



Firefighters' Pension Scheme Circular

Circular Number:	FPSC 3/2006	Date Issued:	10/2/2006
Action:	Fire and Rescue Authorities to take urgent action.		
Title:	<i>New Tax Rules on Commutation</i>		
Issued by:	Martin Hill, Firefighters' Pension Team, Local Government and Firefighters' Pensions Division		
Summary:	This circular provides important instructions on Commutation rules (B7(7)) following receipt of new guidance from HM Revenue and Customs.		

Addressed to:	Please Forward to:
The Chief Executive of the County Council The Clerk to the Fire and Rescue Authority The Commissioner of the London Fire and Emergency Planning Authority The Chief Fire Officer	Pension and Human Resources managers Active members of the FPS

REMINDER

Please note:

Medical appeal papers should be addressed to:

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COMMUTATION OF PENSION IN RETIREMENT FOR LUMP SUMS

A number of public service schemes including the Firefighters' Pension Scheme (Rule B7(7)), have rules or practice allowing members up to six months after retirement to decide whether to commute part of their pension to provide a lump sum. Under the current tax legislation, such lump sums may be paid tax free. We have been advised by HM Revenue and Customs (HMRC) that, under the simplified tax regime for registered pension schemes, to avoid a tax charge, decisions to commute must be made before a pension comes in to payment. We are making the necessary amendment to Rule B7 (See FPS Circular 1/2006, Appendix B, Para 1.2).

Background

From 6 April the only lump sum that may be paid in connection with the member becoming entitled to a scheme pension is a pension commencement lump sum (PCLS) – Finance Act 2004 (FA04), s.166(1)(a) refers.

To be a PCLS, a lump sum must satisfy the conditions set out in paragraph 1(1) of Schedule 28 to FA04.

One condition is that the member must become entitled to the lump sum in connection with becoming entitled to a relevant pension (which includes a scheme pension).

S.166(2)(a) provides that a person becomes entitled to a PCLS immediately before becoming entitled to the pension in connection with which it is paid. And a person becomes entitled to a pension when the person first acquires an actual right to receive the pension (s.166(3)(b)).

HMRC interpretation is that commutation of a pension to provide a PCLS must be done at the time of entitlement to a pension first arises.

The scheme then has a period of 3 months in which to pay the lump sum derived by the commutation of pension if it is to be a PCLS. The 3 month rule is intended to cater for possible administrative delays in paying a lump sum, not to permit commutation after retirement.

Accordingly, a lump sum paid by commutation of a pension already in payment cannot be a PCLS. It would become an unauthorised payment and the tax charges for unauthorised payments would apply as appropriate.

In addition, the scheme pension payable at 6 April 2006 would be reduced following commutation. This reduction would fall foul of paragraph 2(3)(b) of Schedule 28 which provides that a reduced pension ceases to be a scheme pension. Since the reduction would not fall within any of the excluded categories set out at sub-paragraph (4), the unauthorised payment tax charges would also apply in respect of the reduced pension.

HMRC do not consider that there is a case for transitionally protecting the option to commute in retirement. Their view is that such an option has never been allowed under HMRC's requirements for discretionary approval where lump sum benefits must normally be paid only once and at the time of retirement - it is a relic of the era when statutory schemes did not have to meet any HMRC requirements or conditions to qualify for tax reliefs.

HMRC has considered whether a degree of protection (for commutation by pre-A Day pensioners before 6 July 2006) is afforded by paragraph 2 of the Pipeline Lump Sums draft regulations (which are available on the HMRC website at www.hmrc.gov.uk/pensionschemes/draftregs.htm). Their view is that where a valid notice to

commute part of the member's pension is received before 6 April 2006, an entitlement arises to a lump sum at that time, so paragraph 2 will apply. Provided the lump sum is paid before 6 July 2006, the lump sum will be a PCLS and the resulting reduction in the scheme pension will not fall foul of paragraph 2(3)(b) of Schedule 28 as the member will only have been entitled to the reduced pension at 6 April 2006.

But where the notice is not received until on or after 6 April 2006, the lump sum will fall outside the lump sum payments covered by the regulations because it is not a lump sum to which the member became entitled before 6 April 2006 as required by paragraph 2(1)(c). This is because the member is entitled to all their benefits in pension form at 5 April 2006. And the reduced pension will also be an unauthorised payment.

Therefore, scheme members who retire before 6 April 2006 and have not already given notice of commutation, will need to give notice before 6 April to avoid giving rise to unauthorised payments and consequent tax charges.

Action required by Fire and Rescue Authorities

HMRC's advice means that FPS administrators will need:

(a) to contact urgently former active and deferred members who started taking a pension after 5 October 2005 but who didn't decide to take any lump sum at that time (if there are any in this category), to warn them that if they are planning to commute pension they need to give formal notice by 5 April 2006;

(b) to ensure that any active or deferred members taking a pension between now and 6 April 2006 are warned that they have only until 5 April 2006 to give formal notice of their commutation decision if they wish to avoid tax charges as explained above;

(c) to tell active and deferred members in general that from 6 April 2006 decisions to commute pension to lump sum have to be taken at the time a pension is first awarded;

(e) to amend any scheme literature as soon as possible to minimise the risk of members being misled and maladministration claims.

ODPM will arrange for the Commentary on the web site to be amended accordingly.

M J Hill