

## **The Local Government Pension Scheme (Scotland)**

### **Limit on Total Amount of Benefits - Lifetime Allowance**

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## **1 Introduction**

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- 1.1 Regulation 22 of the Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2008 ('the Benefits Regulations') (SSI No. 230 of 2008) says that a member and any dependent of his shall not be entitled to receive benefits the capital value of which exceeds his lifetime allowance increase except in accordance with guidance issued by the scheme actuary, and that any calculation of the capital value of a member's benefits for the purposes of this or any other of these Regulations is to be carried out in accordance with guidance issued by the scheme actuary. The full text of the regulation is given in Annex C.
- 1.2 This note has been prepared by GAD for the Scottish Public Pensions Agency (SPPA). The main purpose of this note is to issue it to SPPA for onward transmission to administering authorities in order to provide the guidance required by Regulation 22(3) in cases where the value of the member's benefits including those associated with a previous and simultaneous Benefit Crystallisation Event (BCE) whether from LGPS or another registered pension scheme exceeds the Lifetime Allowance (LTA).
- 1.3 This note sets out how members can receive benefits which exceed their lifetime allowance, and determines the appropriate reduction in LGPS benefits where members choose to request that the scheme pays their Lifetime Allowance Charge (LTAC).
- 1.4 Section 2 of this guidance covers members who do not have Enhanced Protection, including members who have Primary Protection. Section 3 covers members who are entitled to Enhanced Protection.
- 1.5 SPPA has informed GAD that a member who has reached their available LTA will be able to take benefits in excess of their available LTA in the form of either a lump sum or pension.

### **Implementation and Review**

- 1.6 This guidance should be reviewed periodically, depending on external circumstances, for example when changes in the actuarial assumptions adopted for other scheme factors take place, or after each triennial cycle of funding valuations of the LGPS.

### **Limitations**

- 1.7 This note should not be used for any purpose other than to determine how members can receive benefits which exceed their lifetime allowance, and the appropriate reduction in LGPS benefits to cover the Lifetime Allowance Charge (LTAC).
- 1.8 This guidance is based on GAD's understanding of the Finance Act 2004. Nothing in this guidance can override any prevailing HM Revenue & Customs (HMRC) restrictions.
- 1.9 This note should be considered in its entirety as individual sections, if considered in isolation, may be misleading, and conclusions reached by a review of some sections on their own may be incorrect.
- 1.10 This note only covers the principles around the calculation of the LTAC. Any legal or tax advice in this area should be sought from an appropriately qualified person or source.
- 1.11 Administrators should satisfy themselves that a LTAC complies with all legislative requirements including, but not limited to, taxation requirements.

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- 1.12 Third parties should not rely on this guidance, but should separately seek their own advice where appropriate.

## **2 Members without Enhanced Protection**

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2.1 This section relates to members without Enhanced Protection, including:

- members with Primary Protection
- members who registered for Enhanced Protection but for whom the protections lapsed

2.2 This section covers the following topics:

- The Available Lifetime Allowance (ALTA)
- Members' benefits
- Calculating the value of benefits
- Calculating the value of benefits over the Available Lifetime Allowance (ALTA)
- Lump sum above ALTA
- Pension above remaining ALTA

### **Available life time allowance**

2.3 Each member will have a LTA setting a ceiling on the pension savings that can benefit from tax relief.

2.4 The standard LTA (SLTA) is fixed for each financial year. The SLTA in 2012-13 is set at £1,500,000. See:  
<http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM11101010.htm>.

2.5 There are various circumstances where the standard lifetime allowance does not apply, including when the member has Primary Protection. Primary Protection applies where total relevant pension rights in approved pension schemes as at 5 April 2006 were valued in excess of £1.5 million and were registered by 5 April 2009 (except in exceptional circumstances). See:  
<http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM03102000.htm>

2.6 Under Primary Protection, the individual is granted a personal lifetime allowance, in place of the standard lifetime allowance. The personal allowance is increased annually in line with the standard lifetime allowance, but taking the latter to be at least equal to £1.8 million for tax years following 5 April 2012. See:  
<http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM11101020.htm>

2.7 The application of the Lifetime allowance is described in the HMRC Registered Pension Schemes Manual:  
<http://www.hmrc.gov.uk/manuals/rpsmmanual/rpsm11300030.htm>

2.8 In summary, part of a member's LTA will be used up at each BCE, whenever pension benefits are crystallised. Such a BCE will reduce the LTA available at subsequent or simultaneous BCEs. Each member is responsible for providing to the LGPS details of the amount of his/her LTA used up by previous BCEs as well as the dates and amounts of lump sum taken at the previous BCEs. Once the amount of previous BCEs is deducted from the member's LTA, the remaining amount is the member's available LTA (ALTA).

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- 2.9 If a member has any BCEs, including the crystallisation of money-purchase type Additional Voluntary Contributions (AVCs), occurring simultaneously with the crystallisation of their LGPS benefits then they should inform LGPS of the order in which the BCEs should be deemed to occur. In the calculation of the payment of benefits from the LGPS, the ALTA should only be reduced by the amount used up by previous BCEs and simultaneous BCEs that are deemed by the member to occur *before* the crystallisation of his/her LGPS benefits. See: <http://www.hmrc.gov.uk/manuals/rpsmmanual/rpsm11300030.htm>.
- 2.10 Under Regulation 23 of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008, a member may use the accumulated value of his AVCs to provide additional benefits under the scheme (see GAD guidance on “Use of accumulated AVCs to provide additional benefits under the Scheme”).
- 2.11 If additional benefits are provided through the scheme, then these can be in the form of a lump sum, a pension, or a combination of the two. Where benefits are provided through the scheme, these are valued for LTA purposes in the same way as a defined benefit pension (ie in the same manner as basic LGPS benefits, with the pension being valued using the appropriate factor given in the HMRC Registered Pension Schemes Manual).
- 2.12 Alternatively, the member can take their AVC benefits outside the fund, by purchasing an annuity from an insurance company. If benefits are provided in this manner, then for LTA purposes they are valued as money purchase benefits, ie the amount of the total AVC fund is used. The member must inform the administrator which BCE occurs first – see <http://www.hmrc.gov.uk/manuals/rpsmmanual/rpsm11102030.htm>.
- 2.13 Lump sum benefits are assumed to be crystallised before pension benefits. See <http://www.hmrc.gov.uk/manuals/rpsmmanual/rpsm11104730.htm>.

**Member's benefits**

- 2.14 The member's standard benefits from the LGPS will be in the form of a pension and a retirement grant.
- 2.15 The member has an option to commute part of their pension for an additional lump sum under regulation 21 of the Benefit Regulations. The member decides how much additional pension they wish to commute, or, equivalently, how much additional lump sum they wish to take. The resulting pension and lump sum after commutation should be calculated. See GAD Guidance on “Lifetime Allowance and Additional Cash Commutation”.

**Calculate value of benefits**

- 2.16 For the purposes of Regulation 22(3) the capital value of the member's accrued rights should be calculated in accordance with Finance Act 2004, associated regulations and HMRC guidance. Reference should also be made to GAD guidance “Lifetime Allowance and Additional Cash Commutation”.
- 2.17 After calculating the amount of pension and lump sum after commutation, the value of these benefits should be calculated. A factor of 20 is used to value a member's pension in determining whether the value of the member's benefits exceeds the ALTA. The capital value of the member's accrued rights is therefore:

$$CV = LS + (20 \times P)$$

Where:

LS = Retirement Grant + Additional lump sum by commutation  
P = Pension after commutation

See: <http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM11104220.htm>.

### **Calculation of benefits over Available Lifetime Allowance (ALTA)**

- 2.18 After calculating the amount of pension and lump sum after commutation, the level of benefits over the ALTA should be calculated.
- 2.19 Regulation 22 states that benefits in excess of the lifetime allowance can only be paid in accordance with guidance issued by the scheme actuary. The guidance set out below is in line with SPPA policy on how such benefits above the lifetime allowance can be paid.

#### **Lump sum above ALTA**

- 2.20 Firstly, the lump sum above the permitted maximum Tax Free Lump Sum (TFLS) should be calculated. A tax charge of 55% applies to any lump sum in excess of the TFLS. In general, the permitted maximum TFLS is one quarter of the ALTA, however there are exceptions to this, see:  
<http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM09104220.htm>

#### **Pension above remaining ALTA**

- 2.21 Lump sum benefits are assumed to crystallise before pension benefits, so the member's ALTA is reduced by the TFLS. The post-commutation pension above the remaining ALTA should then be calculated. If the member has any post-commutation pension above the remaining ALTA, the member has three options, namely:
- Option 1 – member commutes pension for a further lump sum
  - Option 2 – member pays tax on value of pension above ALTA
  - Option 3 – scheme pays tax on value of pension above ALTA and the member's pension is reduced

The member may take a combination of options 1, 2 and 3.

#### **Option 1 – member commutes pension for a further lump sum**

- 2.22 The member can take all or part of any pension above the remaining ALTA as a further lump sum. A tax charge of 55% will apply to this additional lump sum.

#### **Option 2 – member pays tax on value of pension above ALTA**

- 2.23 If the member has not commuted their entire pension above the remaining ALTA for a lump sum, they can receive the pension and pay the Lifetime Allowance Charge (LTAC) on the pension above the remaining ALTA. A LTAC of 25% applies to the value of any pension in excess of the available LTA.

#### **Option 3 – scheme pays tax on value of pension above ALTA and the member's pension is reduced**

- 2.24 As an alternative to option 2 in paragraph 2.23, a member may choose to have their pension reduced in respect of any LTAC to be recovered. There will be a consequential adjustment ('Lifetime Allowance debit') made to the member's pension entitlement from the scheme in respect of the tax charges met by the scheme.

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- 2.25 The Lifetime Allowance debit will not be applied to the benefits payable to a future surviving spouse, civil partner or children on the member's death, including any lump sum on death before retirement.
- 2.26 The member's age (required to select the appropriate factor from Table A or B) should be calculated as at the retirement date.
- 2.27 The Lifetime Allowance pension debit ('LTAPD') to apply to the member's pension entitlement at retirement is calculated as:

$$\text{LTAPD} = \text{LTATC} \div F_P$$

LTATC            Lifetime Allowance tax charge payable by the scheme administrator

$F_P$             pensioner cash equivalent factors for divorce purposes that are in force at retirement are used, these are provided in tables 1.1, 1.2, 2.1 and 2.2 of the guidance 'The Local Government Pension Scheme (Scotland) Pension Sharing Following Divorce Calculation of Cash Equivalents'. The most recent guidance was issued on 18 January 2012, and the factors contained in that guidance have been reproduced in tables A and B in Annex B.

### 3 Enhanced Protection

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3.1 This part of the guidance covers members with Enhanced Protection.

#### **Retaining enhanced protection**

- 3.2 Members registered for Enhanced Protection must meet the requirements of the Finance Act 2004 to retain the protection on retirement. If these requirements are not met and Enhanced Protection lapses, the procedure appropriate to those subject to standard provisions earlier in this note should be followed.
- 3.3 Scheme should ask for confirmation from members claiming Enhanced Protection that they have not already lost this status through actions relating to another scheme.
- 3.4 HMRC will provide the member with a certificate confirming the registration of the Enhanced Protection and, if relevant, showing the protected lump sum percentage, which indicates the maximum percentage of the value of total benefits that can be taken as a tax-free lump sum. See <http://www.hmrc.gov.uk/manuals/rpsmmanual/rpsm03100530.htm>.
- 3.5 A member who is registered for Enhanced Protection is responsible for providing the LGPS with the unique reference number from the relevant HMRC certificate with details of their protection. The member should also provide the LGPS with the relevant form giving them authorisation to view the HMRC certificate.
- 3.6 A member will automatically lose Enhanced Protection in any of the following circumstances (see <http://www.hmrc.gov.uk/manuals/rpsmmanual/rpsm03104070.htm>):
- 3.6.1 Where 'relevant benefit accrual' occurs under any arrangement in a registered pension scheme (including LGPS AVCs);
  - 3.6.2 Where a transfer is made from any arrangement holding rights for the individual in a registered pension scheme and that transfer is not a "permitted transfer";
  - 3.6.3 Where a new arrangement relating to the individual is made under a registered pension scheme otherwise than
    - (i) to receive a permitted transfer;
    - (ii) as part of a retirement-benefit activities compliance exercise; or
    - (iii) as part of an age-equality compliance exercise;
  - 3.6.4 Where an arrangement receives an impermissible transfer; and
  - 3.6.5 Where the member notifies HMRC that they no longer wish to be covered by enhanced protection.
- 3.7 Whilst Enhanced Protection remains valid, an individual has no liability to the Lifetime Allowance Charge on any Benefit Crystallisation Event, and in addition an individual cannot take a lifetime allowance excess lump sum. See <http://www.hmrc.gov.uk/manuals/rpsmmanual/rpsm03104040.htm>. However the individual is only entitled to their benefit limit (see paragraph 3.6).
- 3.8 Once Enhanced Protection ceases, Benefit Crystallisation Events for the individual are potentially liable to the Lifetime Allowance Charge. See <http://www.hmrc.gov.uk/manuals/rpsmmanual/rpsm03104100.htm>.



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**Defined Benefit Accrual Limit**

- 3.9 When a member retires, the administrator must determine whether the member's benefits are above the appropriate limit (as per paragraph 3.7.2 above). If the member's accrued LGPS benefits exceed the appropriate limit then this limit is the maximum amount that should be paid to the member, otherwise their Enhanced Protection is lost.
- 3.10 The first step is to determine the capital value of the member's accrued LGPS defined benefit rights as at 5 April 2006 ( $CV_{DB\ 5/4/06}$ ). This is calculated as for determining the total value of benefits on 5 April 2006, but money purchase AVCs should be excluded as they are part of a separate arrangement. This should be after any surrender of excess rights, if this was required.

$$CV_{DB\ 5/4/06} = 20 \times P_{5/4/06} + RG_{5/4/06}$$

where,

$P_{5/4/06}$  = annual scheme pension before commutation as at 5 April 2006

$RG_{5/4/06}$  = retirement grant as at 5 April 2006

- 3.11 The Enhanced Protection limit (EP Limit) is a multiple of  $CV_{DB\ 5/4/06}$ , determined as the higher of four calculations (see <http://www.hmrc.gov.uk/manuals/rpsmanual/rpsm03104525.htm>)

$$EP\ Limit = \text{Max} (CV_{DB\ 5/4/06} \times \text{indexation, earnings recalculation amount})$$

Where indexation is the maximum of,

- 1.05 raised to the power of the number of years (with part years in decimal) between 5 April 2006 and the BCE
- $\frac{\text{Retail Price Index in month of BCE}}{\text{Retail Price Index in April 2006}}$
- increase in line with the formula in Statutory Instrument 2006/130.

The earnings recalculation amount is

Final Pensionable Pay at the first LGPS BCE

Final Pensionable Pay at 5/4/06

$$\times [RG_{5/4/06} \times (1 - \{ERF_{LS}/100\}) + 20 \times P_{5/4/06} \times (1 - \{ERF_{Pen}/100\})]$$

Final Pensionable Pay should be calculated according to the rules of the LGPS on 5 April 2006. If a member's pay was capped at 5 April 2006, then the Final Pensionable Pay after 5 April 2006 should be based on the notional cap published by HMRC. Some members may have been capped but transferred in service on an uncapped basis. In this situation, an increase based on the change in capped salary may be applied to all benefits.

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$ERF_{LS}$  and  $ERF_{Pen}$  are the early retirement factors that would be applied to the member's benefits at the date of crystallisation, but calculated according to the LGPS regulations on 5 April 2006. If the member is entitled to unreduced benefits, the early retirement factors are zero. If the member is retiring after age 65, then the increase permitted under regulation 20(4A) should be allowed for, rather than a reduction.

- 3.12 The total lump sum that the member can take from the scheme must not exceed the permitted maximum, see:  
<http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM09104220.htm>
- 3.13 The member's pension from the scheme must not exceed the remaining appropriate limit (as described in paragraph 3.11) after allowing for the lump sum taken. The pension paid to the member should be the lower of the remaining appropriate limit and the pension calculated in accordance with the scheme's regulations.
- 3.14 SPPA have confirmed that no further benefits should be paid from the scheme to members with Enhanced Protection.
- 3.15 A member can however choose not to use their Enhanced Protection, in which case no reduction would apply and the member instead receives full benefits as prescribed under the scheme regulations, with any benefits in excess of their ALTA being subject to any lifetime allowance charge as appropriate as described in Section 2.

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## ANNEX A – Example

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### 1. Member retiring at age 65 on ordinary grounds, with Lifetime Allowance charge

The following information is needed for this calculation:

<b>A.</b> Member date of birth	1 January 1949
<b>B.</b> Retirement date	1 January 2014
<b>C.</b> Member age	65
<b>D.</b> Gender	Female
<b>E.</b> Lifetime allowance tax charge	£30,000

Under 2.26, the Lifetime Allowance pension debit is calculated as:

$$\text{LTAPD} = \text{LTATC} / F_P$$

We have:

$$\text{LTATC} = 30,000 \text{ (from E.)}$$

$F_P = 17.54$  (pensioner cash equivalent factors for divorce purposes are used. At the time of writing this guidance the current factor is given in **Table A** of this guidance.)

Substituting these values into the formula we get:

$$\begin{aligned} \text{LTAPD} &= 30,000 / 17.54 \\ &= \text{£}1,710.38 \end{aligned}$$

The current pension will be reduced by **£1,710.38** per annum.

## **2. Male member retiring at age 60 on ordinary grounds, with Lifetime Allowance charge**

Consider a 'standard' member, with no primary or enhanced protection of benefits, who at his retirement in 2012-13 has not taken any previous BCEs, and for whom the current value of their benefits is in excess of the individual's available LTA at retirement.

SLTA in 2012-13 = £1,500,000

### **Member's benefits**

Annual scheme pension (P) = £100,000  
Retirement grant from the scheme (RG) = £250,000  
AVC fund value = £0

ALTA at retirement = £1,500,000 since no previous BCEs.

The member chooses to take a lump sum of £500,000.

To do so, he must take the shortfall in the lump sum over the RG, of £250,000 by commuting scheme pension of £20,833.33 per annum (£250,000 / 12).

The member's reduced pension, following commutation to reach the desired LS, (RP)  
= £100,000 - £20,833.33  
= £79,166.67

The administrator must check that this level of commutation is allowable in accordance with GAD Guidance on "Lifetime Allowance and Additional Cash Commutation"

### **Calculate value of benefits**

The revised CV is now = (RP x 20) + LS  
= (79,166.67 x 20) + 500,000  
= £2,083,333.40

Where: LS = Retirement Grant + Additional lump sum by commutation  
RP = Pension after commutation

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**Lump sum above ALTA**

The lump sum in excess of the TFLS (XLS)  
= LS – TFLS  
= £500,000 - £375,000  
= £125,000

The tax charge  $LTAC_{LS} = 0.55 \times XLS = £68,750$

The member's ALTA is now £1,125,000 which is the previous ALTA less the TFLS (or LS had that been lower).

**Pension above remaining ALTA**

The scheme pension in excess of the tax allowance amount (XSP)  
= RP – ALTA / 20  
= £79,166.67 - £1,125,000 / 20  
= £22,916.67

The member has three options:-

**Option 1 – member commutes pension for a further lump sum**

Further lump sum = 12 x £22,916.67  
= £275,000.04

$LTAC_{LS} = 0.55 \times \text{further lump sum} = £151,250.02$

Remaining pension = £79,166.67 - £22,916.67  
= £56,250

**Option 2 – member pays tax on value of pension above LTA**

$F_P = 18.56$  (pensioner cash equivalent factors for divorce purposes are used. At the time of writing this guidance the current factor is given in **Table A** of this guidance.)

Value of pension above LTA = XSP x  $F_P$   
= £22,916.67 x 20  
= £458,333.40

$LTAC_P = 0.25 \times \text{value of pension above LTA} = 0.25 \times £458,333.40$   
= £114,583.35

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**Option 3 – scheme pays tax on value of pension above LTA and the member's pension is reduced**

The scheme pays the  $LTAC_P$

Pension is reduced by  $LTAC_P / F_P = £114,583.35 / 18.56$   
 $= £6,173.67$

leaving a pension of  $79,166.67 - 6,173.67 = 72,993.00$

NB Spouse's and children's pensions are unaffected by commutation or the reduction of the member's pension under option 3.

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**ANNEX B – Factors to use**

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**Table A – Factors for calculating Lifetime Allowance debit (non ill-health cases)**

**Males and Females**

Age last birthday at retirement	Gross Pension of £1 per annum	
	Males	Females
50	22.22	22.99
51	21.93	22.73
52	21.63	22.46
53	21.30	22.16
54	20.95	21.84
55	20.57	21.50
56	20.18	21.14
57	19.79	20.78
58	19.38	20.41
59	18.97	20.03
60	18.56	19.64
61	18.14	19.24
62	17.71	18.83
63	17.27	18.41
64	16.83	17.98
65	16.37	17.54
66	15.90	17.09
67	15.43	16.63
68	14.94	16.16
69	14.44	15.68
70	13.94	15.19
71	13.45	14.70
72	12.95	14.20
73	12.45	13.69
74	11.95	13.18

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**Table B – Factors for calculating Lifetime Allowance debit (retirement in ill health)  
Males and Females**

Age last birthday at retirement	Gross Pension of £1 per annum	
	Males	Females
20	25.56	27.22
21	25.40	27.06
22	25.24	26.90
23	25.08	26.73
24	24.91	26.57
25	24.73	26.40
26	24.56	26.23
27	24.38	26.06
28	24.21	25.89
29	24.04	25.73
30	23.87	25.57
31	23.71	25.40
32	23.55	25.23
33	23.39	25.06
34	23.23	24.88
35	23.07	24.70
36	22.91	24.52
37	22.75	24.33
38	22.58	24.14
39	22.40	23.94
40	22.22	23.74
41	22.02	23.53
42	21.81	23.32
43	21.58	23.09
44	21.35	22.85
45	21.09	22.61
46	20.83	22.35
47	20.54	22.09
48	20.24	21.82
49	19.93	21.54
50	19.60	21.26
51	19.27	20.96
52	18.94	20.67
53	18.59	20.36
54	18.24	20.04
55	17.89	19.72
56	17.52	19.39
57	17.15	19.05
58	16.78	18.70
59	16.41	18.34
60	16.03	17.97
61	15.66	17.60
62	15.28	17.20
63	14.89	16.80
64	14.49	16.39



## **ANNEX C – Regulations**

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Regulation 22 of the Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations 2008 ('the Benefits Regulations') (SSI No. 230 of 2008) says:-

- (1) A member and any dependent of his shall not be entitled, under any provision of these Regulations, to receive benefits the capital value of which exceeds his lifetime allowance increased, where applicable, by the member's primary protection or the member's enhanced protection except in accordance with guidance issued by the scheme actuary;
- (2) In this regulation, "lifetime allowance", "primary protection" and "enhanced protection" are to be construed in accordance with section 218 of, and Schedule 36 to, the Finance Act 2004;
- (3) Any calculation of the capital value of a member's benefits for the purposes of this or any other of these Regulations is to be carried out in accordance with guidance issued by the scheme actuary;
- (4) The appropriate administering authority is responsible for deducting from any payment of benefits under the Scheme any tax to which they may become chargeable under the Finance Act 2004.