

**FIREFIGHTERS' PENSION SCHEME  
FSC 3/2011**

**WHO SHOULD READ:** The Clerk to the Fire and rescue Authority, Chief Fire Officers, FRA pension managers and human resource managers

**ACTION:** For information and action

**SUBJECT:** Firefighters' Pension Scheme 1992 – Revised Commutation Factors

**The purpose of this circular is to:**

- Advise FRAs on the revised commutation factors prepared by the Government Actuary for the purpose of calculating lump sums payable under Rule B7 of the Firefighters' Pension Scheme 1992. These revised factors should be applied to members who retire on or after 19 April 2011.

**Background**

1. This circular advises FRAs about the revised commutation factors prepared by the Government Actuary for the purposes of calculating the lump sums payable to persons who commute part of their firefighter's pension under Rule B7 of the Firefighters' Pension Scheme 1992 (FPS). The revised commutation factors have been attached to Annex A.
2. The impact of these changes being applied is an overall increase in the factors which mean that higher lump sums will now become due for those FPS members choosing to commute part of their pension.
3. The new factors must be applied to any member who retires on or after 19 April 2011. This is the date GAD reviewed and revised the current factors and therefore is the date that must be used to introduce the new factors.

**Potential Tax Implications**

4. FRAs should be aware that as some of the revised commutation factors are higher than 20:1 there may be tax implications for some members where the value of their commuted lump sum exceeds the maximum permitted by HMRC (i.e. which is currently set at 25% of the total value of benefits vested).
5. Where the commuted lump sum exceeds the HMRC 25% limit then the amount of lump sum in excess of the limit will be an unauthorised payment and subject to a 40% tax charge.

For example: using a hypothetical commutation rate of 25 to illustrate the point

Annual (pre-commutation) pension = £10,000. Member elects to commute 25% (£2,500 a year) to generate a lump sum of £2,500x25=£62,500. Annual (post commutation) pension



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= £7,500.

HMRC assess the total value of the benefits as 20 times the pension actually received plus the lump sum actually received i.e.  $(20 \times £7,500) + £62,500 = £150,000 + £62,500 = £212,500$

Maximum tax-free lump sum permitted by HMRC is 25% of the total value of benefits vested i.e.  $25\% \times £212,500 = £53,125$ .

For this particular member the commuted lump sum of £62,500 will have exceeded the HMRC limit by £9,375. As a result the tax charge due to the member would be £3,750.

6. In addition to the tax charge incurred by the scheme member the pension scheme would also be liable to pay a Scheme Sanction Charge. More information on the Scheme Sanction Charge can be accessed on the HMRC website via: <http://www.hmrc.gov.uk/manuals>

7. As outlined above the increase in factors mean that at certain levels the HMRC limits on Pension Commencement Lump Sums (PCLS) will be exceeded. This is unavoidable due to the fact that the FPS scheme rules provide that any commuted lump sum has to be the actuarial equivalent of the pension being given up. However when considering whether to commute or not members should be made aware where full commutation will incur a tax charge. This will allow them to consider reducing the amount of pension they wish to commute to ensure they stay within PCLS limits. Ultimately it is down to the individual member to decide on how much pension, if any, they wish to commute.

8. Any lump sums already paid from and including 19 April 2011 will need to be reviewed and arrears paid accordingly. Rule B7 (5) limits the amount of lump sum to  $21/4$  times the pension where the member retires with less than 30 years service before normal retirement age. If any such restricted lump sum payments have already been made from and including 19 April 2011 then administrators will need to carefully review those particular awards.

9. FPS members who retired with less than 30 years service and who commuted to give a maximum lump sum of  $21/4$  times the annual pension before commutation cannot receive any additional lump sum payment, but must instead receive the extra money to which they are entitled in the form of additional annual pension.

10. Please note that for those who administer both police and firefighter pensions that the demographic assumptions adopted for the Fire and Police commutation factors are based on an analysis of the experience of members in the Firefighters' and Police Pension Schemes, respectively, and undertaken as part of the most recent valuations for both schemes. The most recent experience in both of the schemes, including pensioner longevity, indicates that different assumptions are appropriate for the respective reviews of Police and Fire commutation factors. As a result the factors are no longer common across the schemes.



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## Software

11. We have been in touch with Heywoods who are the main fire pension software provider about the new format for the factors. We understand that the necessary software changes will be made to accommodate the new factors. If you use another provider you will need to inform them of the change.

**Jenny Coltman**  
**Policy Manager**  
**27 April 2011**

### Contact Information:

Should you have any enquiries about this circular, or require further information, please contact:

Jenny.Coltman@scotland.gsi.gov.uk

**Scottish Public Pensions Agency**  
**7 Tweedside Park**  
**Tweedbank**  
**GALASHIELS**  
**TD1 3TE**

[www.sppa.gov.uk](http://www.sppa.gov.uk)  
Telephone: 01896 893000



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