GAD
GOVERNMENT ACTUARY'S DEPARTMENT

The Local Government Pension Scheme (Scotland)

Regulation 18A – Benefits in Excess of the Lifetime Allowance

Members without Primary or Enhanced Protection

Determination of Tax Charge and Resultant Reduced Benefits

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1 Introduction

1.1 Under Regulation 18A of the Local Government Pension Scheme (Scotland) Regulations 1997 ('the Principal Regulations') (SI No. 366 of 1998), as amended by the Local Government Pension Scheme (Scotland) Amendment (No 2) Regulation 2006 (SSI No. 468 of 2006) 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 Scottish Public Pensions Agency (SPPA). 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 18A(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 19 sets out how to test whether the ALTA is exceeded for most members.

1.3 This note sets out how to calculate the Lifetime Allowance Charge (LTAC) and determine the appropriate reduction in LGPS benefits to cover the LTAC. Cases where the LTA is not exceeded are covered by the GAD note on Regulation 19.

1.4 This note does not cover a member who has successfully applied for Primary or Enhanced Protection or who has applied for protection under Regulation 18 of the Local Government Pension Scheme (Scotland) Amendment (No 2) Regulations 2006. Additional guidance will be issued in respect of members with Primary or Enhanced Protection.

1.5 SPPA has informed GAD that a member who has reached his/her available LTA will be able to take benefits in excess of his/her available LTA in the form of a lump sum.

1.6 This guidance is based on GAD's and SPPA's understanding of the Finance Act 2004. Any prevailing HMRC restrictions will take precedence over this guidance. Authorities may wish to seek additional advice in particular cases.

2 General Principles

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

2.2 The standard LTA (SLTA) is fixed for each financial year. The SLTA in 2006/07 is set at £1,500,000 and this is intended to increase each year.

2.3 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 SLTA, the remaining amount is the member's available LTA (ALTA).

2.4 If a member has any BCEs, including the crystallisation of money-purchase type Additional Voluntary Contributions (AVCs), occurring simultaneously with the crystallisation of his/her LGPS benefits then s/he should inform LGPS of the order in which the BCE's 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.

2.5 Lump sum benefits are assumed to be crystallised before pension benefits.

2.6 Initial capital value of a member's LGPS benefits.

Initial capital value of LGPS benefits (CV) = 20 x P + RG + AVCs where: P = annual scheme pension RG = retirement grant AVCs = value of money-purchase additional voluntary contributions drawn at the same time as the main LGPS benefits

If CV $\leq$ ALTA then the member can usually be dealt with under the GAD note on Regulation 20. In some cases, it is possible for the member to commute pension to reduce CV to below ALTA.

3 Calculations

Tax-free lump sum

3.1 The amount of tax-free lump sum and pension that a member is entitled to will depend on their ALTA.

3.2 Maximum tax-free lump sum

The amount of the lump sum which can be taken tax-free (TFLS)

I: If CV > ALTA
TFLS= Max [0, 0.25 x ALTA]

II: CV $\leq$ ALTA, or the member is proposing to exercise an option so that CV $\leq$ ALTA
TFLS= Max [0, 0.25 x CV]

CV should now be calculated using the pension and lump sum after commutation.

Total lump sum

3.3 A member is entitled to take a lump sum higher than his/her RG by using some or all of the AVC fund and commuting part of his/her pension for additional lump sum. Any residual AVCs will be used to secure additional pension.

3.4 However, the lump sum should be such that the capital value of the pension benefits following commutation uses up the remaining ALTA. This is to ensure that no unauthorised payment is made to the member.

I: If CV > ALTA
If MAC is the maximum amount of AVCs that may be taken as cash, then the maximum lump sum that the member may take (MLS) is:

MLS =

$$\text{Max}\left[\text{TFLS}\ ,\ 12 \times P + RG + \frac{2 \times MAC + 3 \times AVC + 3 \times TFLS - 3 \times ALTA}{5}\right]$$

If MLS=TFLS, then the member is likely to be able to avoid the LTAC by commuting sufficient pension.

II: If CV $\leq$ ALTA
MLS = TFLS

3.5 A member may elect for any lump sum (LS) between RG and MLS. Lump sum in excess of TFLS is a Lifetime Allowance Excess Lump Sum and will be subject to the LTAC as shown below.

Determination of LTAC and reduced benefits

3.6 A tax charge of 55% applies to the value of any lump sum in excess of the tax free amount. A LTAC of 25% applies to the value of any pension in excess of the available LTA. It is necessary to determine separately the amounts by which pension and lump sum exceed the tax allowable limits.

3.7 LTA lump sum tax charge and reduced lump sum.

Amount of lump sum in excess of TFLS, (XLS)
= Max [0, (LS – TFLS)]

where LS is the lump sum selected, between RG and MLS.

LTAC on lump sum ($LTAC_{LS}$) = 0.55 x XLS

Reduced lump sum = LS - $LTAC_{LS}$

If the member is taking an AVC lump sum as well as a scheme lump sum, then the tax-free part is allocated to the components (AVC or main scheme lump sum) in the order in which they are crystallised. This does not affect the level of the LTAC, but may affect the source of the LTAC payment.

The ALTA is reduced by Min(LS,TFLS) where LS is the lump sum, between the RG and MLS, that the member chooses to take.

3.8 If the member decides to crystallise an AVC and scheme pension at the same time, then they must decide the order in which this occurs. The following two calculations should be carried out in the order that the member chooses to crystallise the scheme and AVC benefits. So, if scheme benefits are crystallised before AVCs, then carry out paragraph 3.10 first, then paragraph 3.11. However, if the member chooses to crystallise AVCs first, then carry out paragraph 3.11 before paragraph 3.10.

3.9 If a member has opted to convert their AVCs to a scheme pension, then the procedure for a scheme pension (paragraph 3.10) is carried out twice, for both the main scheme pension and the converted AVC scheme pension.

3.10 LTA pension tax charge and reduced pension (scheme pension)

Pension in excess of tax allowable amount (XSP)
= P – (LS – RG –AC)/12 – ALTA/20
= RP – ALTA/20
= RP - TFP

where:
RP is the reduced scheme pension (pension following deductions for commutation of pension for lump sum),
AC is the amount of AVCs that the member chooses to take as a lump sum, and
ALTA is that following the crystallisation of the lump sum and any pension other than this BCE.

If XSP is negative the ATLA has not yet been reached. The entire scheme pension can be taken tax free. The ALTA is reduced by 20*RP

If XSP is equal to zero, then the ALTA is now zero, and no LTAC on the scheme pension is payable.

If however, XSP is positive then the ALTA is now zero but there is LTAC to pay.

LTAC on scheme pension ($LTAC_{scheme\ pen}$) = 0.25 x 20 x XSP

Pension payable (after commutation and tax charge) = RP – $LTAC_{scheme\ pen}$ / 20

A deduction is also made to a widow(er) or civil partner's pension payable after the death of the member. The deduction is 50% of the deduction to the member's pension (i.e. $LTAC_{scheme\ pen}$ / 40)

3.11 LTA pension tax charge and reduced pension (AVC pension)

Value in excess of tax allowable amount (XAVC)
= (AVCs-AC)-ALTA

where:
(AVCs-AC) is the balance remaining in the AVC fund to be converted into an annuity, following the crystallisation of the lump sum, and
ALTA is that following crystallisation of the lump sum and any pension other than this BCE.

If XAVC is negative the ATLA has not yet been reached. The entire AVC pension can be taken tax free. The ALTA is reduced by the value of the AVC fund.

If XAVC is equal to zero, then the ALTA is now zero and no LTAC on the AVC pension is payable.

If XAVC is positive then the ALTA is now zero but there is LTAC to pay.

LTAC on AVC pension ($LTAC_{AVC\ pen}$) = 0.25 x XAVC

Net AVC fund available to convert to annuity = (AVCs – AC) - $LTAC_{AVC\ pen}$

3.12 Total LTAC

$$\text{Total LTAC} = \text{LTAC}_{LS} + \text{LTAC}_{\text{scheme pen}} + \text{LTAC}_{\text{AVC pen}}$$

3.13 If at the end of the process, ALTA has not been extinguished, the scheme should ensure that the lump sum paid does not exceed MLS. If it does, then part of the lump sum would be an unauthorised payment, subject to additional tax payable by the scheme. In this situation, the member should be asked to reduce the proposed lump sum by commuting less pension.

ANNEX – Example

Consider a 'standard' member, with no primary or enhanced protection of benefits, who at his retirement in 2007-08 has not taken any previous BCE's. His scheme benefits are as follows:

Annual scheme pension (P) = £100,000
Retirement grant from the scheme (RG) = £300,000
AVC fund value = £0

SLTA in 2006-07 = £1,5000,000
SLTA in 2007-08 = £1,600,000

ALTA at retirement = £1,600,000 since no previous BCE's.

The administrator has confirmed that the member is not covered by the note on Regulation 20 because the capital value of his benefits exceed his ALTA.

<u>Scheme calculations</u>

CV = 20 x P + RG + AVCs = £2,300,000
CV>ALTA

The amount of lump sum which can be taken tax-free (TFLS)
= Max[0, 0.25 ALTA]
= £400,000

MLS
= 12 x P + RG + (3 x TFLS – 3 x ALTA) / 5
= 12 x £100,000 + £300,000 + (3 x £400,000 – 3 x £1,600,000) / 5
= £780,000

The member may take a lump sum between £300,000 and £780,000 with any lump sum in excess of £400,000 being subject to LTAC.

Member chooses to take the maximum lump sum. To do so, he must take the shortfall in the MLS over the RG, of £480,000 by commuting scheme pension of £40,000 per annum (£480,000/ 12).

The member's reduced pension, following commutation to reach the desired LS, (RP)
= £100,000- £40,000
= £60,000

Since the member has no AVCs, none can be taken as lump sum.
The revised CV is now = RP x 20 + LS = £1,980,000

where LS is the lump sum that member has chosen to take, which in this case is the MLS

Lifetime allowance charge calculations

The member may be required to pay a lifetime allowance charge if the lifetime allowance is breached.

Lump sum
The lump sum in excess of the TFLS (XLS)
= LS – TFLS
= £380,000

$LTAC_{LS}$ = 0.55 x XLS = £209,000

The member's ALTA is now £1,200,000 which is the previous ALTA less the TFLS (or LS had that been lower).

Scheme pension
The scheme pension in excess of the tax allowance amount (XSP)
= RP – ALTA / 20
= £60,000- £1,200,000 / 20
= £0

Since XSP is zero, the ALTA has been exactly used up, with no LTAC on pension payable.

SUMMARY

Total LTAC paid = £209,000

The member's benefits at retirement are now therefore:
Annual scheme pension = RP – 0.25 x XSP = £60,000
Total lump sum = LS – 0.55 x XLS = £571,000