount is:	£45,000
Less	
The Annual Allowance threshold*	
(including any available carry forward)	£32,500
Taxable 'excessive' pension savings	£12,500

(*this is the lesser of the standard Annual Allowance or the Tapered Annual Allowance).

Step 2 – Calculate the tax charge due

Taxable 'excessive' pension savings	£12,500
Multiplied by	
Highest marginal rate of tax	45%
Tax charge payable	£5,625

Step 3 – What can be covered by 'Mandatory' Scheme Pays?
'Mandatory' Scheme Pays election can meet the tax liability arising on the level of pension savings that exceed the standard Annual Allowance threshold.

The total Pension Input Amount is:	£45,000
Less	
The standard Annual Allowance threshold:	£40,000
Excess above the standard threshold	£5,000
Multiplied by	
Highest marginal rate of tax	45%
The member can elect the Scheme to pay	2,250

If the member makes a valid 'Mandatory' election, the Teachers' Pension Scheme will become jointly and severally liable for this amount of tax until it has been paid to HMRC.

However, the total tax charge was for £5,625; how do we account for the remaining balance?

Step 4 – What can be covered by 'Voluntary' Scheme Pays?

Tax charge payable	£5,625
Less	
The 'Mandatory' amount the Scheme can pay	£2,250
(if you elect for the Scheme to pay this amount)	
Balance of tax to pay to HMRC	£3,375

Summary

Election	Scheme	Tax	Balance of tax remaining
Mandatory	career average	£2,250	£3,375
Voluntary	career average	£3,375	£0
Total		**£5,625**	

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Worked Example 5 – New Member (career average scheme only)

For the purposes of this example, let us assume that:

1. A teacher has a Pension Input Amount of £35,000.
2. They have Adjusted Income of £255,000 and therefore a Tapered Annual Allowance of £32,500.
3. Their highest marginal rate of income tax is 45%.
4. There is no carry forward of unused relief available from the previous 3 years.

Step 1 – Calculate the excess Pension Input Amount

The total Pension Input Amount is:	£35,000
Less	
The Annual Allowance threshold*	
(including any available carry forward)	£32,500
Taxable 'excessive' pension savings	£2,500

(*this is the lesser of the standard Annual Allowance or the Tapered Annual Allowance).

Step 2 – Calculate the tax charge due

Taxable 'excessive' pension savings	£2,500
Multiplied by	
Highest marginal rate of tax	45%
Tax charge payable	1,125

Step 3 – What can be covered by 'Mandatory' Scheme Pays?
The career average scheme did not have pension savings above the standard Annual Allowance threshold. Therefore, Mandatory Scheme Pays would not be available here.

Furthermore, as the tax charge is below £2,000, this would also fail the requirements for mandatory Scheme Pays.

Step 4 – What can be covered by 'Voluntary' Scheme Pays?

Tax charge payable	£1,125
Less	
The 'Mandatory' amount the Scheme can pay	
(if you elect for the Scheme to pay this amount)	£0
Balance of tax to pay to HMRC	£1,125

Teachers' Pensions

Important

A Scheme Pays election, whether it is made on a 'Mandatory' or 'Voluntary' basis, is irrevocable once it has been made. Therefore, you need to be certain as to the extent of your liability (if indeed there is any) before applying. However, the amount of tax that you request us to pay can be changed.

How to apply for Scheme Pays

To make a scheme pays election you should complete the necessary form. Please be aware that there are statutory deadlines in which an 'Election' must be made.

Please see the Briefing Notes in the 'Tax and National Insurance' section of our website for further details about this and other facts about the process as a whole.

How to change a Scheme Pays election once it has been accepted

If a mistake is made, or you have previously submitted a Scheme Pays election based on an estimate, you may amend it providing that we receive your request no later than the 31st July that follows the end of the period of 4 years from the end of the tax year to which your liability relates.

E.g. If you have requested a Scheme Pays election for the 2018/19 Pension Input Period which ended 5th April 2019, you will have 31 July 2023 in which to advise HMRC and Teachers' Pensions of any changes.

Will my Pension Saving Statement show my Tapered Annual Allowance?

No. Teachers' Pensions are required to report against the standard AA only.

It is therefore up to you to tell us what your tax charge is once you have accounted for TAA and available Carry Forward

Important timescales to be aware of

A pension scheme must provide a Pension Savings Statement by the later of:

- 6th October following the closure of the PIP on the preceding 5th April
- Within three months following receipt of a request from a member, or receipt of the required data from your employer, if the information from your employer is received after 6th July following the tax year in question.

If a member intends to make a 'Voluntary' Scheme Pays election, interest will apply if the pension scheme pays over the amount of tax due after the relevant 31 January.

If you are in any doubt about the effect of potential tax liabilities arising from the AA, please seek independent financial advice in view of the complexities of this subject.

You can find a list of independent financial advisers at www.unbiased.co.uk

There are fact sheets and calculator tools on the HMRC website which provide further guidance and can provide you with an indication as whether you may have a liability to the Annual Allowance that may require further action.

Website links

Calculator:
https://www.tax.service.gov.uk/paac

How to work out a TAA:
https://www.gov.uk/guidance/pension-Schemes-work-out-your-tapered-annual-allowance

General guidance
https://www.gov.uk/tax-on-your-private-pension

Detailed guidance:
https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm050000

The information in this Briefing Note and the examples shown are based on our current understanding of the tax and legal position. This document is for reference purposes only and does not constitute financial advice. If you think you may be affected by the Annual Allowance, we recommend that you take independent financial advice from a regulated individual, who can assess and quantify the extent of any tax liability that may be due.

Note: The examples are purely an illustration in their simplest form. Each individual situation will be different and will be reflective of your own personal financial circumstances.