East Lothian Council

REPORT TO: East Lothian Council

MEETING DATE: 25 October 2022

BY: Executive Director for Council Resources

SUBJECT: Lothian Pension Fund: Voluntary Scheme Pays 2021/22

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1 PURPOSE

1.1 For the Council to determine whether East Lothian Council should exercise its annual discretion to adopt the Lothian Pension Fund Voluntary Scheme Pays mechanism in respect of the tax year 2021/22.

2 RECOMMENDATIONS

2.1 That Council considers the options at Paragraphs 3.3 and 3.4, decides which of these to adopt, and authorise offices to communicate that decision to Lothian Pension Fund.

3 BACKGROUND

Lothian Pension Fund Voluntary Scheme Pays

3.1 Lothian Pension Fund requires the Council to make an annual decision with regard to whether "Voluntary Scheme Pays" (VSP), should be allowed. The annual bulletin from Lothian Pension Fund explains the impact of VSP and the potential risk to the Council were it to agree to the option. This is a potential benefit that is only of relevance to the most highly paid members of public sector staff. A copy of the bulletin is attached as Appendix 1.

3.2 The Local Government Pension Scheme obliges employers to pay an employer's pension contribution of circa 20% of salary in addition to an employee's own pension contribution from salary. The current annual tax-free allowance for pension savings is £40,000. Employees who exceed this standard allowance can opt for the Pension Fund to pay the tax due by way of a "Mandatory Scheme Pays" election, with a consequential reduction in their annual pension to cover this sum. However, those earning in excess of £200,000 could be subject to a tapered annual allowance and therefore can face considerable personal tax liability in respect of their pension savings. This liability can be alleviated by the Fund meeting the tax due and later recouping that by making a reduction in the amount of the annual pension paid to the individual once they retire. This is only possible if Council were to agree to VSP. Agreement is now sought annually by the Lothian Pension Fund relating to the past tax year. For tax years 2019/20 and 2020/21, Committee agreed to participate in the Scheme. This report relates to the tax year 2021/22. The threshold income for the tapered allowance rose from £110,000 to £200,000 in the tax year 2020/21. East Lothian Council has no employees earning more than £200,000. The Pension Fund nevertheless requires an annual election from each of its member employers.

3.3 **Option One – Agree to Voluntary Scheme Pays**

This will mean that affected individuals can elect not to pay the tax due themselves and have the Fund pay it for them, agreeing to receive a reduced pension when it is due. This would have the benefit of assisting any members of staff who might find themselves experiencing financial difficulty in meeting their tax obligations.

If the Council were to agree to this option and should a member of staff who utilised it die before drawing down their pension or before the whole tax is recouped, the Pension Fund would require the Council to bear the cost of the tax paid on behalf of that member of staff. East Lothian Council currently has no members of staff that might seek to access VSP. Of course, we have no control over changes to limits and the resultant impact on risk, therefore the decision as to whether to participate in VSP will be revisited annually.

3.4 **Option Two – Do Not participate in Voluntary Scheme Pays**

This would remove all financial risk to the Council but it could create personal financial difficulty in the future for some of our most senior members of staff leading to lowered morale and even disaffection that could affect staff retention at the most senior level.

4 POLICY IMPLICATIONS

4.1 None.

5 INTEGRATED IMPACT ASSESSMENT

5.1 The subject of this report does not affect the wellbeing of the community or have a significant impact on equality, the environment or economy.

6 RESOURCE IMPLICATIONS

6.1 Financial - None

6.2 Human Resources - None

6.3 Other - none

7 BACKGROUND PAPERS

7.1 None

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Appendix 1

Voluntary Scheme Pays

Lothian Pension Fund checks members' pension savings against the annual allowance limits every year. If pension savings exceeds the annual allowance and there is no carry-forward allowance from the previous three years, then the member will be liable to pay tax on the excess savings over the annual allowance. We must inform members who have exceeded the annual allowance by 6 October each year in line with HMRC legislation.

If a member has a tax charge because they have exceeded the standard allowance they can make a 'Mandatory Scheme Pays Election'. The Fund and the employer have no discretion over this, i.e. we must accept the member's election and pay the tax charge in exchange for a debit to the member's pension. The debit is applied when the member retires or leaves the Fund.

However, members who earn more than £200,000 ('threshold income') have to assess their tax liability to see if they are also affected by the additional tapered annual allowance – Lothian Pension do not carry out these calculations. The 'taper' reduces the Standard Annual Allowance to a minimum of £4,000.

There is discretion for administering authorities to pay some or all of an annual allowance charge on a member's behalf in circumstances where their pension savings are not in excess of the standard Annual Allowance but are in excess of the tapered Annual Allowance. This is known as 'Voluntary Scheme Pays'. Pensions Committee has previously agreed that 'Voluntary Scheme Pays' can be an option for members, on the condition that the member's employer agrees to this.

Use of the voluntary scheme pays option does present some risk to both the employer and the Fund. This is because the tax charge payable is paid in full by the Fund and a debit is applied to the member's pension. This means that the member's pension will be permanently reduced. The risk arises if the member dies before the tax charge paid is recouped - the debit would not be applied to any survivor's pension payable in the event of the member's death.

Under the current regime, given the scheme has no discretion over the mandatory scheme pays, for any member who is affected by the taper the maximum annual risk for an employer would be a member's additional tax charge of £16,560 based on someone in the 46% tax bracket.

For example, if a member has a pension input of £100,000 (and assuming they have no carry forward to offset this), they are over the standard annual allowance by £60,000 and this is the taxable amount. Say they were on a 46% tax rate they would have a tax charge of £27, 600.

If they were subject to the Tapered Allowance, and their allowance has been reduced by the maximum to £4,000, their chargeable amount would be £96,000. The tax charge at 46% would be £44,160. As we would have to accept a mandatory scheme pays for the £27,600 charge, the amount relating to the taper is an additional £16,560 (£27,600 + £16,560 = £44,160).

If the election goes ahead, the scheme would pay the £44,160 and the member's annual pension would have a debit applied. The debit amount is calculated based on factors by the Government Actuary's Department and depends on how far away the member is from State Pension Age. For example, for a member aged 50 whose normal pension age is 67, the current actuarial factor to be used would be 10.96.

Using the above example, the scheme debit would be £44,160 / 10.96 which is £4029.20. This would be deducted from the member's annual pension amount when they retire. The reduced pension amount is payable for life. The member could decide however to settle the tax charge directly with HMRC and it would not affect their pension.

Next steps

If you agree to the 'Voluntary Scheme Pays' option to be allowed in respect of your members, please confirm this to us in writing.

The time limit for the Fund to pay the voluntary scheme pays charge is 31 January 2023. Therefore, we need you to reply by no later than **27 November 2022** to allow us confirm to carry out the required calculations and advise members. Your response should be on headed paper and signed by a Director/other authorised signatory. Your decision on voluntary scheme pays can be amended at any time and as an employer you can decide whether to apply this to some or all members affected. Please send your response to employer.pensions@edinburgh.gov.uk.