

## REPORT OF THE CHIEF FINANCIAL OFFICER

### FINANCIAL CONSEQUENCES OF TAX CHANGES

#### 1. Purpose of Report

This report provides information to Members on changes in taxation legislation that have a financial consequence for police officers in the force.

#### Recommendations

Members are asked to note this report.

#### 2. Background Information

One of the Government's objectives is a system of pension tax relief that is fair, affordable and sustainable. Reform of the pension tax regime is also an integral part of the Government's deficit reduction plans. The Government aims to implement the restriction on pension tax relief in a way that ensures that defined benefit pension schemes are treated fairly in relation to defined contribution pension schemes and personal pensions, and to introduce a new system in a way that minimises administrative burdens.

Legislation was therefore introduced in the Finance Bill 2011 to restrict pension tax relief for individuals by reducing the annual allowance from £255,000 to £50,000 and the lifetime allowance from £1.8 million to £1.5 million.

In addition, the Finance Act 2004 introduced an increase in the Minimum Pension Age from 50 to 55 years of age, effective from the 6th April 2010. The rights of members of the 1987 Police Pension Scheme to retire in certain circumstances before that age were protected and those members have a Protected Pension Age. However, that protection can be lost in certain circumstances, meaning that payments become unauthorised and taxable.

This report provides more information on each of these changes in legislation and the financial consequences on individuals. ***Please note that the examples included within this report are by way of illustration only and do not reflect the circumstances of any one individual.***

#### 3. Finance Act 2011 – Lifetime Allowance

The lifetime allowance is the maximum amount of pension and/or lump sum that an individual can get from their pension schemes that benefit from tax relief. There is no limit on the amount of benefits that a pension scheme can pay. However, if the pension scheme gives a benefit to an individual of more than their lifetime allowance they will pay an extra tax charge on the amount over the lifetime allowance. This tax charge is called the lifetime allowance charge.

The amount of the lifetime allowance was £1.8 million but the Bill introduced a decrease in the amount of the lifetime allowance from 6<sup>th</sup> April 2012 to £1.5 million. The current level of lifetime allowance means that it affects someone with a pension in the 1987 Police Pension Scheme of £75,000 or more.

Despite this reduction, most people will not be affected by the lifetime allowance charge as they do not have pension savings of more than £1.5 million. However, many Chief Constables will be affected by this change in legislation as illustrated in the example below:

Illustrative example 1.

The tax liability resulting from the decrease in the lifetime allowance on a Chief Constable retiring after 30 years service is **£128,656**.

#### **4. Finance Act 2011 – Annual Allowance**

The annual allowance is the maximum amount of pension savings an individual can have each year that benefits from tax relief. There is no limit on the amount an individual can save in a pension scheme, but there is a limit on the amount that can get tax relief each year. If a member's pension saving is more than the annual allowance they will pay a tax charge on the amount over the annual allowance. This tax charge is called the annual allowance charge.

From the 6th April 2011 the amount of the annual allowance is £50,000 a reduction from the previous limit of £255,000.

Illustrative example 2.

For a Deputy Chief Constable being promoted to a Chief Constable with 27 years' service, this results in a tax liability as follows:

- Annual Allowance tax liability £108,466
- Lifetime Allowance tax liability £128,656

Total tax liability **£237,082**

Illustrative example 3.

For an Assistant Chief Constable paid at spine point 5, being promoted to a Deputy Chief Constable with 24 years' service, this results in an annual allowance tax liability of **£31,751**.

Illustrative example 4.

For a Chief Superintendent being promoted to an Assistant Chief Constable with 21 years' service, this results in an annual allowance tax liability of **£44,185**.

#### **5. Finance Act 2004 – Protected Pension Age**

Since April 2010 the minimum retirement age for most employees has been 55 years of age (formerly 50 years of age). However, an exemption was granted for police officers through a mechanism called Protected Pension Age. In order to use the Protected Pension Age the officer must leave service and draw all their pension benefits. There are strict rules on re-employing individuals who have used a Protected Pension Age to draw benefits before the pension age of 55. All officers who have retired since the 6<sup>th</sup> April 2010 before reaching the age of 55 have done so using a Protected Pension Age.

Those officers who were under the age of 50 when they drew their pension benefits are exempt from this issue. This is a hangover from the old rules that allowed those under the age of 50 to retire before the previous minimum retirement age of 50. The only restrictions for the under 50s apply to connected persons. A connected person is a relative, partner or business partner to the sponsoring employer. Police Officers are not connected persons and are therefore free to be re-employed after any break.

Those officers who were between the ages of 50 and 54 (inclusive) when they drew their pension benefits are caught by this issue. They must have a break of

at least one month before being re-employed and in some cases this may be six months – however this is being confirmed with HMRC.

If a Protected Pension Age is lost, all pension payments up to the time the recipient reaches the age of 55 become Unauthorised Payments.

Unauthorised Payments attract taxes on both the member and the scheme as follows:

- The Scheme Sanction Charge will be 40% of the total of all unauthorised payments unless the scheme can show that all member charges have been met in which case it will be reduced to 15%. The scheme must pay these taxes.

A typical Charge for a Constable retiring aged 50, assuming all member charges have been met and that the Pension Commencement Lump Sum is caught by the loss of the Protected Pension Age is £24,000.

- The member charges are expected to be 40%, resulting in many members having to pay additional tax.

A typical member charge for the above example would be £64,000.

Where a Protected Pension Age is lost through re-employment it is not clear whether the Pension Commencement Lump Sum is caught by the loss of the Protected Pension Age. It may be that it is the subsequent re-employment that triggers the loss of the Protected Pension Age.

The above is subject to confirmation by HMRC but the force is working with the tax consultants to obtain clarity on this issue and therefore the above figures should not be taken as definitive.

## 6. Impact Consideration

Implication	Impact Considered (Yes/No)	Impact Identified (paragraph reference)
Legal	Yes	None
Financial	Yes	Main Report
Race and Equality	Yes	None
Human Rights	Yes	None
Environmental and Sustainability	Yes	None
Risk Analysis	Yes	None
National Park Implications	Yes	None

## 7. Appendices

None applicable

## 8. Background papers

Technical papers on HMRC website

## 9. Contact details

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