HMRC/ACA exchanges re: AA and deferred members

The exchange (concluding with a response from Trevor Smeath of HM Revenue & Customs, HMRC) relates to how Annual Allowance might be used (or not used) up by **deferred members who become such before 6 April 2006**, where they take up options or have accrual.

We hope Members will find the exchange useful as a reassuring steer on HMRC's views on two very common scheme exercises to the extent that they apply to such deferred members. I hope that at some stage HMRC will be able to issue something on the HMRC website but I do not know when this may be. In the meantime, ACA members who are carrying out exercises for clients touching on this might choose to write to HMRC to get direct reassurance for that client exercise, if they feel that to be appropriate.

The email exchange also notes HMRC's awareness of a broader issue for such members, which HMRC are considering.

Regards

Karen

Karen Goldschmidt
Chair, ACA Pension Taxation Committee

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From: trevor.smeath@hmrc.gsi.gov.uk [mailto:trevor.smeath@hmrc.gsi.gov.uk]
Sent: 01 February 2013 14:43
To: Karen Goldschmidt (LCP)
Subject: FW: AA & Pre 2006 leavers - loss of DMCO [Protective Marking: PROTECT]

Karen

Sorry for the delay in getting back to you.

The example below concerns an individual with pre-6 April 2006 deferred benefits and the exercising of 'PIE' or 'levelling' options in relation to those deferred benefits.

I assume a 'levelling' option is where the pension is paid at a higher rate until State Pension age and at a reduced rate thereafter.

The concern is that the exercise of such an option relation to a set of pre-6 April 2006 deferred benefits would be accrual. As a consequence the individual's pre-6 April 2006 deferred benefits would be subject to the annual allowance.

In both cases, I take it that there is intended to be a broad actuarial equivalence between the pre-option benefit and the post-option benefit. Put another way, the option involves cutting the existing 'pension cake' in different way rather than increasing the size of the 'pension cake'.

If so then I would not regard the exercise of the option as being accrual and so the pre-6 April 2006 deferred benefit would remain outside of the annual allowance provisions.

Whilst I hope this reply will cover the points raised as far as the particular retirement options are concerned I accept it does not cover the more general point about what happens if there is an accrual of further benefit. Clearly having a nil opening value for a set of 're-activated' pre-6 April 2006 deferred benefits could result in substantial pension input amounts when that opening value is then compared against a closing value that takes in both the pre-6 April 2006 deferred benefits and the post-6 April 2006 accrual.

Other than the obvious point that we are aware of the issue all I can say the moment is that the issue is being considered in terms how it might be dealt with.

Trevor

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From: Karen.Goldschmidt@lcp.uk.com [mailto:Karen.Goldschmidt@lcp.uk.com]
Sent: 17 December 2012 07:42
To: Truelove, Jane (Specialist PT Pensions); Cottis, Paul (Specialist PT Pensions); Prothero, Jon (Specialist PT)
Cc: 'Mike.Richardson@puntersouthall.com'
Subject: Re: AA & Pre 2006 leavers - loss of DMCO

I have thought of a solution to this specifically for the pension increase exchange option (but it won't work for all common options). This does show how tricky the whole area is, and that a full toolkit is needed to avoid unreasonable outcomes.

One would set up a new arrangement in the scheme for the individual's top up benefit. For the Pension Increase Exchange case, one would essentially be surrendering benefits (pension increases) in Arr A in exchange for benefits in Arr B (albeit that the AA is blind to the benefits in A that have been surrendered). The surrender won't cause accrual and / or a PIP to begin in any way. The PIA in total works as expected ie just reflects the top up. (This of course accepts the point that PIA is caused by an option that is expected to create no extra monetary benefit for the individual overall.)

From: Karen Goldschmidt (LCP)
Sent: Friday, December 14, 2012 05:13 PM
To: jane.truelove@hmrc.gsi.gov.uk <jane.truelove@hmrc.gsi.gov.uk>; Cottis, Paul (CAR Pensions) <paulcottis@hmrc.gsi.gov.uk>; jon.prothero@hmrc.gsi.gov.uk <jon.prothero@hmrc.gsi.gov.uk>
Cc: 'Mike Richardson' <Mike.Richardson@puntersouthall.com>
Subject: FW: AA & Pre 2006 leavers - loss of DMCO

Jane

I gather from Nick that you are aiming to give answers to our letters by Tuesday.

In relation to the question about split NPAs, we suggested a mechanism to aid Trustees on what would otherwise a difficult call, involving using an internal transfer between arrangements.

We have just spotted another issue where this mechanism may be the only solution to an unintended outcome. It relates to individual who became deferred pensioners of a scheme before 6 April 2006

(I note that "pension increase exchanges" are very much a current activity given recent Codes of Practice showing the best way for them to be done.)

Jon/Paul

I am copying you in because in our telecon earlier today we started thinking about knock-ons arising because DB DP transfers count as "accrual". I haven't had time to think it through, but the below feels as though it might be a relevant issue.

Karen

From: Karen.Goldschmidt@lcp.uk.com [mailto:Karen.Goldschmidt@lcp.uk.com]
Sent: 14 December 2012 14:17
To: Mike Richardson
Cc: Peter.Clarke@lcp.uk.com
Subject: RE: AA & Pre 2006 leavers - loss of DMCO

Potentially wider implications. What if on wind up a pre 2006 deferred get an uplift because there is surplus in the scheme. If this counts as accrual [and I admit that I don't really understand how AA works on wind up surpluses] so the member loses the carve out and this causes PIA, does the below mean that the PIA is not just for the top up but for the whole deferred pension?

This does make a stronger argument for internal transfer being an important mechanism, but until we hear from Jane – and indeed get lawyers to agree that "internal" is intended – I don't think this can be a mechanism to rely on solving problems

From: Mike Richardson [mailto:Mike.Richardson@puntersouthall.com]
Sent: 14 December 2012 14:16
To: Karen Goldschmidt (LCP)
Cc: Peter Clarke (LCP)
Subject: RE: AA & Pre 2006 leavers - loss of DMCO

Agreed.

Is the answer here, as is it to so many things, internal TVs between arrangements?

So member has 10K pa in arrangement A, where there is no PIP.

Transfers 10K pa into arrangement B, and then exercises a PIE and moves to 13K pa before retiring.

No PIA iro Arrangement A, as you haven't done anything in that arrangement to trigger a PIP.

For Arrangement B, raw opening and closing balances are nil and 16 x 13 = 208 respectively, as per Peter's email. But you can now use the closing balance adjustment in 236(5) to unwind the TVin, meaning that the adjusted closing balance is 3 x 16 = 48?

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From: Karen.Goldschmidt@lcp.uk.com [mailto:Karen.Goldschmidt@lcp.uk.com]
Sent: 14 December 2012 13:45
To: Mike Richardson
Cc: Peter.Clarke@lcp.uk.com
Subject: FW: AA & Pre 2006 leavers - loss of DMCO

I think Peter is right. The situation is just not envisaged.

From: Peter Clarke (LCP)
Sent: 14 December 2012 12:05
To: Karen Goldschmidt (LCP)
Subject: AA & Pre 2006 leavers - loss of DMCO

I'm obviously missing something but can't work out what (it's been a long week!).

A pre 2006 leaver (with just revaluation, ie no salary linkage or other special benefits) has no PIA because they don't have a PIP (no "accrual" post 2006)

They exercise an option (eg PIE, pension increase exchange or for a levelling option) that wasn't in the rules prior to 2006 and so is deemed to have accrual.

This accrual generates a PIP under s238 (which starts on the day rights are deemed to have accrued and ends on the next 5 April unless other nominated otherwise)

Having now got a PIP, a PIA will follow:

S234 states that the "opening value" is the 16 x the rate of pension (based on the valuation assumptions etc) at the end of the previous PIP "**or is nil if the pension input period is the first pension input period of the arrangement"**

Surely this can't be right. This would mean that the AA calc for a member with a pension of £10k pa at NRD who exercises a PIE and is granted a pension of £13k pa would be:

(16 x £13k) – [16 x (0 x 1+cpi)] = 208k!

What have I missed?

Regards
Peter

238 Pension input period
(1)**In the case of an arrangement under a registered pension scheme the following are pension input periods¾**
(a)**the period beginning with the relevant commencement date** and ending with ¾
(i)a nominated date falling before the anniversary of the relevant commencement date, or
(ii)if there is not such a nominated date, the first 5 April after the relevant commencement date (or, if the relevant commencement date is itself 5 April, that date), and

(b)each subsequent period beginning immediately after the end of a period which is a pension input period (under paragraph (a) or this paragraph) and ending with the appropriate date.

(2)**"The relevant commencement date" means¾**
(a)**in the case of a** cash balance arrangement or a **defined benefits arrangement**, or a hybrid arrangement the only benefits under which may be cash balance benefits or defined benefits, **the date on which rights under the arrangement begin to accrue** to or in respect of the individual,
(b)in the case of a money purchase arrangement other than a cash balance arrangement, the first date on which a contribution within section 233(1) is made, and
(c)in the case of a hybrid arrangement not within paragraph (a), whichever is the earlier of the date mentioned in that paragraph and the date mentioned in paragraph (b).

234 Defined benefits arrangements
(1)The pension input amount in respect of a defined benefits arrangement is the amount of any increase in the value of the individual's rights under the arrangement during the pension input period of the arrangement that ends in the tax year.

(2)There is an increase in the value of the individual's rights under the arrangement during the pension input period if-
(a)the opening value of the individual's rights under the arrangement, is exceeded by
(b)the closing value of the individual's rights under the arrangement.

(3)The amount of the increase in the value of the individual's rights under the arrangement during the pension input period is the amount of that excess.

(4)**The opening value of the individual's rights under the arrangement is**-
(**16 ´ PB**) + LSB
where-
PB is the annual rate of the pension which would, on the valuation assumptions (see section 277), be payable to the individual under the arrangement if the individual became entitled to payment of it **at the end of the immediately preceding pension input period (or is nil if the pension input period is the first pension input period of the arrangement**) , and