GAD

GOVERNMENT **ACTUARY'S** DEPARTMENT

Local Government Pension Scheme (Scotland)
Annual Allowance Charges:
Calculation of Scheme Pays Offset

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1 Introduction

Purpose

1.1 The purpose of this note is to provide guidance to administrators following an election to use the Scheme Pays mechanism to pay an annual allowance charge.

1.2 It sets out the general method for assessing a consequential pension offset that is applied to those Local Government Pension Scheme (LGPS) (Scotland) members who incur Annual Allowance charges, as defined in Section 227 of the Finance Act 2004, and subsequently elect for the scheme to meet part, or all, of this charge through the "scheme pays" mechanism.

1.3 This note has been prepared following a request from The Scottish Public Pensions Agency (SPPA) for the purposes of administering the Annual Allowance scheme pays arrangement within the LGPS (Scotland). It is acknowledged that this note will be shared with administering authorities, but otherwise it must not be reproduced, distributed, published or communicated in whole or in part to any other person without GAD's prior written permission. Other than the SPPA, no person or third party is entitled to place any reliance on the contents of this note, except to any extent explicitly stated herein, and GAD has no liability to any person or third party for any act or omission taken, either in whole or part, on the basis of this note.

Implementation and Review

1.4 The factors contained in this note are taken from other guidance issued by GAD, which will be reviewed periodically. This will depend on external circumstances, for example when changes in the actuarial assumptions adopted for other scheme factors take place, or following each triennial cycle of future valuations of the LGPS (Scotland).

1.5 I have followed our normal quality processes for work conducted on public service pension matters[1].

Limitations

1.6 This guidance note should not be used for any purpose other than to determine the reduction to benefits following an election to utilise the Annual Allowance scheme pays mechanism.

1.7 This guidance 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.

1.8 Administrators should satisfy themselves that the pension offset resulting from a scheme pays election complies with all legislative requirements including, but not limited to, tax and contracting out requirements. Any legal advice in this area should be sought from an appropriately qualified person or source.

1.9 This guidance note does not cover the method for determining the amount of any Annual Allowance charge, Cash Equivalent Transfer Values (CETV), Club transfers involving the Local Government Pension Scheme or the service credits on transfers-in (Club or CETV).

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[1] *GAD seeks to achieve a high standard in all our work. Please go to our website for details of the standards we apply.*

2   Annual Allowance - Scheme Pays Mechanism

Introduction

2.1   This section sets out the method and instructions for calculating the pension offset applied to a member who incurs an Annual Allowance charge and elects to utilise the scheme pays mechanism to meet this charge. The Scheme Pays mechanism will not be available to all members incurring Annual Allowance charges and administering authorities will need to ensure members' eligibility before applying the approach set out in this guidance note.

2.2   It is our understanding from HM Treasury's initial documentation prepared during the development of the revised Annual Allowance regime, that costs incurred by the authorities in relation to operating the scheme pays mechanism may not be recovered from the member concerned.

2.3   SPPA have confirmed that the Relevant Date (also known as the Implementation Date) will be the day after the end of the pension input period. The pension input period in the LGPS (Scotland) runs from 1 April to 31 March.

Calculation of the initial pension offset

2.4   The calculation of the Pension Offset for different categories of member is set out in the following sections. We note that:

- Unlike in the calculation of pension debits following a pension sharing order the pension offset is initially calculated using a normal retirement age of 65. The offset will later be adjusted to reflect the date their pension comes into payment.

- Pension debits resulting from pension sharing orders have a consequential impact on the benefits payable to a surviving spouse or civil partner upon the member's death. This will not be the case for scheme pays pension offset.

- The scheme pays pension offset will initially be based on the pension relating to post 1 April 2009 service (ie on the current tranche of benefits). Where the post-2009 pension is insufficient to cover the pension offset, then these cases need to be referred to SPPA for onward transmission to GAD.

Pension offset for an active member

2.5   The principle is that the pension offset acts like a negative deferred pension (note that the calculation is different if the member has retired). The offset should be expressed as a deduction to the member's pension which is to be recovered from age 65. The calculation will be carried out at the Relevant Date for the particular member. The calculation of the pension offset is:

Pension offset = AATAX / AAFAC

Where:

AATAX = the Annual Allowance tax charge that the member has notified the scheme that they wish to meet via the scheme pays mechanism.

AAFAC = the Annual Allowance scheme pays factor from Table A1 based on the member's gender and age at the Relevant Date. These tables are based on a normal retirement age of 65 and are included in Section 4 of this note. The factors in this table are copies of the 'Club and outward CETV factors' in tables 1.1 and 1.2 of version 4.1 of the transfer suite dated 22 February 2012. If the transfer suite has since been updated then the most recent factors should be used.

2.6   The member's age at the Relevant Date required to select the appropriate factors from Table A1.

2.7   The pension payable to the member at retirement will be reduced by an amount equal to the member's pension offset.

2.8 Pension offsets do not affect GMPs.

2.9 Administrators should store the offset calculated above with the Relevant Date on the member's record. Where a member has multiple allowance debits, they should be recorded separately.

2.10 The pension offset should be increased in accordance with the Pensions (Increase) Act 1971 (currently this reflects changes in CPI) during the period between the Relevant Date and the member's eventual retirement.

2.11 If the pension is drawn before age 65 either as a result of the member having their retirement age protected by virtue of Schedule 2 of the Local Government Pension Scheme (Transitional Provisions) (Scotland) Regulations 2008 (SSI 2008/229), early retirement or on grounds of ill health then the pension offset should be reduced. This is because the offset is expected to be applied over a longer period than was assumed when calculating the original offset, so a lower amount should be deducted.

2.12 In the case of ill health retirement, the early retirement factor can be found in Table B1 of Section 4. In all other cases of retirement or exit before age 65, an early retirement factor from Table B2 should be applied.

2.13 Where a member retires after age 65 then the pension offset should be increased in accordance with the latest GAD guidance note on late retirement. The late retirement increase is set out in C1 of Section 4.

Contingent survivor benefits

2.14 The benefits payable to a spouse, civil partner or other partner who is eligible to a pension on the member's death will not be reduced as a result of the scheme pays mechanism. This will apply regardless of whether the member dies during active service, in deferment or after retirement.

Other benefits

2.15 No debit will be applied to children's pensions.

2.16 No debit will be made to the lump sum death grant payable to an active member who dies in service.

2.17 No debit will be made from the death in deferment lump sum award that is payable to deferred members who incurred an Annual Allowance charge prior to exit, and elected for the scheme pays mechanism. However the lump sum will be based on the pension after any scheme pays offset has been applied.

2.18 No debit is made to any lump sum paid on death after retirement that is payable to pensioner members who incurred an Annual Allowance charge prior to exit, and elected for the scheme pays mechanism. However the lump sum will be based on the pension after any scheme pays offset has been applied.

Adjusting benefit offsets on leaving

2.19 If the member leaves the scheme prior to receipt of their pension then the pension offset should be treated in the same way as a pension debit following divorce (except the Scheme Pays offset applies to member benefits only). In particular if the member leaves with a club transfer the Scheme Pays offset will be preserved in the receiving scheme as described in paragraph 7.16 of the Club Memorandum. This approach has been agreed with the Club Secretariat.

Adjusting benefit offsets at retirement

2.20 This section sets out the method and instructions for calculating the pension offset to be applied at the point of retirement. In many cases this could be several years after the pension offset was initially calculated.

2.21 When the member retires, the total pension is initially calculated ignoring the pension offset. The pension is then reduced to allow for the pension offset. The offset should be revalued from the Relevant Date up to the April immediately before the date of

retirement in line with the Pensions Increase Act (currently reflecting changes in CPI). If the pension is not drawn at age 65 then the pension offset will need to be adjusted. The offset should be increased by a full years PI in the year immediately following retirement (this may not be the same increase that applies to the members pension).

2.22 Administrators should take care to ensure that the most recent Early Retirement Factors and Late Retirement Factors are applied. At the time of writing the most recent guidance relating to Early Payment of Pension was issued by GAD on 28 March 2012 and the most recent guidance relating to Late Retirement was issued by GAD on 1 February 2012. It is the responsibility of administrators to ensure that they are using the most recent factors.

2.23 The pension offset to be applied if a member retires before age 65 is as follows:

Pension offset at retirement at age 65 = Pension offset $\times$ PI

Where:

Pension Offset = as calculated in paragraph 2.5

PI = the pensions increase uprating factor between the Relevant Date and the April immediately before the date of retirement.

2.24 The pension offset to be applied if member retires before age 65 is as follows:

Pension offset at retirement before age 65 = Pension offset $\times$ PI x (1 – ERF)

Where:

Pension Offset = as calculated in paragraph 2.5

PI = the pensions increase uprating factor between the Relevant Date and the April immediately before the date of retirement.

ERF = where the member retires on ill health the relevant factor should be used from Table B1, for all other cases Table B2 should be used. The factors in these tables are copies of the factors contained in our Pension Debit note dated 28 March or our Early Retirement guidance dated 28 March 2012. If the early retirement factors have since been updated then the most recent factors should be used.

2.25 The pension offset to be applied if the member retires after age 65 is as follows:

Pension offset at retirement after age 65 = Pension offset $\times$ PI x (1 + LRF)

Where:

Pension Offset = as calculated in paragraph 2.5

PI = the pensions increase uprating factor between the Relevant Date and the April immediately before the date of retirement.

LRF = late retirement factor from the latest GAD guidance and set out in C1 of Section 4. The factors in this table are copies of the factors contained in our Late Retirement guidance dated 1 February 2012. If the early retirement factors have since been updated then the most recent factors should be used.

2.26 The pension offset to be applied if the scheme pays election occurs just before retirement is as follows:

Pension offset at retirement = AATAX / AAFAC

Where:

AATAX = the Annual Allowance *tax charge that the member has notified the scheme that they wish to meet via the scheme pays mechanism*

AAFAC = if the member is retiring on age grounds then the Annual Allowance *scheme pays factor shown in Table D1 based on the member's gender and age at the Relevant Date. If the member is retiring on ill health grounds then consider the factor from Table E1.*

2.27 In some circumstances a member retiring on ill health grounds will be exempt from incurring an Annual Allowance charge in the year preceding retirement. However this will not apply to all ill health retirements. Members who are exempt in their final year of service may also have incurred Annual Allowance charges, and opted for Annual Allowance scheme pays, earlier in their careers. In these cases benefit offsets will be applied at retirement but different adjustment factors (shown in table B1) will be applied than those used for other retirements (which can be found in table B2).

Additional guidance for certain specific circumstances

2.28 **Interaction between Annual Allowance and Scheme Pays Lifetime Allowance ("LTA") charges**
We understand that when calculating LTA charges the pension tested should be that which would come into payment after allowing for the impact of any Annual Allowance Scheme Pays offsets. The calculations set out in this document should therefore be carried out prior to any LTA test being applied to these members.

2.29 **Multiple Annual Allowance and Scheme Pays offsets**
Some members may breach the Annual Allowance on more than one occasion during their careers. Since there is no limit on the number of times a member may opt to utilise scheme pays (subject to usual eligibility), a member may also have multiple Annual Allowance Scheme Pays offsets. In this circumstance each offset can be considered separately and treated in accordance with the guidance set out above.

2.30 **Interaction between Annual Allowance, Scheme Pays offsets and Pension debits**
It is possible for members to have both AA Scheme Pays offsets and pension debits resulting from Pension Sharing on Divorce ("PSOD"). In this case each instance of the Annual Allowance Scheme Pays offset or the PSOD pension debits is treated in accordance with the relevant set of guidance. At the time of writing the current pension debit guidance is set out in our note of 23 May 2011, noting that the factors contained in that guidance are superseded by the CETV Factors dated 22 February 2012 and the pensioner CETV factors dated 18 January 2012.

2.31 **Members exercising options at the point of retirement**
Some members are able to exercise options at the point of retirement such as commuting pension for lump sum. This guidance note does not attempt to illustrate the

interaction between Annual Allowance scheme pays offsets and any of these member options.

2.32 Interaction between Scheme Pays offsets and Flexible Retirement

Where a member opts to draw-down their membership, the debit relating to that part of the membership which is being drawn-down should be applied at the point of flexible retirement (and having regard to paragraphs 2.23 to 2.25 where relevant). Where the member elects to only draw-down a proportion of the membership, the debit should be pro-rated (in proportion to the membership being drawn-down) and applied to the relevant benefit being drawn-down with allowance for early / late retirement factors as appropriate. The remaining debit should be applied when the member eventually retires.

3   Example Calculations

3.1   This section provides some examples of the calculations described by this note.

Example 1: Calculation of the pension offset

The following information is needed for this calculation:

A. Member date of birth		23 January 1977
B. Tax year Annual Allowance charge is incurred		2011/12
C. Relevant date		6 April 2012
D. Member age (last birthday)		35 years
E. Gender		Male
F. Tax charge		£4,000

From 2.5, the formula for calculating the pension offset is:

Pension offset = AATAX / AAFAC

We have:

AATAX = £4,000 (from **F.**)

F_p = 7.19 (which is the scheme pays factor for a male member at age 35, obtained from **Table A1**)

Substituting these values into the formula we get:

Pension offset = 4,000 ÷ 7.19 = 556.33 pa

This debit is recorded on the member's record with Relevant date of 6 April 2012.

This debit will increase in line with CPI and will be adjusted if the member's pension comes into payment before or after age 65.

Example 2: Member retiring at age 65 on ordinary grounds, with pension offset

The following information is needed for this calculation:

A. Member date of birth	23 March 1949
B. Retirement date	31 March 2014
C. Member age	65
D. Gender	Male
E. Member's pension before debit	£30,000 pa
F. Pension offset for 2011/12 (at 65)	£450 pa
G. Pension increase uprating factor 2011/12 (from 2011/12 debit Relevant Date, 5 April 2012, to retirement)	1.035

From 2.23, the formula for calculating the pension offset at retirement is:

Pension offset at retirement at age 65 = Pension Offset x PI

We have:

Pension offset = 450 (from **F.**)

PI = 1.035 (from **G.**)

Substituting these values into the formula we get:

Adjusted pension debit = 450 x 1.035

$$= 465.75 \text{ pa}$$

The pension to be implemented is the full pension (£30,000 pa from **E.**) less the pension offset at the retirement age. Therefore the pension to be implemented is:

= 30,000 – 465.75

= 29,534.25 pa

4   Tables of factors

Table A1: Scheme Pays factors based on normal retirement age of 65

Age last birthday at relevant date	Male Factor	Female Factor
16	4.32	4.59
17	4.44	4.72
18	4.56	4.84
19	4.69	4.98
20	4.81	5.11
21	4.94	5.25
22	5.08	5.40
23	5.22	5.54
24	5.36	5.70
25	5.50	5.85
26	5.65	6.01
27	5.80	6.18
28	5.96	6.35
29	6.12	6.52
30	6.29	6.70
31	6.46	6.88
32	6.64	7.07
33	6.82	7.26
34	7.00	7.46
35	7.19	7.67
36	7.39	7.88
37	7.59	8.10
38	7.80	8.32
39	8.02	8.55
40	8.24	8.79
41	8.47	9.03
42	8.70	9.29
43	8.94	9.54
44	9.19	9.81
45	9.45	10.09
46	9.71	10.37
47	9.98	10.66
48	10.26	10.96
49	10.55	11.27
50	10.84	11.59
51	11.15	11.92
52	11.46	12.27
53	11.79	12.62
54	12.13	12.99
55	12.48	13.37
56	12.84	13.77
57	13.22	14.18
58	13.62	14.61
59	14.03	15.05
60	14.46	15.52
61	14.92	16.00
62	15.39	16.49
63	15.89	17.01
64	16.42	17.55

Notes:
1.   The reduction in pension applies only to the member's pension. Dependants' benefits are not affected.
2.   The reduction in pension is equal to the tax charge divided by the appropriate factor.

Table B1 – Reduction to pension offset on ill health retirement

Years until age 65 at date of retirement	Pension Offset Reduction (%)	
	Males	Females
0	0	0
1	3	3
2	6	6
3	9	8
4	13	11
5	18	14
6	22	16
7	26	19
8	29	22
9	33	25
10	36	29
11	39	33
12	42	36
13	44	39
14	47	42
15	49	44
16	51	47
17	54	49
18	56	52
19	57	54
20	59	56
21	61	58
22	62	59
23	64	61
24	65	63
25	67	64
26	68	66

Years until age 65 at date of retirement	Pension Offset Reduction (%)	
	Males	Females

27	69	67
28	70	69
29	71	70
30	72	71
31	73	72
32	74	73
33	75	74
34	76	75
35	77	76
36	78	77
37	79	78
38	79	79
39	80	80
40	81	80
41	82	81
42	82	82
43	83	83
44	83	83
45	84	84

Notes:

(1) Where the age at retirement is not an integer number, the reduction factors from the table should be interpolated for part years.

Table B2 – Reduction to pension offset on retirement before age 65

Years until age 65 at date of retirement	Pension offset Reduction (%)	
	Males	Females
0	0	0
1	6	5
2	11	11
3	16	15
4	20	20
5	25	24
6	29	27
7	32	31
8	36	34
9	39	37
10	42	40

Notes:

(1) Where the age at retirement is not an integer number, the reduction factors from the
table should be interpolated for part years.

C1 – Increase to pension offset for retirement after age 65

The pension offset should be uplifted by 0.014% simple for each day after the member's 65th birthday but before the member's actual retirement date. This is set out in the latest GAD guidance on late retirements dated 1 February 2012.

Table D1 – Age pensioner pension offset factors

Age last birthday at relevant date	Male Factor	Female Factor
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
75	11.45	12.67

Table E1 – Ill health pensioner pension offset factors

Age last birthday at relevant date	Male Factor	Female Factor
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
65	14.07	15.96
66	13.65	15.52
67	13.22	15.07
68	12.79	14.61
69	12.36	14.14
70	11.93	13.67
71	11.50	13.20

Age last birthday at relevant date	Male Factor	Female Factor
72	11.08	12.72
73	10.66	12.24
74	10.24	11.76
75	9.83	11.28

Age last birthday at relevant date	Male Factor	Female Factor