# ‘Voluntary’ Scheme Pays elections in respect of the 2016/17 tax year and beyond.

April 2020

## Background

The Finance Act 2011 introduced a dramatic reduction in the Annual Allowance threshold. The reduction was severe, lowering the threshold from £255,000 to £50,000 in one fell swoop. A further reduction to £40,000 was applied from 2014 and this is still applicable today.

An immediate consequence of this action was that the scope of this tax was no longer reserved just for the highest earners. Those lower down the income scale with long service or those stepping up after receiving promotions, were now exceeding the Annual Allowance threshold and were becoming subject to this additional tax charge.

The Treasury was aware that a reduction of this magnitude and the unanticipated tax charges that would follow would more than likely be beyond the personal resources of those members who were now affected.

Therefore a ‘Scheme Pays’ mechanism was introduced to allow a member to require their pension scheme to pay the tax charge immediately upon their behalf, in exchange for a debit to be applied to their pension /and or lump sum when they retire. As long as they met the following conditions:

- They had a tax charge in excess of £2k, and
- They had exceeded the standard Annual Allowance threshold, and
- They had given formal ‘Scheme’ Pays notification in a prescribed manner by 31 July in the year following year in which the tax year to which the Annual Allowance charge relates

This is what is known as a ‘Mandatory’ Scheme Pays election.

However, further legislation brought in an overarching modification of existing scheme rules to allow (on a discretionary basis) a scheme pays election to be accepted which does not meet with the conditions described above. This is what is known as a ‘Voluntary’ Scheme Pays election. Previously, the Teachers’ Pension Scheme only accepted Voluntary Scheme Pays elections on an exceptional basis.

So what has necessitated a change in policy?

The Finance (No 2) Act 2015 introduced a ‘Tapering’ (reduction) of the standard Annual Allowance for higher earners who have an ‘Adjusted’ income in excess of £150,000.

In the budget on 11 March 2020 it was announced that the parameters around the taper were changing with effect from 6 April 2020 so that only those who have an adjusted income in excess of £240,000 are effected by the taper. This means that for every £2 earned above £240,000, the standard Annual Allowance is reduced by £1. There is a maximum reduction of the Annual Allowance to £4,000 which accords to an 'Adjusted' income of £300,000 and above.

However, the criteria to allow a member to require their pension scheme to pay the tax charge on their behalf still maintains a link to the standard Annual Allowance, in that the total pension savings must be in excess of £40,000.

Therefore, a member with a Tapered Annual Allowance will have a proportion of their tax charge which cannot be accommodated by the Mandatory Scheme Pays mechanism.

The following example illustrates this concern:

Let us assume a teacher has an 'Adjusted' income of £312,000 pa, and that they have a Pension Input Amount (PIA) of £60,000 in the current Pension Input Period. Their highest marginal rate of income tax is 45%.

Their standard Annual Allowance will therefore be tapered from £40,000 down to £4,000.

They will have the following tax charge to settle:

[£60,000 (PIA) less £4,000 (Tapered AA)] x 45%

=

£25200

However, they can only request that their pension scheme pays the tax charge on the amount of excess pension savings over the standard Annual Allowance £40,000.

As a 45% tax payer, they can only ask Teachers' Pensions to pay the following as part of a Mandatory Scheme Pays election:

[£60,000 (PIA) less £40,000 (Standard AA)] x 45%

=

£9,000.

So although the total tax due is £25,200, they can only request that £9,000 is paid from the scheme as part of a Mandatory Scheme Pays election. Without allowing for a Voluntary Scheme Pays election, the teacher would have to pay the remainder (£16,200) directly to HMRC from their own resources.

Voluntary Scheme Pays means that the teacher could ask the Teachers' Pension Scheme to meet the additional £16,200 tax charge.

It is important to note that for any Voluntary Scheme Pays election, the part of the tax charge, over and above what could be met through a Mandatory Scheme Pays election, remains the sole responsibility of the member. As such any delay in payment beyond the 31st January coincident with the fiscal period covered by his Annual Return will attract late payment interest and charges. The Teachers' Pension Scheme takes no responsibility and assumes no liability for any such interest or charges. They cannot be settled by the scheme as part of a Voluntary Scheme Pays election.

**Important**

**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 is due.**