report

meeting	**PENSIONS ADMIN SUB COMMITTEE**	
date	**12th SEPTEMBER 2005**	agenda item number

REPORT OF THE DIRECTOR OF RESOURCES

LOCAL GOVERNMENT PENSION SCHEME: COMPLIANCE WITH INLAND REVENUE TAX REGIME FROM APRIL 2006

1. Purpose

1.1 To inform the Pensions Administration Sub-Committee of:

1.1.1 the proposed changes to the Scheme;

1.1.2 a proposed response to the Office of the Deputy Prime Minister (ODPM).

2. Background

2.1 A series of proposed changes to the Scheme have been issued by the ODPM in July 2005, which following consultation, will amend the Local Government Pension Scheme Regulations 1997 to bring it in line with changes introduced by the Finance Act 2004. The period of consultation ends on 16 September 2005.

3. Proposed Changes

3.1 At present the Inland Revenue operates a multi-tiered tax regime, of which three tiers primarily affect the LGPS. These different arrangements are being replaced with single regime. Therefore, the Inland Revenue will no longer operate on the basis of:

- Class A, B and C tax categorisation for post – 1989, 1987-89 and pre-1987 joiners respectively
- A limit of 15% of taxable pay on which tax relief will be granted on contributions to pension arrangements
- A perceived limit of 40 years maximum service

- A two thirds' maximum accrual in respect of a single scheme, with retained benefits relating to a transfer of rights from a different scheme

- A capping regime for post -1989 joiners, so that contributors are only made on £105,600 and benefits, effectively, limited to 66% of the cap in respect of that employment and accrual

- Category B and C members earning in excess of the cap being required to average their last three years' salary to arrive at the pensionable pay figure used in calculation of pension

- Limits on the lump-sum of £105,600 which can be paid to a Class B member

3.2 Instead, from the beginning of the 2006/7 tax year the new single regime will:

- Introduce annual and lifetime tax allowances

- Allow the maximum sum an individual can put into a pension scheme in a single tax year (from 2006) to be a sum equal to annual salary (up to a maximum of £215,000). If more than the maximum is put into a pensions arrangement (or arrangements), then a tax charge will fall due

- Introduce a capital limit of £1.5 million which maybe built up over a person's working lifetime. Where the capital value in total of an individual's pension rights breach this lifetime limit, a tax recovery charge must be made. (To put this into context, only employees earning in excess of £130,000 per annum and with 40 years' membership in a scheme with accrual rates as per the current LGPS could be affected. This is because the method of calculating capital value is done on the basis of multiplying pension by 20 and adding any lump-sum.)

- Allow for the release of a pension from a scheme operated by an employer by who they are still employed

- Allow individuals to contribute towards concurrent pension arrangements in respect of the same employment

3.3 The necessary amending regulations will move the LGPS onto the new tax regime which will come into force from April 2006. The changes proposed will require software providers for Pension Scheme Administrations to reconfigure their current systems. To facilitate this it is envisaged the regulations being made in Autumn 2005, following this period of consultation.

3.4 The attached Appendix details the specific regulations with the recommended response noted.

4. Recommendation

4.1 That the Pensions Administration Sub-Committee notes the content of this report, and approves the proposed response to the ODPM.

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Director of Resources

Personnel Implications

None.

Equal Opportunities Implications

There are no equal opportunities implications arising from the recommendation in the report.

Crime and Disorder Implications

None.

Appendix A: Regulations requiring change

The Local Government Pensions Scheme Regulations are written with due reference to other legislation so the proposed change to tax legislation will require a number of changes to the LGPSR listed below.

For each potential change, the recommended response of the Director of Resources has been determined and is provided for consideration.

1. Periods of membership: "total membership": Regulation 9(1A) currently prevents a member from counting service after their 65th birthday as a period of membership. From April 2006 this restriction is to be removed. Members will be entitled to accrue membership in relation to any relevant employment, at any age. There is currently an Inland Revenue and Department of Trade and Industry limit of further accrual up to the age of 75.

1a Recommended response** ; **Supportive

2. Employers' discretion to reduce members' contribution rate: Regulation 15 Inland Revenue will no longer impose a restriction on maximum membership contribution (currently 40 years for class A members). The ability for an employer to resolve to waive a member's contributions where they have attained 40 years membership will be removed.

2.1 For extant members, provision will be considered to either let employers still waive the contributions but count the period of membership or to allow members whose contributions have been waived to now make the necessary contributions (+ interest) in order that any period of membership which would not have counted under the principal regulations may now be counted for the purpose of calculating benefits.

2a Recommended response ; Generally supportive but concerned that extant members may lose out on the current option of a two year contributions holiday that includes entitlement to death benefits - need assurances about this

3. Inland Revenue Limits on Contributions: Regulation 16 there will no longer be a limit on the amount of contributions a member may make. Instead, the new regime provides an annual tax free allowance on the amount of contributions (initially £215,000 or total salary or £3,600, whichever is the lower). A tax charge becomes payable where the amount of pensions benefits a member may accrue in any financial year, exceeds this limit. Regulation 16 will therefore be deleted.

3a Recommended response ; Supportive

4. Calculations: Regulations 20 (3) and (4A) There is no intention at present to replace the calculation of lump sum. But see also regulation 59. Membership after a members 65th birthday will now count for the purposes of calculating their LGPS benefits. It is proposed that membership prior to age 65 will be actuarially increased post the 65th birthday where pension is not released.

4a Recommended response ; Supportive - the Government's wish to encourage longer working lives and thereby improve Fund viability has previously been supported by Nottinghamshire Pensions Committee

5. Revenue Limits: Regulation 24 The new regime does not provide a limit in terms of a maximum replacement rate on the amount of benefits that a member may become entitled to under the LGPS. Regulation 24 will therefore be deleted, but see Schedule 4.

5a Recommended response ; Generally supportive as part of the wider removal of limits and bars but wary that there may be some administrative complexity introduced

6. Amounts of Ill-Health Pension and Grant: Regulation 28(3) There is no need for the retention of a 40 year limit for calculating enhanced membership and therefore it is proposed that this regulation will be amended accordingly.

6a Recommended response ; Generally supportive but would like to see the amendments and how it is intended to calculate enhancements before committing fully

7. Re-employed and Rejoining Members: Regulation 32(2) References to class B and C members will no longer be relevant and will therefore be deleted. The regulations will provide that a former period of councillor membership may only be aggregated with a subsequent period of councillor membership.

7a Recommended response; Supportive – There appears to be no specific impact to the current regulation, and hence do not understand why this has been included.

8. Requirements as to Time of Payment: Regulation 35 This regulation will be amended in order to accommodate flexible retirement - i.e. the capacity for members to draw a pension without "retiring" completely.

8a Recommended response ; Very supportive of the principle of stepping down into retirement but need to see details of the intended options

9. Meaning of Eligible Child: Regulation 44 The new regime introduces a new definition of "dependant child" which has to be reflected by all registered pension schemes. This prohibits the payment of a child's pension after the age of 23 unless the child was dependent on the scheme member at the date of their death by virtue of a physical or mental disability which arose whilst they were a child.

9a Recommended response ; Generally supportive - will make no discernible difference to current situation

10. Purchase of Added Years: Regulation 55 Although the maximum referred to under regulation 55(2) will no longer necessarily apply under the new regime - it is necessary to consider whether added years contracts should be restricted. This is because of individual choice impacting on employer costs, and this is particularly relevant in view of the fact that they are treated as paid in full where a member retires on ill health grounds. In due course under proposals for changes from 2008 this problem may resolve itself, but at present it may be appropriate to consider a scheme limit on added years, and therefore consultees may feel it is necessary to retain this provision.

10a Recommended response ; Removal of the current 'headroom' checks would be consistent with the rest of the legislation and encourage simplification the potential for significant unexpected employer cost between 2006 and 2008 is not identified by Mercers as a problem so remove the restrictions on added years contracts

11. Election for Lump Sum in lieu of Pension: Regulation 59 The maximum lump sum references in regulation 59(5) will be incorrect under the new tax regime and will therefore need amending so it makes reference to the maximum allowable under Inland Revenue overall limits. A decision will need to be made that this is over and above the three times pension that is now payable.

11a Recommended response *;* ***Supportive***

12. Elections to pay AVCs: Regulation 66 Employers will be able, at their discretion, to allow employees to contribute to a registered additional voluntary contributions scheme. But there will be no requirement for them to do so. The new regime will allow members to contribute to any concurrent registered pension arrangement, for example a personal pension.

12.1 For extant contributors of AVC schemes, an election made before the amendment regulations come into effect shall continue to apply as though the regulations had not been amended.

12a Recommended response ; Generally supportive – Although there is slight concern about implied changes in terms of the role for Employers.

13. Over-provision: Regulation 85 Over provision as currently applying will no longer be applicable under the new regime as Inland Revenue will cease to restrict such benefits, subject to satisfactory annual and life timer limits.

13a Recommended response ; Supportive

14. Annual Benefit Statements: Regulation 106A These provisions will be updated to provide annual benefit statements in accordance with the new annual allowance provisions and to show the Inland Revenue value of benefits accrued in the relevant financial year.

14a Recommended response ; Supportive - there will be no continuing value to identifying prospective benefits at 'Normal retirement date' under the new regime

15. Schedule 4: In its current format this will become redundant and will be replaced with a schedule to reflect the new regime as introduced by Finance Act 2004.

15.1 The new schedule will set out;

a. that the scheme will become a registered pension scheme for the purposes of paragraph 1 of Schedule 36 Finance Act 2004, immediately before the commencement of that Act.

b. that administering authorities are responsible for the payment of any lifetime allowance charge applicable to a member's LGPS benefits.

c. Notification to Inland Revenue of reportable matters

d. Provisions for the recovery of a lifetime allowance tax charge. Where a scheme member becomes subject to a lifetime allowance charge following the crystallisation of their LGPS benefits, the scheme administrator will be liable to pay the charge to the Inland Revenue. Provision will be made to reduce the LGPS benefits an equivalent amount, as determined by the Government Actuary.

e. Annual and Lifetime limits

f. Crystallisation events – ie the point in time where the capital value calculation must be made with comparison against IR limits

g. What constitutes Inland Revenue maximum lump sum

h. Transitional protections - for a member who was a class A member immediately before the amendment regulations come into force, the Inland Revenue earnings cap will cease to apply. The current earnings cap is £105,600. If a class A member had been earning £158,400 prior to 6 April 2006 they would have only paid contributions on the £105,600. The removal of the limit will mean they are now accruing benefits on a salary of £158,400. Such a windfall would be significant (i.e. a 50% increase in this example) and would create an unacceptable liability on the relevant pension fund. There are a number of ways in which this issue can be addressed; of which the following are examples

   i. The scheme replicates the old Inland Revenue earnings cap in its provisions (indexed annually by the corresponding 12 month change in RPI to the anniversary) to apply to all post 1989 joiners;
   (This would continue to restrict the pensionable pay of post 1989 joiners effectively retaining an earnings cap so there are no 'windfall' gains from the removal of the cap. By keeping the same earnings cap methodology it retains the £ per annum. pension accrual and results in no additional cost to Fund, employer or member)

   ii. Such members are treated as deferred members, and begin to accrue separate membership from 6 April 2006 calculated against actual salary;
   (This would require that post 1989 joiners pre 2006 benefits are retained as deferred benefits and that post 2006 service is treated as a second pensionable benefit on which the earnings cap on pensionable pay is removed. Though this methodology has no direct cost to Fund employer or member, there may be problems relating to transferability, increases in earnings over pensions increases and early retirement reductions)

iii. Such members are offered the opportunity to count the accrued service in respect of their service up to the 5 April 2006 in the same way that the Scheme currently allows for individuals with concurrent employments, with an appropriate service adjustment;
(The Post 1989 joiners would have their pre 2006 service reduced in length in direct proportion to the increase in pensionable pay which results from the removal of the earnings cap. By converting the service this methodology retains the £per annum. pension accrual and results in no additional cost to Fund, employer or member) or

iv. Such members are offered the opportunity in respect of their service up to the 5 April 2006 to make effectively backdated contributions as calculated by fund actuary so that their accrued membership may be aggregated with post 5 April 2006 membership on a day for day basis. ***(This would allow the member to backdate contributions on actual pay. This methodology will increase the members overall pension benefit accrued albeit at a cost to both member and employer)***

15.2 It will also be necessary to permit some individuals to make use of the IR facility to use a 2006 figure where the lifetime limit is already exceeded or likely to be exceeded. Where primary or enhance protection is agreed the Scheme will then be able to calculate pension by reference to these figures.

15a Recommended response ; The Pensions Committee has made clear its views on transitional arrangements many times during the course of the Stocktake exercise - the two key aspects are i) that existing Fund members do not lose out on the package that they were promised when they joined the LGPS and ii) that the measures required are not unduly administratively complex.

With regard to the options suggested in point h above, Members are required to agree the preferred option.