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Dear Andrew

Scheme Sanction Charge

You will be aware that the above subject has been mentioned at several FPC meetings since October last year and to date the Committee has not had any specific papers to consider

It appears that the issue may be coming to the fore as it has been brought to my attention that a fire and rescue authority has indicated that a Scheme Sanction Charge is payable in respect of commuted lump sums exceeding HMRC limits and that the charge would be recovered from the relevant scheme member.

Having undertaken some research, we have discovered that at least one other FRA intends to adopt this approach.

The matter seems to have had a higher profile within the police service where, from police authority papers available on the Internet, many forces have adopted the approach described above. However, despite Home Office guidance on the subject, there is still uncertainty as to liability for the charge and whether the powers exist to allow the charge to be recovered from individual members of the Police Pension Scheme.

Whilst the police guidance identifies the issues, it passes responsibility for interpretation to police authorities. We consider this to be unhelpful when one would think it possible for Government departments such as the Home Office and HMRC to agree the definitive position rather than create a requirement for authorities to duplicate effort many times over, risking inconsistency and misinterpretation.

The Appendix to this letter attempts to interpret Home Office and HMRC guidance and concludes that no scheme sanction charge should be payable, consequently, the question of who pays it (the administrator or the scheme member) should be irrelevant.

Whether or not the Department agrees with our conclusion, it is hoped that DCLG will be more helpful to fire rescue authorities and this communication seeks to highlight the issues to be considered.

If no other papers on the subject of Scheme Sanction Charge are available for the next FPC meeting the FOA would be happy for this letter and the Appendix to be tabled for discussion.

Yours sincerely

Glyn Morgan
Chief Executive

Scheme Sanction Charge: Appendix to FOA letter

Assume a firefighter retires with entitlement to a pension under FPSO 1992 – an HMRC registered pension scheme. It is within HMRC “Lifetime Allowance” limits

He elects, under Rule B7, to commute the maximum portion of pension (25%) to a lump sum. This would be permitted under Rule B7 and would be within the “available portion” limits permitted by HMRC but, because the relevant GAD factor exceeds 20, it would be greater than the “applicable amount” permitted as a pension commencement lump sum by the Finance Act 2004. Rather than reducing the amount commuted so that the lump sum would be within HMRC limits, he insists that he wishes to commute the full 25%. This makes the portion of lump sum which is in excess of the permitted authorised amount an “unauthorised member payment” as defined by Finance Act 2004 s160(2)(a), i.e. “a payment by a registered pension scheme to or in respect of a person who is or has been a member of the pension scheme which is not authorised by section 164 (“authorised member payments”)”.

Certain excess payments are covered in the Registered Pension Schemes (Authorised Payments) Regulations 2009 [SI 2009/1171] but this does not appear to be one of them. Consequently, as an unauthorised payment, it would attract an “unauthorised payments charge” (s208 of the Finance Act 2004) payable by the scheme member. If the payment is more than 25% of the member’s fund value, an “unauthorised payments surcharge” (s209 of the Finance Act 2004) would also be payable by the member. The unauthorised payments charge is 40% and the unauthorised payments charge is an additional 15%. A total of 55% would be payable by the member to HMRC, normally through self-assessment.

The unauthorised payment would also attract a “scheme sanction charge” under s239 of Finance Act 2004. The person liable to the scheme sanction charge is the scheme administrator, i.e. in this case the FRA. The scheme sanction charge is 40% of the chargeable payment, but, if the scheme member has paid to HMRC the unauthorised payments charge and any unauthorised payments surcharge which are due, the scheme sanction charge is reduced to 15%. Because the scheme administrator would not necessarily know whether or not the scheme member had paid over to HMRC the charge and surcharge, HMRC said that with effect from 6 April 2010 they would allow the administrator to get the member to sign a mandate, giving the administrator the authority to withhold the charge and surcharge from the lump sum upon payment. The administrator would then pay the member’s charge and any surcharge directly to HMRC on behalf of the member. In the knowledge that the scheme member had made the necessary payment in this way, the administrator would be able to reduce the scheme sanction charge – for which the administrator is liable – to 15%. However, there is nothing in the HMRC April 2010 guidance which suggests that the administrator can require the member to pay this, too, either directly or by agreeing to it being withheld from the payment. Nor does there seem to be anything in FA 2004, SIs made under the Act, nor the HMRC Registered Pension Schemes Manual which permits the transfer of responsibility for the scheme sanction charge from the administrator to the member.

Rule B11 of FPSO 1992, amended with effect from 6 April 2006 when the new tax regime commenced, says “A fire and rescue authority shall deduct from any payment which is chargeable to tax, or subject to a lifetime allowance charge within the meaning of the Finance Act 2004, the amount of tax charged or the amount of charge to be recovered.” While this would appear to be in order for the deduction of the unauthorised payments charge and surcharge payable by the member if the member has given a mandate to this effect, it would surely be out of order to extend this power to deduction of the scheme sanction charge when s239 of the Finance Act 2004 clearly states that the person liable to the scheme sanction charge is the scheme administrator. The intent of B11 is surely to permit the FRA to deduct tax due from a member’s benefits where the tax is payable by the member or deductible from benefits under HMRC pension rules.

Looking at the Home Office guidance issued in 2011: -

In the second paragraph it mentions that HMRC view the police pension schemes as split schemes with each administering police authority being the scheme administrator. The same view would apply to the fire pension schemes.

Point 1 of the guidance refers to s241(2)(d) of the Finance Act 2004 and says that the Home Office believes that this applies in the case of the commuted lump sums in question. It says that s241(2) deals with the circumstances in which an unauthorised payment is not scheme chargeable, i.e. the scheme sanction charge is not payable. “Paragraph (d) appears to provide an exemption if a decision not to make a payment to a scheme member would NOT be supported by the courts.”

The actual wording of s241(2) is “An unauthorised payment is exempt from being scheme chargeable if – (d) it is made on the ground that a court or any such person or body is likely to order the making of the payment (or would be were it asked to do so).”

Point 1 of the Home Office guidance goes on to say that Regulation B7(7) of the Police Pensions Regulations 1997 does not give a police authority discretion as to whether or not it pays a lump sum, or as to the amount. Consequently if the police authority failed to comply with the regulation, the Home Office believes that the officer concerned would “have an unanswerable claim for judicial review (assuming the conditions of eligibility for the lump sum under the Regulations were made out)”.

This could read across to the FPSO 1992. Rule B7 permits commutation, and B7(9) is the approximate equal to Police Pensions Regulation B7(7). Rule B7(9) says that when a person’s notice of commutation takes effect, the FRA shall – within three months of the date of retirement – pay him the lump sum. There is currently nothing in the FPSO 1992 which prevents payment of the lump sum if a portion is an unauthorised payment. (If proposed amendments to the FPSO proceed as drafted then references to a “lump sum” in B7(2) would be amended to a reference to a “pension commencement lump sum” and that would restrict the payment to an authorised amount; this question of the scheme sanction charge and who pays it would cease to be an issue.)

Under Rule H3 of the FPSO 1992, if a person “claims that he is entitled to an award or to any payment in respect of an award” and the FRA refuse it in part or in whole they must reconsider the case at his request. If dissatisfied with the FRA’s determination on reconsideration, he may appeal to Crown Court.

If any such claims have been made in respect of failure to pay an unauthorised amount of lump sum by commutation, they have not been publicised. (This does not mean that none have been made nor are pending.) So it is a matter of guesswork as to whether or not the Court would require payment of the full lump sum. It seems possible, though, that this could be the case. This means that the Home Office guidance perhaps indicates that no scheme sanction charge would be payable in respect of the unauthorised amount of the lump sum. The Home Office say that they cannot identify anything in the Finance Act 2004 which would prevent this interpretation of s241(2)(d) in relation to a Police Pension commutation. So, presumably, there would be nothing to prevent the same interpretation in respect of a FPSO 1992 commutation.

If then, no scheme sanction charge is due, the question of who pays it – the scheme or the firefighter – is not relevant.

The Home Office guidance adds a further three points regarding scheme sanction charges.

In Point 2 they say that HMRC have confirmed that the scheme sanction charge only applies in respect of benefits built up since 6 April 2006. “We understand they have been in contact with some administrators about how this should be apportioned.” If, as appears from Point 1 of their guidance, a scheme sanction charge is not due for the unauthorised element of lump sum, this is irrelevant to the point in hand. (Although it could be relevant should some other form of unauthorised payment be made.)

In Point 3 they say that the Police Pensions Regulations do not specify whether a scheme sanction charge can be passed on to the member. As explained above there is nothing specific in the FPSO 1992 either. They say “We understand that HMRC’s view is that there is no requirement in tax law for a specific provision in the scheme to enable this.” There probably isn’t, but surely its absence from tax law does not mean that a scheme can do it without a specific scheme provision.

In Point 4 they say that HMRC has confirmed that it believes the payment of excessive lump sums in this situation would be very unlikely to result in the de-registration of the pension scheme. Presumably the point of scheme sanction charges is to deter scheme administrators from making unauthorised payments. But in the face of persistent disregard to their rules, HMRC can remove a scheme’s registration. Their comment suggests that HMRC understand the reason why police and fire pension scheme administrators feel they are being penalised for rule-breaking which is beyond their control. But no doubt they would approve of the scheme rules being amended to prevent the situation arising. The sooner the proposed amendment to define the FPSO Rule B7 lump sum as a pension commencement lump sum can be introduced, the better.

Conclusion

If this interpretation of the Home Office/HMRC guidance is correct, no scheme sanction charge is payable and so the question of who pays it – the administrator or the scheme member – should not arise.