Pensions Management Institute
ACHIEVING PENSIONS EXCELLENCE

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Defined Benefit Arrangements

Assignment 3 Notes

Part 3 – Taxation and Governance of DB schemes)
Recommended Time: 3 hours

1. **You are a senior administration manager and you will be training a junior colleague on the key aspects of the lifetime allowance and how protection against the lifetime allowance works.**

   Draft some notes which you can refer to and give to your colleague for future reference that explain the lifetime allowance and the purpose of primary protection, enhanced protection, fixed protection 2012, fixed protection 2014, fixed protection 2016, individual protection 2014 and individual protection 2016.

   20 marks

Describe how current HMRC rules work, including:

- What the lifetime allowance (LTA) is, the LTA tax charge, why primary and enhanced protection exist i.e. to maintain expectations for those members whose benefits at 5 April 2006 already exceeded the LTA, or were expected to exceed the LTA by the time they retired. Explain why fixed protection 2012 was introduced from 6 April 2012 i.e. to maintain expectations for members whose benefits may exceed the reduced LTA of £1.5 million when they come to take them. Why fixed protection 2014 and individual protection 2014 were introduced from 6 April 2014 i.e. to maintain expectations for members whose benefits may exceed the reduced LTA of £1.25 million when they come to take them. Also, why fixed protection 2016 and individual protection 2016 were introduced from 6 April 2016 i.e. to maintain expectations for members whose benefits may exceed the reduced LTA of £1 million when they come to take them

- Primary protection is for members whose benefits at 5 April 2006 were valued at over £1.5 million. The value of their accrued benefits as at that date (increased on the assumption that the LTA is now £1.8 million) is protected from the LTA charge, but the LTA charge will apply to further benefits. Members with this type of protection have an enhanced LTA. Although the LTA has been reduced several times and is now £1 million, these members will still have their enhanced LTA calculated on the higher of £1.8 million and the standard LTA at the time the benefits are paid

- Enhanced protection is mainly for members whose benefits at 5 April 2006 were over £1.5 million, though it can be available for anyone. Under this type of protection benefits are completely protected from the LTA charge but, post 5 April 2006, no DC contributions can be made and only very small additional DB benefits can accrue

- Fixed protection 2012 was for members who believed that the value of their benefits would be higher than £1.5 million when they come to take them. It was introduced at 6 April 2012 when the standard LTA was reduced to £1.5 million. Under fixed protection 2012 benefits up to £1.8 million in value are protected from the LTA charge, but benefits in excess of this amount will be subject to the charge

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- Fixed protection 2014 was for members who believed that the value of their benefits would be higher than £1.25 million when they come to take them. It was introduced at 6 April 2014 when the standard LTA was reduced to £1.25 million. Under fixed protection 2014 benefits up to £1.5 million in value are protected from the LTA charge, but benefits in excess of this amount will be subject to the charge

- Fixed protection 2016 is for members who believed that the value of their benefits would be higher than £1 million when they come to take them. It was introduced at 6 April 2016 when the standard LTA was reduced to £1 million. Under fixed protection 2016 benefits up to £1.25 million in value are protected from the LTA charge, but benefits in excess of this amount will be subject to the charge

- Members with any type of fixed protection cannot accrue any further benefits in DB schemes apart from an allowance for inflation. The payment of a DC contribution after 5 April 2012 for members with fixed protection 2012, after 5 April 2014 for members with fixed protection 2014, or after 5 April 2016 for members with fixed protection 2016, would lead to the loss of fixed protection

- Individual protection 2014 is available to certain members whose benefits were valued at greater than £1.25 million on 5 April 2014. Under individual protection 2014 members will receive a personal LTA based on the value of their benefits on 5 April 2014, subject to a maximum of £1.5 million. These members will be able to accrue further benefits but will be liable for the LTA charge on the value of their benefits exceeding their personal LTA

- Individual protection 2016 is available to certain members whose benefits were valued at greater than £1 million on 5 April 2016. Under individual protection 2016 members will receive a personal LTA based on the value of their benefits on 5 April 2016, subject to a maximum of £1.25 million. These members will be able to accrue further benefits but will be liable for the LTA charge on the value of their benefits exceeding their personal LTA

- Previously, members who applied to HMRC for any form of protection were issued with a protection certificate. From 6 April 2016 all new applicants for fixed protection 2016 and individual protection 2016 must apply online and will instead receive a protection reference number and a pension scheme administrator reference from HMRC. It is expected that in due course administrators will be able to use these to check the member's protection status online.

(The relevant sections of the Study Manual are Part 3, Chapters 1.2, 1.2.1, 1.2.2, 1.2.3 and 1.2.5.)

2. **You are the administrator for a DB scheme. A member has written to you asking you to explain what the annual allowance is and how they can test their benefits against this allowance.**

   Draft some notes that describe the points that you would cover in your reply to the member.

20 marks

The annual allowance (AA) was introduced under the Finance Act 2004. The AA is the maximum increase in the value of a member's benefits that can occur in each tax year before a tax charge arises, known as the annual allowance charge. The allowance was originally set at a high level but from April 2011 it was reduced to £50,000 and from April 2014 it was further reduced to £40,000.

There are some circumstances when the operation of the AA is different:

- A Tapered Annual Allowance was introduced from April 2016 for individuals with incomes over £150,000. For every £2 of income they have over £150,000, their AA is reduced by £1. Anyone with adjusted income of or above £210,000 will have an AA of £10,000

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- Where the member is also subject to the Money Purchase Annual Allowance the operation of the AA is different

A member may be able to offset any excess increase in benefits against any unused AA from the three previous tax years. This is referred to as 'carrying forward' unused AA.

Each arrangement in which the member has any benefits will have a 'pension input period' (PIP). This is the period across which the increase in the value of the member's benefits, known as the 'pension input amount', is calculated for testing against the AA.

Previously all PIPs were set by the scheme and, while they may have been aligned with the tax year, in most cases they were usually some other period, such as the scheme year. With the introduction of the Tapered Annual Allowance, all PIPs had to switch to tax years from 2016/17. To allow for this, transitional arrangements were introduced for 2015/16.

For each tax year, the member must check whether they need to pay an Annual Allowance charge on the increase in the value of their benefits. To do this the member must compare, against the AA for that tax year, the total increase in the value of their benefits (in all registered schemes in which they participate) in that tax year. If a tax charge is due, the member may be able to ask their pension scheme to pay the charge on their behalf.

To enable the member to determine their total pension input amounts, if their pension input amount in any one scheme exceeds the AA for that tax year, that scheme must automatically notify the member of the pension input amount for that tax year and also for the preceding three tax years. In all other cases, the member can request this information from the scheme.

(The relevant sections of the Study Manual are Part 3, Chapters 1.3.1, 1.3.2, 1.3.3, 1.3.4 and 1.3.5.)

3. **You are the Scheme Administrator for the Colourboxx Scheme. Prepare short notes outlining the circumstances under which the scheme would pay a 40% tax charge; the "Accounting for Tax" requirements and the consequences of submitting an event report late.**

20 marks

Your notes should cover:

40% tax charges

Deregistration charge – if the scheme were to be deregistered, HMRC would levy a charge at 40% of the scheme assets valued immediately before deregistration.

Scheme sanction charge – if an unauthorised payment is made to a member, the scheme will have to pay 40% tax on the payment. However, if the person receiving the unauthorised payment has paid their unauthorised payment tax charge to HMRC by the time HMRC sends the scheme sanction charge assessment to the scheme, the scheme's charge is reduced to 15%.

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Unauthorised payments charge – HMRC allows a scheme to withhold from an unauthorised payment the 40% tax payable by the person receiving it, provided that the recipient completes a mandate agreeing to this. In such a case, the scheme will need to pay the recipient's unauthorised payment charge direct to HMRC. By doing this the scheme ensures that the scheme sanction charge will be 15%.

'Accounting for Tax'

Quarterly return of income tax due to be paid must be sent to HMRC on an Accounting for Tax (AFT) return, with the actual tax payment due.

Quarters end on 31 March, 30 June, 30 September and 31 December.

Returns and any tax due must be submitted to HMRC within 45 days after the quarter end. Nil returns not required.

Penalties will apply for late returns.

Late submission of an event report

Explain when an event report is due, ie generally no later than the 31 January after the end of the tax year to which it relates, assuming it is an active scheme. Nil report is not required.

HMRC imposes a penalty on the Scheme Administrator of up to £300 if the event report is late or not submitted at all. If the delay continues, further penalties can be up to £60 a day.

(The relevant sections of the Study Manual are Part 3, Chapters 1.1, 1.4.2, 1.4.3 and 1.4.5.)

4. Outline the key responsibilities of trustees under trust law.

5 marks

The answer should include the principles of acting in line with the Trust Deed and Rules, to act prudently, responsibly and honestly, to act in the best interests of the beneficiaries, to act impartially.

(The relevant section of the Study Manual is Part 3 Chapter 2.1.1.)

5. Outline three changes introduced by the Pensions Act 1995 or the Pensions Act 2004 which have impacted on the way in which pension schemes are managed, explaining how you think each change has had a positive influence.

5 marks

The answer should include three items from Part 3 Chapter 2.1.2 with an explanation in each case as to how the legislative changes should have benefited pension schemes. For example, a requirement to have a certain number of trustees selected by the members will ensure member representation in trustee decisions and will reduce the risk that the interests of the employer dominate or inappropriately influence trustee decisions.

(The relevant section of the Study Manual is Part 3 Chapter 2.1.2.)

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6. Outline the stated objectives of the Pensions Regulator and three ways in which it seeks to influence the behaviour of trustees and employers, giving examples of each.

5 marks

The regulator's objectives are set out under Part 3 Chapter 2.3. The ways in which the regulator influences trustee behaviour could include the statutory powers as set out in this chapter, the threat of action which the regulator can take in certain circumstances (e.g. the issue of a contribution notice), Codes of Practice and guidance (examples given in Chapter 2.4.1) and the Trustee Toolkit.

(The relevant sections of the Study Manual are Part 3, Chapter 2.3 and Chapter 2.4.1.)

7. Explain the purpose of the Pensions Regulator's Codes of Practice and guidance and outline the key elements of the Code of Practice on Trustee Knowledge and Understanding.

5 marks

The answer should include the fact that the Codes of Practice and guidance documents are not statements of law, but a court or tribunal must take them into account when determining whether the underlying legal requirements have been met. The answer should also explain the two key elements of 'Knowledge and Understanding' and 'Conversance with scheme documents' in the Code of Practice on Trustee Knowledge and Understanding.

(The relevant section of the Study Manual is Part 3, Chapter 2.4.1.)

8. You have been contacted by the Chairman of Trustees of a small DB scheme who wishes to review the scheme's governance framework and make recommendations as to any areas where changes would be beneficial. As a first step in this process he has asked for a summary of the key areas which need looking at together with a note of what would constitute good practice in each case for a scheme of this type. Produce a draft response in letter format for issuing to the Chairman of Trustees.

20 marks

The answer should cover the following points:

- The provision of the information required in the format of a business letter
- Recognition that this is a small scheme and that the approach taken should be chosen accordingly whilst recognising that the appropriate legislative requirements must be complied with
- A detailed explanation of at least 5 of the items listed under Part 3 Chapter 2.5 including what you would view as good practice in each case

(The relevant section of the Study Manual is Part 3, Chapter 2.5.)