

The Local Government Pension Scheme (England and Wales)

Guidance effective from 1 April 2008

**Benefits in Excess of the Lifetime Allowance
Members with Enhanced Protection**

**Determination of Tax Charge and Resultant Reduced
Benefits**

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1 Introduction

- 1.1 Under Regulation 22 of the Local Government Pension Scheme Regulations (Benefits, Membership and Contributions) 2007 (“the Benefits Regulations”) (SI No. 1166 of 2007), effective from 1 April 2008, the Government Actuary's Department (GAD) is required to issue guidance to determine the capital value of a member's benefits.
- 1.2 This note has been prepared by GAD for the Department for Communities and Local Government (DCLG). The main purpose of this note is to issue it to DCLG 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). The GAD note on Regulation 21 sets out how to test whether the LTA is exceeded for most members.
- 1.3 This note sets out the treatment for members with Enhanced Protection. Cases where the member does not have protection and the capital value of accrued benefits does not exceed the LTA are covered by the GAD note on Regulation 21. Other cases are covered by the appropriate GAD note on Regulation 22 depending on the protection status of the member. These notes provide more detail than is usual in order to further assist scheme administrators.
- 1.4 This note does not cover the determination of any member's entitlement to Enhanced Protection based on their status at 5 April 2006. The guidance assumes such calculations have been carried out, the member has surrendered any rights in excess of their maximum permitted pension and that the necessary registration process has been complied with.
- 1.5 This note does not cover a member who has successfully applied for protection under Regulation 48 of the Local Government Pension Scheme (Amendment) Regulations 2006.
- 1.6 For those registered for Enhanced Protection but failing to meet the eligibility requirements at retirement, the guidance for standard members applies unless they also have Primary Protection, in which case that guidance applies.
- 1.7 DCLG has informed GAD that members will be able to notionally split the crystallisation of their defined benefit rights. This will allow members with Enhanced Protection to crystallise benefits below the relevant benefit accrual limit so Enhanced Protection is retained during that crystallisation. When the remaining benefits are crystallised, Enhanced Protection would be lost and the appropriate guidance under Regulation 22 for members with or without Primary Protection should be followed. The LGPS regulations do not currently include a mechanism for this process. Authorities may therefore wish to confirm with HMRC that they will recognise splitting of rights without an explicit rule change.
- 1.8 DCLG has informed GAD that a member who has reached his/her personal LTA will be able to take benefits in excess of his/her available LTA in the form of a pension or lump sum. However, the scheme regulations do not permit a lump sum lower than the amount of the retirement grant.
- 1.9 This guidance is based on GAD's understanding of the Finance Act 2004. Any prevailing HMRC restrictions will take precedence over this guidance.

2 Retaining Enhanced Protection

- 2.1 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 for those subject to standard provisions or Primary Protection in the complementary notes should be followed. It is the member's responsibility to inform HMRC if they take action which causes the Enhanced Protection to lapse.
- 2.2 Schemes should ask for confirmation from members claiming Enhanced Protection that they have not already lost this status through actions relating to another scheme.
- 2.3 HMRC will provide the member with a certificate confirming the registration of the Enhanced Protection and, if relevant, showing the protected lump sum percentage (PLSP), which indicates the maximum percentage of the value of total benefits that can be taken as a tax-free lump sum.
- 2.4 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.
- 2.5 A member will automatically lose Enhanced Protection if they do any of the following:
 - 2.5.1 Make a contribution to a money-purchase pension arrangement (including LGPS AVCs)
 - 2.5.2 Crystallise a defined benefit arrangement with benefits above the appropriate limit
 - 2.5.3 Make certain transfers to or from a scheme
 - 2.5.4 Set up a new pension arrangement other than to receive a transfer that does not cause Enhanced Protection to be lost.

3 Calculations

Defined Benefit Accrual Limit

- 3.1 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 considered separately for this purpose. 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

- 3.2 The Enhanced Protection limit (EP Limit) is a multiple of $CV_{DB\ 5/4/06}$, determined as the higher of four calculations.

EP Limit = Max ($CV_{DB\ 5/4/06}$ x 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

$\frac{\text{Final Pensionable Pay at the first LGPS BCE}}{\text{Final Pensionable Pay at 5/4/06}}$

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

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.

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.

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3.3 Initial capital value of a member's LGPS defined benefit rights is:

$$\text{Initial capital value of LGPS DB rights (CV}_{DB0}) = 20 \times P + RG$$

where,

P = annual scheme pension before commutation

RG = retirement grant

If $CV_{DB0} \leq EP$ limit the member will be able to avoid a LTAC

If $CV_{DB0} > EP$ limit then the benefits will have to be notionally split and a LTAC is likely to have to be paid, but may be avoided or payable at a reduced level by commuting some pension into additional lump sum.

3.4 The member should decide the extent to which s/he wishes to commute pension. The actual capital value of a member's LGPS DB rights is then:

$$\text{Actual capital value of LGPS benefits (CV}_{DB1}) = 20 \times RP + LS$$

where,

RP = reduced scheme pension after commutation, excluding AVC pension

LS = lump sum including commutation, but excluding AVC lump sum

If $CV_{DB1} \leq EP$ limit the member will be able to avoid a LTAC

If $CV_{DB1} > EP$ limit the benefits will have to be notionally split and a LTAC will have to be paid.

3.5 The lump sum selected will have to be checked to ensure that it is within the relevant limits, as in the section "Calculations: Tax-Free Lump Sum" set out in the next section.

Tax- free Lump Sum

- 3.6 The amount of tax-free benefits that a member is entitled to while covered by Enhanced Protection will depend on their EP limit and protection status.
- 3.7 Maximum tax-free lump sum (member with enhanced protection but no protected lump sum)

The amount of the lump sum which can be taken tax-free (TFLS)
= Max [0, 0.25 x min(SLTA less current value of previously crystallised benefits, $CV_{DB1} + AVCs$, EP limit + AVCs)]

Current value of previously crystallised benefits
= $\frac{\text{Capital value of the benefits at crystallisation} \times \text{Current SLTA}}{\text{SLTA when benefits were crystallised}}$

SLTA is the Standard Lifetime Allowance for the year

This second calculation should be carried out for each BCE prior to this one. The total is then used in the first calculation above.

- 3.8 Maximum tax-free lump sum (member with enhanced protection and a protected lump sum)

If the member had lump sum rights of more than £375,000 on 5 April 2006, they will have protected lump sum rights. The amount of lump sum that can be taken tax-free will be limited by the Protected Lump Sum Percentage (PLSP) specified on the certificate provided by HMRC, with a possible further restriction within LGPS regulations if $CV_{DB1} \leq EP$ limit. The PLSP must be considered separately for AVCs and defined benefit rights.

Maximum AVCs taken as cash (MAVCLS)
= AVCs x PLSP

Maximum defined benefit lump sum (MDBLS)
= $CV_{DB1} \times PLSP$

If $CV_{DB1} \leq EP$ limit, the scheme restriction on lump sums also applies:

Maximum lump sum (MLS)
= $25\% \times (CV_{DB1} + AVCs)$

4 Crystallisation and splitting of benefits

- 4.1 The member must decide the order in which to crystallise their benefits. The different components are AVC benefits, defined benefit rights below the EP limit and defined benefit rights above the EP limit.
- 4.2 The member should decide if he or she wishes to notionally split their defined benefit rights and if so on the split of those rights.
- 4.3 If $EP\ limit < CV_{DB1}$, the member will be able to take his/her entire benefits within the scope of Enhanced Protection without having to split their benefits. No LTAC is payable.
- 4.4 If $EP\ limit > CV_{DB1}$ the member will usually benefit from notionally splitting their defined benefit rights in order to crystallise defined benefit rights to the value of EP limit in one set of crystallisations, while retaining Enhanced Protection. The crystallisation of the remaining defined benefit rights will cause Enhanced Protection to be lost.
- 4.5 In all cases, the maximum lump sum crystallised while retaining Enhanced Protection should be no more than as described above. It may well be possible to repackage the excess benefits by commuting pension for additional lump sum when benefits are crystallised once Enhanced Protection has been lost.
- 4.6 If AVC rights are crystallised before Enhanced Protection is lost, then none of them are subject to a Lifetime Allowance Charge.
- 4.7 When each component is crystallised, the value of the benefits crystallised should be recorded as usual.
- 4.8 When a member crystallises benefits which cause Enhanced Protection to be lost, this guidance should no longer be referred to. The member should either be treated as a member with Primary Protection (if s/he also successfully registered for it) or as "standard" member, with the appropriate guidance on Regulation 19A being applied.
- 4.9 If the member's Lifetime Allowance under the appropriate complementary guidance is higher than the EP limit, there will be some scope to take some or all of the excess benefits free of the LTAC. The member's Lifetime Allowance must however be reduced by the value of benefits taken within Enhanced Protection, before calculations under the complementary guidance are undertaken.
- 4.10 If the EP limit is higher than the member's Lifetime Allowance under the appropriate complementary guidance, then LTAC will be payable on all of the excess benefits. The amount of the LTAC will depend on the form of the excess benefits the member chooses to take, which could consist of pension, lump sum or a combination of the two.

5 ANNEX

Example 1 – Member registered for both Primary and Enhanced Protection – no AVCs

Consider a member registered for Primary Protection (PP) and Enhanced Protection (EP). The member is first treated under EP, and PP applies only once EP lapses.

Standard Lifetime Allowance (SLTA)

2006-07: £1,500,000

2007-08: £1,600,000

At 5/4/06, LGPS details are as follows:

Service : 30 years

Final Pensionable Salary: £200,000

Scheme Pension = £75,000

Retirement Grant = £225,000 → less than £375,000 so no protection of lump sum.

Capital Value of her defined benefit rights as at 5/4/06 ($CV_{DB\ 5/4/06}$)

= 20 x Scheme Pension + Retirement Grant

= £1,725,000

As expected, this is equal to the EP limit on the certificate issued by HMRC. She has also registered for Primary Protection and has a personal lifetime allowance 15% higher than the SLTA.

The member retires on 5 April 2008 with unreduced benefits. During the 2 years to retirement, the member retains her EP. At retirement, her LGPS details are as follows:

Service : 32 years

Final Pensionable Salary: £225,000

Scheme Pension (P) = £90,000

Retirement Grant (RG) = £270,000

Capital Value of her defined benefit rights as at retirement ($CV_{DB\ 0}$)

= 20 x P + RG

= £2,070,000

The member's EP limit goes up in accordance with the best of the three methods of indexation or the earnings recalculation.

Her earnings recalculation amount proves to be the best of the four.

The EP limit is therefore = £1,725,000 x (£225,000 / £200,000) = £1,940,625

Member benefits

After taking independent financial advice, member has decided she would like to take the maximum tax-free lump sum while covered by Enhanced Protection:

Lump Sum (LS) = £400,000

Reduced pension following commutation (RP) = £79,166.67 [90,000 - ((400,000 - 270,000) / 12)]

Capital Value of her defined benefit rights as at retirement ($CV_{DB\ 1}$)

= 20 x RP + LS

[20 x 79,166.67 + 400,000]

= £1,983,333.40

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As $CV_{DB 1} > EP$ limit, the member's benefits will need to be split into two separate events, the first to which EP will apply, and the second to which PP will apply.

Event One

The maximum lump sum that the member can take at event one is the tax-free lump sum (TFLS) and she chooses to crystallise this amount of lump sum.

$$= \text{Max} (0, 0.25 \times \text{Min}(\text{SLTA less current value of previously crystallised benefits, } CV_{DB 1} + \text{AVCs, EP limit} + \text{AVCs}))$$

$$= \text{Max} (0, 0.25 \times \text{Min}(\pounds 1,600,000; \pounds 1,983,333.40; \pounds 1,940,625))$$

$$= \text{Max} (0, 0.25 \times \pounds 1,600,000)$$

$$= \pounds 400,000$$

Lump Sum = $\pounds 400,000$

The maximum pension that can be crystallised without losing enhanced protection is therefore

$$\text{Pension} = (\text{EP limit} - \pounds 400,000) / 20 = \pounds 77,031.25$$

The member has now used up all her scope within EP and has crystallised benefits worth $\pounds 1,940,625$.

Event Two

The member crystallises the remaining benefits on the same day as the benefits crystallised within the Enhanced Protection limit. At crystallisation of any further LGPS defined benefit rights, the member will lose EP since she has crystallised benefits up to the EP limit.

The member's PLTA in this tax year is $115\% \times \pounds 1,600,000 = \pounds 1,840,000$. However, she has already crystallised benefits worth more than this so has no remaining available lifetime allowance. All further benefits will be subject to the Lifetime Allowance Charge, but may be taken in the form of a lump sum.

Uncrystallised benefits are

Lump sum = nil

$$\text{Pension} = \pounds 2,135.42 \quad [79,166.67 - 77,031.25]$$

The member decides to commute the whole of the uncrystallised pension to provide a lump sum of $\pounds 25,625.04$

$$[2,135.42 \times 12]$$

$$\text{LTAC}_{\text{Lump sum}} = 55\% \times \text{Lump Sum} = \pounds 14,093.78$$

$$\text{Remaining lump sum} = \pounds 11,531.26$$

SUMMARY

The member's benefits at retirement are now therefore:

Annual scheme pension = $\pounds 77,031.25$ pa

Total lump sum = $\pounds 411,531.26$

Total LTAC paid = $\pounds 14,093.78$

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Example 2 – Member registered for both Primary and Enhanced Protection with AVCs

Consider a member registered for Primary Protection (PP) and Enhanced Protection (EP). The member is first treated under EP, and PP applies only once EP lapses.

Standard Lifetime Allowance (SLTA)

2006-07: £1,500,000

2007-08: £1,600,000

At 5/4/06, LGPS details are as follows:

Service : 30 years

Final Pensionable Salary: £200,000

Scheme Pension = £75,000

Retirement Grant = £225,000

AVCs = £40,000

The member's Retirement Grant is less than £375,000 so there is no protection of the lump sum in this case.

Capital Value of her defined benefit rights as at 5/4/06 ($CV_{DB\ 5/4/06}$)

= 20 x Scheme Pension + Retirement Grant

= £1,725,000

She has also registered for Primary Protection and has a personal lifetime allowance 18% higher than the SLTA based on a total capital value of £1,765,000.

The member retires on 5 April 2008 with unreduced benefits. During the 2 years to retirement, the member retains her EP. At retirement, her LGPS details are as follows:

Service : 32 years

Final Pensionable Salary: £225,000

Scheme Pension (P) = £90,000

Retirement Grant (RG) = £270,000

AVCs = £50,000 (no further AVC contributions have been made since 5 April 2006)

The member's EP limit goes up in accordance with the best of the three methods of indexation or earnings recalculation.

Her earnings recalculation amount proves to be the best of the four.

The EP limit is therefore = £1,725,000 x (£225,000 / £200,000) = £1,940,625

Member benefits

After taking independent financial advice, the member has decided she would like to take the maximum tax-free lump sum while covered by Enhanced Protection:

Scheme Lump Sum (LS) = £350,000

AVCs = £50,000 (to be taken as lump sum)

Reduced pension following commutation (RP) = £83,333.33 [90,000-(350,000-270,000)/12]

Capital Value of her defined benefit rights as at retirement ($CV_{DB\ 1}$)

= 20 x RP + LS

= £2,016,666.60 [20 x 83,333.33 + 350,000]

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As $CV_{DB\ 1} > EP$ limit, the member's defined benefit rights will need to be split into two separate events, the first to which EP will apply, and the second to which PP will apply.

Event One

The maximum lump sum that the member can take at event one is the tax-free lump sum (TFLS) and she chooses to crystallise this amount of lump sum.

$$\begin{aligned}
 &= \text{Max} (0, 0.25 \times \text{Min}(\text{SLTA less current value of previously crystallised benefits, } CV_{DB\ 1} \\
 &+ \text{AVCs, EP limit} + \text{AVCs})) \\
 &= \text{Max} (0, 0.25 \times \text{Min}(\pounds 1,600,000; \pounds 2,066,666.60; \pounds 1,990,625)) \\
 &= \text{Max} (0, 0.25 \times \pounds 1,600,000) \\
 &= \pounds 400,000
 \end{aligned}$$

Lump Sum = $\pounds 400,000$ (50,000 AVCs and 350,000 scheme)

The maximum scheme pension that can be crystallised without losing enhanced protection is therefore

$$\text{Pension} = (\text{EP limit} - \pounds 350,000) / 20 = \pounds 79,531.25 \text{ pa}$$

The member has now used up all her scope within EP and has crystallised benefits worth $\pounds 1,990,625$. $[20 \times 79,531.25 + 350,000 + 50,000]$

The member has crystallised her AVC benefits while retaining enhanced protection.

Event Two

The member crystallises the remaining benefits on the same day as the benefits crystallised within the Enhanced Protection limit. At crystallisation of any further LGPS defined benefit rights, the member will lose EP since she has crystallised benefits up to the EP limit.

The member's PLTA in this tax year is $118\% \times \pounds 1,600,000 = \pounds 1,888,000$. However, she has already crystallised benefits worth more than this so has no remaining available lifetime allowance. All further benefits will be subject to the Lifetime Allowance Charge, but may be taken in the form of a lump sum.

Uncrystallised benefits are

Lump sum = nil

AVCs = nil

$$\text{Pension} = \pounds 3,802.08 \quad [83,333.33 - 79,531.25]$$

The member decides to commute the whole of the uncrystallised pension to provide a lump sum of $\pounds 45,624.96$ $[12 \times 3,802.08]$

$$\text{LTAC}_{\text{Lump sum}} = 55\% \times \text{Lump Sum} = \pounds 25,093.73$$

$$\text{Remaining lump sum} = \pounds 20,531.23$$

SUMMARY

The member's benefits at retirement are now therefore:

Annual scheme pension = $\pounds 79,531.25$ pa

Total lump sum = $\pounds 420,531.23$

Total LTAC paid = $\pounds 25,093.73$