SCOTTISH PUBLIC PENSIONS AGENCY

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To the listed addressees

Your ref:
Our ref: LGT/01/15/00

15th July 2005

Dear Sir/Madam

**LOCAL GOVERNMENT PENSION SCHEME (SCOTLAND):
COMPLIANCE WITH INLAND REVENUE TAX REGIME FROM APRIL 2006**

**Consultation Draft**

I enclose for comment, at annex A, a series of proposed changes to the Scheme, prior to finalising draft regulations which will amend the Local Government Pension Scheme (Scotland) Regulations 1998 to bring it into line with changes introduced by the Finance Act 2004. You are asked to make your comments by 16 September 2005. A draft statutory instrument will subsequently be issued for a further period of consultation taking into account comments made during this exercise.

**Background**

The Finance Act 2004 introduces wide ranging reforms which impact on all occupational pension schemes, designed to simplify the present complex arrangements which define the limits for tax-approved pension saving. The Act when implemented on 6 April 2006 will replace the numerous existing tax regimes with one 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, outwith retained benefits relating to a transfer of rights from a different scheme

- a capping regime for post 1989 joiners, so that contributions 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 [£105,600] which can be paid to a Class B member

Instead from the beginning of the 2006/07 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 pension arrangement [or arrangements] then a tax charge will fall due

- introduce a capital limit of £1.5 million which may be 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 in Scotland 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 whom they are still employed

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

**Fundamentals of the new tax regime**

- The proposals will come into force on 6 April 2006, which is referred to as 'A-Day'.

- The maximum amount of tax-advantaged pension saving which will be set at a new lifetime allowance (LTA) value, initially £1.5 million. Individuals may accrue benefits in excess of the LTA, but those excess benefits will be subject to a tax known as a recovery charge.

- A standard factor of 20:1 is used by the Inland Revenue to value an individual's benefits for the purposes of the LTA. To consider an example of how the 20:1 factor works; if an individual has an accrued pension of £10,000 per annum, the LTA value of the pension is (20 x £10,000 = £200,000). The amount of any standard lump sum benefit should be added on to the above calculation (ie £30,000) to arrive at a total LTA in this example of £230,000.

- The recovery charge for funds above the lifetime allowance will be 25% if the excess is to be taken in the form of a pension (and then additionally subject to PAYE), or at 55% if the excess is to be taken in lump sum form.

- When valuing for the purposes of the LTA a pension which is actually in payment, the relevant factor to use is 25:1.

- There is a maximum limit for the tax-approved benefits which an individual may accrue in any one financial year. In the case of a defined benefit scheme like LGPS in Scotland this is calculated by taking the amount of increase in scheme benefits from a defined point (say 31

March) to the following 31 March, with the value of the accrual multiplied by a factor of 10. The limit for 2006/07 is £215,000.

- A tax free lump sum of 25% of the LTA value of the retirement benefits may be taken, subject to a maximum of £375,000 for 2006/07.

- The treatment of pension sharing orders on divorce has been changed, in that members who have pension debits (ie deductions) will have their benefits valued for LTA purposes reduced by the value of the pension debit.

- There are two forms of protection available for members who have LTA values which are close to or in excess of £1.5 million as at A-Day -

    - Primary protection is available to those with values greater than £1.5 million at A-Day and protects accrued benefits by specifying a new individual LTA calculated at April 2006.

    - The second form of protection is enhanced protection, in which a member must cease accrual of benefits in the scheme, but in doing so may protect the value in full of benefits accrued prior to A Day.

  It is important to emphasise that it is a member's personal responsibility to check if he/she falls to be affected by the new lifetime allowance test although the LGPS will aim to provide information to scheme members by way of guidance.

- The Inland Revenue will no longer require an individual to "retire" before becoming eligible to receive retirement benefits, although pension schemes must decide individually if and when they wish to implement the new flexible retirement opportunities.

**Impact on LGPS in Scotland**

The necessary amending regulations which will move the LGPS in Scotland onto the new tax regime will come into force from 6 April 2006. The changes being introduced will require software providers for pension scheme's administration to reconfigure their current systems. To facilitate this we envisage the regulations being made in autumn 2005, following this period of statutory consultation.

The attached annex details the regulations we believe will require changing and the policy intention behind the required changes. They have been set out in the LGPS (Scotland) 1998 regulation sequence. It will be seen that some decisions on the exact operation of this new regime still need to be taken. At the same time LGPS employers, in conjunction with their HR specialists, will need to be assessing the impact of these provisions on their workforce pay and employment strategies.

**Responses**

Comments on the consultation document should be sent, no later than Friday 16th September 2005, to Jean Steel, Policy Officer, LGPS, Scottish Public Pensions Agency, 7 Tweedside Park, Tweedbank, Galashiels, TD1 3TE. Responses may be sent by e-mail to locgovpensionsreform@scotland.gsi.gov.uk. If you wish to discuss any of the proposals in depth please do not hesitate to contact me on 01896 893227 or send any queries by e-mail to david.lauder@scotland.gsi.gov.uk.

The Agency may wish to publish responses to this consultation in due course, or deposit them in the library of the Scottish Parliament, unless we are asked specifically to treat a response as confidential. Confidential responses will be included in any published statistical summary of comments received and views expressed.

Yours faithfully

D Lauder

D Lauder
Policy Manager, LGPS

Addressees
COSLA
TGWU
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STUC
UNISON
AMACUS
Secretary, LGPC
Union of Construction, Allied Trades and Technicians
Strathclyde Passenger Transport Authority
Audit Scotland
National Association of Pension Funds
CIPFA
Women's National Commission
Other Relevant Government Departments.