Transfer Club and Annual Allowance – August 2016

An HMRC Order entitled "The Finance Act 2004 (Registered Pension Schemes and Annual Allowance Charge) (Amendment) Order 2015" came into effect on **28th January 2015**. The Order can be found at http://www.legislation.gov.uk/uksi/2015/80/contents/made.

The Transfer Club is unique as an arrangement because the transfer value paid between the schemes does not fully reflect the value of benefits being transferred and members maintain salary and/or in-service revaluation links with the transfer. These features mean that further guidance is required to interpret the Order for years where the member takes a Club Transfer.

This guidance supersedes the previous guidance, labelled Version 1.0 and dated February 2015.

The approach agreed with HMRC is that the changes in the member benefits, as a result of a Club Transfer, should be ignored when calculating the pension input amounts. However, where the member's accrued pension has increased in real terms as a result of a salary increase or any in-service revaluation (for the CARE schemes) this should be included in the pension input amounts. Therefore the member should be in a similar position to a member who had remained in (or returned to) the same scheme throughout the year.

This document sets out a suggested methodology to ensure appropriate pension input amounts are calculated and consistency is maintained between the Club schemes. The examples are fairly complex and have been designed to cover the majority of scenarios likely to occur in practice. However, further scenarios may arise and the general process and principles should be followed if not set out explicitly in this note. The general approach to determine the pension input amounts is in four parts:

1. Calculating the pension input amount for the transferring scheme up to the point of transfer
2. Create a notional opening balance for the receiving scheme to remove the impact of the re-shaping of benefits from the Club Transfer
3. Calculating the pension input amount for the receiving scheme from the point of transfer
4. Member needs to add the relevant pension input amounts from each scheme together to test against the annual allowance

Scheme managers should ensure their pension administrators are given this information, and may also wish to send it to the scheme actuary and other interested parties.

The examples in this note are designed to assist scheme administrators in calculating pension input amounts (PIAs) for a pension input period (PIP) and the terminology and approach in the note is also designed to be consistent with (and assumes familiarity with) HMRC's Pensions Tax Manual[1] and the Public Sector Transfer Club memorandum[2]. The examples cover both transfers of final salary benefits and career average benefits (for Inner Club Transfers) and are expected to be calculated in the current timeframes for Annual Allowance (AA) calculations (i.e. at the end of the tax year in which the transfer takes place). Consumer Prices Index (CPI) is assumed to be 2% p.a. for all of the examples.

As is currently the case, each scheme administrator will only calculate the PIA that relates to their own schemes. The total PIA for the year has been shown in the examples below for illustrative

[1] https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual
[2] http://www.civilservicepensionscheme.org.uk/media/95419/club-memorandum-december-2015.pdf

purposes and would be for the member to collate and consider in relation to the AA and possible tax charge.

As highlighted by the examples below, the transfer value for a Club transfer does not directly feature in the calculation of the adjustment to the PIA. This is because the benefits received in the receiving scheme are not designed to be equivalent in value to the transfer value.

Final Salary schemes

When an individual takes a Club Transfer their years of service may be actuarially adjusted to reflect differences between schemes. This adjustment is not an enhancement, hence the policy intent is to remove the impact of the adjustment from the pension input.

Separate to any actuarial adjustment, members will benefit from any salary increase between their employments. This increases the value of their pension, and the policy intent is that the value of this increase should result in a pension input, as it would do for individuals experiencing an increase in final pensionable salary without changing schemes.

Example 1

Example transfer from Employer A, where the member is in Scheme A, to Employer B, where the member will be in Scheme B.

Member details	**At transfer**
Age	40
Gender	Male
Final salary service	10.5 years
Pensionable pay:	
Employer A[3]	£30,000 p.a.
Employer B[4]	£40,000 p.a.

Scheme details	**Scheme A**	**Scheme B**
Scheme structure	Final Salary	Final Salary
Accrual rate	1/80	1/60
Automatic lump sum	3/80	None
Spouses proportion	50%	37.5%
Normal pension age	60	65
Deferred revaluation	CPI	CPI

We are also assuming that the Club transfer takes place half way through the PIP and that there is no gap between the member leaving Scheme A and joining Scheme B.

The opening balance for Scheme A[5] = 30,000 x 10 x 1/80 x 1.02 x 16 + 30,000 x 10 x 3/80 x 1.02 = £72,675.00

Accrued pension at the transfer date = 30,000 x 10.5 x 1/80 = £3,937.50

Accrued lump sum at the transfer date = 30,000 x 10.5 x 3/80 = £11,812.50

The closing balance of Scheme A would be zero but needs adjusting due to the transfer gives 3,937.50 x 16 + 11,812.50 = £74,812.50

So the PIA for scheme A = 74,812.50 – 72,675.00 = **£2,137.50**

[3] Pensionable pay is assumed to be unchanged from the start of the PIP to the transfer date.
[4] Pensionable pay is assumed to be unchanged from after the transfer to the end of the PIP.
[5] In all examples the 'opening balance' is defined as calculation is accrued pension at the start of the year (pensionable salary x pensionable service x accrual rate – for final salary schemes) increased in line with CPI over the year and multiplied by the annual allowance factor plus the accrued lump sum increased in line with CPI over the year.

The Club service credit[6] in Scheme B = (3,937.50 x 10.74 + 11,812.50 x 0.57 + 3,937.50 x 0.5 x 2.48) / (30,000 x 1/60 x 8.24 + 30,000 x 1/60 x 0.375 x 2.48) = 11.76 years (11 years 276 days). So an increase by 1.26 years (1 years 94 days)

The notional opening balance for Scheme B is zero but adjusting it due to the transfer gives[7] 30,000 x 11.76 x 1/60 x 16 = £94,080.00

The closing balance for Scheme B = 40,000 x (11.76 + 0.5) x 1/60 x 16 = £130,773.33

The PIA for scheme B = 130,773.33 – 94,080.00 = **£36,693.33**

The total PIA for the individual across both schemes for the PIP = 36,693.33 + 2,137.50 = £38,830.83

Example 2

This example is identical to example 1 except that there is a 3 year gap between leaving Scheme A and joining Scheme B (the member left at age 37 so is still age 40 at the transfer date). Also the PIP in this example is for the year of transfer into Scheme B (rather than any previous years).

As the member is a deferred pensioner there is no further accrual of benefits or links to salary growth and so there is no PIA for Scheme A.

Notional deferred salary at the transfer date[8] = 30,000 x 1.01 x 1.02 x 1.02 = 31,524.12

The Club service credit in Scheme B[9] = 11.76 years (the same as example 1)

The notional opening balance for Scheme B is zero but adjusting it due to the transfer gives 31,524.12 x 11.76 x 1/60 x 16 = £98,859.64

The closing balance for Scheme B = 40,000 x (11.76 + 0.5) x 1/60 x 16 = £130,773.33

The PIA for scheme B = 130,773.33 – 98,859.64 = **£31,913.69**

Career Average Schemes (LGPS 2014 scheme and other post 2015 schemes)

The Club CARE transferred-in pension is essentially the accrued pension from the sending scheme, adjusted as necessary to reflect any differences in the basic benefit structure between the two schemes (e.g. if the spouse/partner's pension proportion is different in the receiving scheme, this will affect the transferred-in pension).

For members taking a Club Transfer of career average benefits, the annual value of the benefit transferred (after any adjustment) will be ring-fenced within the receiving scheme and receive revaluation equal to what would have been received in the previous scheme for as long as the member remains active (but in all other regards the pension is under the rules of the new scheme, not the previous scheme).

[6] Using factors and methodology from PSTC 5 version of the Club memorandum

[7] The adjustment is based on the scheme benefits the member would have received if they had the same salary as before the transfer

[8] Includes revaluation from the date of leaving until the previous April (1.01 x 1.02 x 1.02) and assumes the pensionable salary at date of leaving equalled the final pensionable salary

[9] The service credit calculation would be based on the accrued pension at the guarantee date, which would be different from example 1 but will result in the same service credit

A member's annual pension may be actuarially adjusted to reflect differences between schemes. This adjustment is not an enhancement and hence the policy intent is to remove the impact of the adjustment from the pension input.

Unlike with final salary schemes, member's accrued pensions are not linked to any salary increase between their employments. However, the member does receive in-service revaluation whilst they remain in service and members may therefore benefit from enhanced revaluation being applied on re-employment to cover the period of the break in employment. This type of increase should be recorded as a pension input.

Example 3

Example transfer from Employer A where the member is in Scheme A to Employer B where the member will be in Scheme B.

Member details	
Age	40
Gender	Male
Accrued pension:	
Start of year[10]	£5,000 p.a.
In year to transfer	£250 p.a.
State Pension Age	67

Scheme details	**Scheme A**	**Scheme B**
Scheme structure	CARE	CARE
In-service revaluation	CPI + 1.5%	CPI
Automatic lump sum	None	None
Spouses proportion	37.5%	37.5%
Normal pension age	65	SPA
Deferred revaluation	CPI	CPI

We are assuming that the Club transfer takes place half way through the PIP, that the member accrues £300 of pension in scheme B, and that there is no gap between the member leaving Scheme A and joining Scheme B

So the opening balance for Scheme A = 5,000 x 1.02 x 16 = £81,600.00

Accrued pension at the transfer date = 5,000 + 250 = £5,250.00

The closing balance of Scheme A would be zero but needs adjusting due to the transfer gives 5,250.00 x 16 = £84,000.00

So the PIA for scheme A = 84,000.00 – 81,600.00 = **£2,400.00**

The Club accrued pension in Scheme B = 5,250.00 x (8.24 + 0.375 x 2.48) / (7.35 + 0.375 x 2.48) = £5,814.31

The notional opening balance for Scheme B is zero but adjusting it due to the transfer gives 5,814.31 x 16 = £93,028.96

The closing balance for Scheme B[11] = (5,814.31 x 1.035 + 300 x 1.02) x 16 = £101,180.97

The PIA for scheme B = 101,180.97 – 93,028.96 = **£8,152.01**

The total PIA for the individual across both schemes for the PIP = 8,152.01 + 2,400.00 = **£10,552.01**

[10] Includes the in-service revaluation awarded at 1 April as PIP assumed to be from 6 April
[11] Includes in-service revaluation for both the transferred pension pot (1.035) and service in the new scheme (1.02) on 1 April (which is before the end of the PIP)

Example 4

This example is identical to example 3 except that there is a 3 year gap between leaving Scheme A and joining Scheme B (the member left at age 37 so is still age 40 at the transfer date). Also the PIP in this example is for the year of transfer into Scheme B (rather than any previous years).

As the member is a deferred pensioner there is no further accrual of benefits or links to in-service revaluation and so there is no PIA for Scheme A.

Accrued pension at date of leaving[12] = 5,000 + 250 = £5,250.00

So the accrued pension at the transfer date is[13] = 5,250 x 1.0175 x 1.01 x 1.02 x 1.02 = £5,613.26

The accrued pension on re-joining Scheme A would be[14] = 5,250 x 1.035 x 1.035 x 1.035 = £5,820.77

The Club accrued pension in Scheme B = 5,820.77 x (8.24 + 0.375 x 2.48) / (7.35 + 0.375 x 2.48) = £6,446.43 (increase in pension by 10.75%)

The notional opening balance for Scheme B is zero but adjusting it due to the transfer gives[15] 5,613.26 x (8.24 + 0.375 x 2.48) / (7.35 + 0.375 x 2.48) x 16 = £99,465.88

The closing balance for Scheme B = (6,446.43 x 1.035 + 300 x 1.02) x 16 = £111,648.88

The PIA for scheme B = 111,648.88 – 99,465.88 = **£12,183.00**

Other considerations

Schemes with currently different PIP

The approach adopted should be consistent with CETV transfers, which I understand would be to determine the PIA for Scheme A based on the Scheme A's PIP and the PIA for Scheme B based on the Scheme B's PIP. The PIAs in the same tax years are then summed together by the member to test against the AA in each tax year. This is consistent with the examples above.

Guarantee date and date transfer received in different PIPs

It is possible that the guarantee date as set by the Club memorandum and the date the transfer is actually received by the receiving scheme fall into different PIPs. For the avoidance of doubt the same approach should be adopted as for CETV transfers, which is generally that the date the transfer is received determines the PIA and PIP. Therefore the calculations produced for the Club transfer (which are based on data as at the guaranteed date) may differ from the calculations set out in this note (which are based on data as at the transfer date).

Transitional rules for tax year 2015-16

[12] This does not including the half year in-service revaluation from previous April until the date of leaving

[13] Includes the half year in-service revaluation (1.0175) and deferred revaluation until the transfer date (1.01 x 1.02 x 1.02)

[14] Includes 3 years of in-service revaluation (1.035 x 1.035 x 1.035)

[15] The notional balance is based on the accrued pension at the transfer date adjusted for the percentage increase in the pension as a result of the Club adjustment [(8.24 + 0.375 x 2.48) / (7.35 + 0.375 x 2.48)]

From 6 April 2016 the PIPs used in all pension schemes must be aligned with the tax year. As a consequence, HMRC guidance sets out transitional arrangements in place during the 2015-16 to achieve this alignment. These transitional arrangements involve splitting the 2015-16 tax year into two mini-PIPs, and replacing the measure of CPI used in Annual Allowance calculations with 2.5%. The transitional changes will not affect the fundamental principles in calculating the adjustment due to a Club transfer as set out in the examples.

GMPs

In principle the transfer of GMPs should not impact on the calculation of PIAs. No additional adjustments should be required as GMPs are not considered when determining accrued pensions for AA purposes.

Pension debits and other benefit adjustments

Adjustments are sometimes made to Club transfers to allow for the impact of pension debits and other benefit adjustments. The approach adopted in these cases should be consistent with the principles underlying the examples above, however, the scheme may wish to discuss with HMRC if further guidance is required.

Aggregation/Linkage

Aggregation or linkage of pensions is primarily where a member with deferred benefits in a scheme brings those deferred benefits into their active record. Such cases should be straightforward in determining the PIA so are not covered in this guidance. However, there may be circumstances for certain schemes where an aggregation or linkage occurs where the benefits are reshaped (e.g. a change to NPA, accrual rate, etc). These aggregations are not the same as a Club transfer, however, it may be reasonable to apply the Club methodology to calculate the PIA for a PIP containing such an aggregation of benefits. Whether it is appropriate to use the Club methodology for specific aggregation cases should be decided by the scheme who may wish to discuss this with HMRC.

Example 5

Scheme and member data:

A member of a CARE pension scheme (which also can provide a service link to final salary benefits within the same tax arrangement) with NPA 65 and in-service revaluation of CPI (Scheme section A) links a deferred final salary (Scheme section B) pension benefits (NPA 60, 80th accrual rate of pension and 3 times pension lump sum) half way through the PIP. On aggregation the linked final salary benefits become; NPA 65, 60th accrual rate and no lump sum (within Scheme section A). Their current salary is £40,000 (both at the point of transfer and at the end of the PIP).

Accrued Scheme section A pension at start of PIP[16] = £2,000

Accrued Scheme section A pension over the PIP = £1,000

Accrued Scheme section B deferred pension at the transfer date = £5,000 (based on reckonable service of 16 years and hence a deferred salary of £25,000)

Linked service = 18 years (to allow for the change in benefit structure increased from 16 years)

Calculations:

[16] Includes the in-service revaluation awarded at 1 April as PIP assumed to be from 6 April

As the member is a deferred pensioner there is no further accrual of benefits or links to in-service revaluation and so there is no PIA for Scheme section B.

So the opening balance for Scheme section A would be = 2,000 x 1.02 x 16 = £32,640.00 but notionally adjusting it due to the transfer to add 25,000 x 18 x 1/60 x 16 = £120,000.00. So the revised balance for Scheme section A would be = 32,640.00 + 120,000.00 = £152,640.00

The accrued final salary pension on joining Scheme section A would be = 40,000 x 18 x 1/60 = £12,000.00

The closing balance for Scheme section A[17] = [(2,000 + 1,000) x 1.02 + 12,000] x 16 = £240,960.00

So the PIA for scheme section A = 240,960.00 – 152,640.00 = **£88,320.00**

[17] The CARE benefits increase in line with the in-service revaluation (1.02) and the accrued final salary pension at the end of the PIP is the same as the point of transfer as the salary is assumed not to change over the remainder of the year