

The Local Government Pension Scheme (England and Wales)

Lifetime Allowance and Additional Cash Commutation

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1 Introduction

- 1.1 Under Regulation 21 of the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (SI 2007/1166) (“the Benefits Regulations”), effective from 1 April 2008, a member may, on a benefit crystallisation event (BCE), elect to increase the retirement grant payable under paragraph (3) of that Regulation by commuting some of their own pension.
- 1.2 Regulation 21(2) states that the total retirement grant received should not exceed 25% of the capital value of the member’s accrued rights where this value is, as set out in Regulation 21(4), to be calculated in accordance with guidance issued by the Government Actuary’s Department (GAD). For this purpose, the accrued rights to be valued are restricted in terms of the Finance Act 2004 to those rights which are actually being crystallised at the point of retirement from Local Government employment. The main purpose of this note, prepared by GAD for the Department of Communities and Local Government (DCLG) and issued to them for onward transmission to administering authorities and employing authorities, is to provide the guidance required by Regulation 21(4).
- 1.3 Regulation 5 paragraph 2D of Schedule 8 to the Local Government Pension Scheme Regulations 1997, in relation to Councillor Members says “The capital value of a member’s accrued rights shall be calculated as shown in guidance issued by the Government Actuary”. This guidance also applies where benefits for Councillor Members are valued under this regulation.
- 1.4 DCLG has confirmed to us that, in determining the value of a member’s benefits for the purpose of this note, any benefits awarded in terms of any Regulations other than the Benefits Regulations, the Local Government Pension Scheme (Administration) Regulations 2008 (SI 2008/239) (“the Administration Regulations”) the Local Government Scheme Pension Scheme Regulations 1997 (SI 1997/1612) (“the 1997 Regulations”) or the Local Government Pension Scheme Regulations 1995 (SI 1995/1019), as amended, should be disregarded.

Implementation and Review

- 1.5 This guidance should be reviewed periodically, depending on external circumstances such as changes to the tax rules or LGPS regulations.
- 1.6 This guidance replaces the previous guidance which was issued on 18 June 2008. The guidance has been simplified to refer to HM Revenue & Customs (HMRC) guidance where applicable.

Limitations

- 1.7 This note should not be used for any purpose other than to ensure that a member’s total retirement grant does not exceed 25% of the capital value of the member’s accrued rights.
- 1.8 The 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.

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- 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 to determine whether a member's total retirement grant exceeds 25% of the capital value of the member's accrued rights. 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 any additional lump sum taken complies with all legislative requirements including, but not limited to, taxation requirements.
- 1.12 Third parties should not rely on this guidance, but should separately seek their own advice where appropriate.

2 Guidance

- 2.1 For the purposes of Regulation 21(4) the capital value of the member's accrued rights should be calculated in accordance with Finance Act 2004, associated regulations and HMRC guidance.
- 2.2 The following paragraphs provide brief comments on the calculation of the capital value. Nothing in these paragraphs or elsewhere in this guidance can override any prevailing HM Revenue & Customs (HMRC) restrictions.
- 2.3 A factor of 20 is used to value a member's pension in determining whether the retirement grant does not exceed 25% of the capital value of a member's accrued rights. 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/rpsmanual/rpsm11104220.htm>

- 2.4 For members who have taken flexible retirement or early retirement under regulation 18 or 30, commutation takes place after any reduction to the member's pension pursuant to regulation 18 or 30.
- 2.5 Under Regulation 26 of the Local Government Pension Scheme (Administration) 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 pension under the Scheme").
- 2.6 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. In this case, LS is the sum of the member's retirement grant, additional lump sum by commutation and lump sum taken from AVC fund, and P is the sum of the pension after commutation and the pension taken from the AVC fund.
- 2.7 Alternatively, the member can take their AVC benefits outside the fund, by purchasing an annuity from an insurance company, and taking part or all of the fund as a lump sum. In this case AVCs are not included in LS and P in the calculation in paragraph 2.3 above.
- 2.8 HMRC provides further guidance setting out how the capital value of a member's benefits should be calculated – see <http://www.hmrc.gov.uk/manuals/rpsmanual/rpsm09104400.htm>.

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- 2.9 HMRC also provides guidance on the maximum amount of lump sum that can be taken where the member has no automatic retirement grant and so is only entitled to a lump sum by commutation – see:
<http://www.hmrc.gov.uk/manuals/rpsmmanual/rpsm09104430.htm>.
- 2.10 If a member also has AVCs, then HMRC also provides a flowchart that should be followed – see:
<http://www.hmrc.gov.uk/manuals/rpsmmanual/rpsm09104490.htm>.
- 2.11 DCLG have instructed that the capital value of the member's accrued rights for the purpose of regulation 21(4) should not exceed the standard lifetime allowance, consistent with the permitted maximum level of pension commencement lump sum payable under Finance Act 2004, see:
<http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM09104220.htm>
- 2.12 Annex A includes three examples to show how this is calculated, and to show how to calculate the maximum allowable lump sum.

Ian Boonin
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ANNEX A

Examples of commutation cases

Example 1

Pension = £5,000 pa
Retirement Grant = £15,000
Commutation factor = 12
Lifetime Allowance = £1.5 million

The member chooses to commute £500 pa of pension, to obtain an additional lump sum of £6,000 (= 500 x 12)

Pension after commutation = 5,000 – 500
= £4,500

Lump sum after commutation = 15,000 + 6,000
= £21,000

Capital value of benefits = (20 x Pension) + lump sum after commutation
= (20 x 4,500) + 21,000
= £111,000

Proportion of benefits taken as lump sum = Lump sum after commutation / Capital value of benefits
= 21,000 / 111,000
= 18.9%

This is less than the limit of 25% (and the lump sum is less than 25% of the lifetime allowance) so the member is able to take this level of lump sum

Example 2

Pension = £5,000 pa
No automatic retirement grant
Commutation factor = 12
Lifetime Allowance = £1.5 million

The member wishes to commute part of their pension in order to receive the maximum allowable lump sum

Maximum lump sum is the lower of:-

- a) $P \times CF / (1 + (0.15 \times CF))$; and
- b) 25% x lifetime allowance

P is the pension before commutation

Maximum lump sum = $5,000 \times 12 / (1 + (0.15 \times 12)) = £21,428.57$
(this is less than 25% of the lifetime allowance)

Pension after commutation = $5,000 - 21,428.57 / 12 = £3,214.29$

[Check that the lump sum does not exceed the permitted maximum of: $0.25 \times [(3,214.29 \times 20) + 21,428.57] = 21,428.59$ – so a lump sum of £21,428.57 is OK]

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Example 3

Pension = £67,500 pa
Retirement Grant = £202,500
LTA = £1.5 million

Capital value of member's benefits = $(20 \times P) + RG$
= $(20 \times 67,500) + 202,500$
= £1,552,500

This is in excess of the LTA.

However the member wishes to commute further pension in order to receive the maximum allowable lump sum.

In this simple example, the maximum additional lump sum is the lower of:-

- a) $(P - 0.15 \times RG) \times CF / (1 + (0.15 \times CF))$; and
- b) $(25\% \times \text{lifetime allowance}) - \text{retirement grant}$

P is the pension before commutation
RG is the automatic retirement grant
CF is the commutation factor (ie 12)

Maximum additional lump sum is the lower of:-

- a) $(67,500 - 0.15 \times 202,500) \times 12 / (1 + (0.15 \times 12)) = £159,107.14$; and
- b) $(25\% \times 1,500,000) - £202,500 = £172,500$

So maximum additional lump sum is £159,107.14

Pension after commutation = $67,500 - 159,107.14 / 12 = £54,241.07$

Total lump sum = $159,107.14 + 202,500 = £361,607.14$

Capital value of member's benefits after commutation
= $(20 \times \text{pension after commutation}) + \text{total lump sum}$
= $(20 \times 54,241.07) + 361,607.14$
= £1,446,428.54

In this example, by commuting part of the pension to receive the maximum lump sum, the capital value of the member's benefits is reduced to below the LTA.

If the resulting lump sum is in excess of one quarter of the LTA and/or the capital value of the member's benefits after commutation is above the LTA, GAD's note "Limit on Total Amount of Benefits – Lifetime Allowance" should be referred to.

ANNEX B

Regulation 21 of the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (SI 2007/1166)

21 Election for lump sum in lieu of pension

- (1) A member in respect of whom a benefit crystallisation event within the meaning of the Finance Act 2004 occurs on or after 1st April 2008 may choose in writing to the appropriate administering authority before any benefits become payable to commute his pension, or a part thereof, at a rate of £12 for every £1 of annual pension entitlement surrendered.
- (2) But the total amount of the member's commuted sum, including any sum received as benefits provided in the form of a lump sum in accordance with regulation 15 shall not exceed 25% of the capital value of his accrued rights.
- (3) For the purposes of this regulation, a member's accrued rights include rights accrued in respect of any payments made by or for him in accordance with the 1997 Regulations.
- (4) The capital value of a member's accrued rights shall be calculated in accordance with guidance issued by the Government Actuary.
- (5) And for the purposes of paragraph (1), a member's pension is his pension after any reduction pursuant to regulation 18 or 30.