

Age discrimination remedy – Unauthorised Payments

Contents

Introduction	2
What is the difference between an authorised and an unauthorised payment?	2
What is a Pension Commencement Lump Sum (PCLS)?	2
What is the permitted maximum?	3
Unauthorised payment charges	3
What is a Protected Pension Age?	4
What is commutation?.....	4
How is commutation affected by an unauthorised payment?	5
How does the age discrimination remedy affect unauthorised payments?	8

Introduction

If an individual was a member of the Firefighters' Pension Scheme 1992 (FPS 1992), upon retirement their choice of lump sum could mean that there is additional tax due in the form of an unauthorised payment charge. This document provides an explanation of what an unauthorised payment is and how one may occur.

The document also explains for members affected by the age discrimination remedy why they might have a new unauthorised payment and what that means to them.

What is the difference between an authorised and an unauthorised payment?

The tax rules split all payments made to members into either "authorised" or "unauthorised".

Authorised payments made to a member can include pensions, lump sums, death benefits and Scheme Administrator Member Payments (SAMPs). The tax rules set out the conditions for a payment to be authorised.

In some cases where a payment does not fall within these rules, it becomes an unauthorised payment and triggers tax charges.

The most common unauthorised payments within FPS 1992 to occur are:

Where a lump sum payment is made which is more than the HMRC permitted maximum.

- The amount above the permitted maximum cannot be paid as a Pension Commencement Lump Sum (PCLS) and will therefore, in HMRC terms, be treated as an unauthorised payment.

Where a member has membership of the FPS 1992 and retires before age 55 and with less than a one-month break, returns or continues to work with a fire authority or sponsoring employer.

- All pension payments, including the lump sum, are deemed to be unauthorised

A tax charge is different to a payment being taxed for income tax, so a payment can be exempt from income tax but still incur unauthorised tax charges.

What is a Pension Commencement Lump Sum (PCLS)?

The Firefighters' Pension Scheme (FPS) allows members to receive a tax-free lump sum payment when they retire, this is called a Pension Commencement Lump Sum (PCLS). To be a PCLS, the lump sum must meet all the payment conditions and one of these conditions limits the amount of the lump sum. This limit is known as the permitted maximum (also called HMRC maximum lump sum). Anything paid above the permitted maximum limit is not a PCLS.

What is the permitted maximum?

The permitted maximum is the amount of tax-free cash lump sum that you can receive, and it is the **lower** of: -

- a) 25% of the capital value of the benefits coming into payment, or
- b) The maximum Lump Sum Allowance (LSA), which for the 2024/25 tax year is set at £268,275.

How to calculate the capital value of benefits

To calculate the capital value of benefits, there is a formula that can be used which is:

$$(20 \times \text{annual pension}) \text{ plus lump sum} = \text{capital value}$$

The annual pension is the amount after taking account of any reductions, increases and after any commutation.

$$25\% \text{ of capital value} = \text{permitted maximum}$$

Where the permitted maximum is greater than the LSA, the LSA will be your permitted maximum.

Unauthorised payment charges

In the FPS, there are three types of charges that can become due when a payment is deemed to be unauthorised. The charge is made on the difference between the authorised payment and unauthorised payment.

In relation to FPS 1992 the unauthorised payment charges are summarised as follows: -

Unauthorised Payment Charge

- Levied on member
- Flat rate of 40%
- Common charge

Scheme Sanction Charge

- Levied on Fire Authority
- Flat rate of 15%
- Common charge

Unauthorised Payment Surcharge

- Levied on member
- Flat rate of 15%
- Less common charge

Scheme Sanction Charge

As the FPS 1992 rules **do not** allow for the Scheme Sanction Charge to be charged to the member, it is a charge payable by the Fire Authority.

Unauthorised payments surcharge

The third type of unauthorised payment charge is an Unauthorised Payment Surcharge and will apply in addition to an unauthorised payment charge where a member has membership of the FPS 1992 and retires before age 55 and with less than a one-month break, returns to work with a fire authority or sponsoring employer¹ and, as a result, loses their protected pension age.

The surcharge does not apply if the member is over age 55 at date of retirement, or if there is a break of at least one month or more before returning to employment and scheme rules provide that benefits may be abated.

Where these circumstances do apply, then all pension payments, including the lump sum, are deemed to be unauthorised.

What is a Protected Pension Age?

Members taking a pension and/ or lump sum benefit before normal minimum pension age are liable for a tax charge unless they retire on the grounds of ill health. From 6 April 2010, the normal minimum pension age was increased from age 50 to age 55.

However, individuals paying into a scheme that allowed members to take their benefits without consent before the age of 55 were entitled to keep their earlier normal minimum pension age, providing that they were a member of that scheme on 5 April 2006. This is known as the member's Protected Pension Age (PPA)². More information is available in the [Protected Pension Age](#) factsheet.

FPS 1992 has a protected pension age of 50 with at least 25 years' service, therefore benefits can be paid from age 50 without additional tax charges. There is no requirement for a member to register this protection with HMRC, it applies automatically.

What is commutation?

Commutation is the action of giving up part of a member's annual pension in exchange for a lump sum.

The amount given up is then multiplied by the relevant commutation factor. Commutation factors for FPS 1992 and FPS 2006 are provided by the Government Actuary Department (GAD).

Each FPS scheme provides for different commutation factors.

- The [FPS 2015](#) and [FPS 2006](#) has a fixed factor of 12.
- The [FPS 1992](#), and [Special FPS 2006](#) has variable factors that are based on age at the date of retirement.

¹ A sponsoring employer in relation to an occupational pension scheme is any employer who participates in that scheme, i.e. they employ members of the scheme. There can be more than one sponsoring employer in relation to an occupational pension scheme. Therefore, any FRA or other employer such as a Local Authority council that pays active members of the Firefighters' Pension Scheme 1992 is a sponsoring employer.

² <https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm062230>

How is commutation affected by an unauthorised payment?

FPS 2015

The rules of FPS 2015 **do not** allow members to commute more than the permitted maximum, so any lump sum commutation taken from these scheme benefits are authorised payments, and unaffected by unauthorised payments. As mentioned in the [previous section](#), FPS 2015 commutation rate is a fixed factor of 12.

Calculation of the PPS 2015 maximum lump sum

Within the Pensions Tax Manual³ HMRC have provided an explanation of the formula that is to be used to calculate the permitted maximum which also enables the calculation of the pension after commutation to be identified.

The calculation is set out as follows:

The formula to be used is: **$20fg/(20 + 3f)$**

Where:

20 = HMRC revaluation rate

f = commutation factor

g = annual pension (after reductions or increases but before commutation)

Example of how this might look:

Where:

f = 12.00 and **g** = £16,100

Permitted maximum example calculation:

$$\frac{20 \times 12.00 \times \pounds 16,100}{20 + (3 \times 12.00)} = \pounds 69,000$$

The amount of pension that would need to be commuted to provide this lump sum can be calculated as:

$$\frac{\pounds 69,000}{12.00} = \pounds 5,750$$

The amount of annual pension after commutation can be calculated as:

$$\pounds 16,100 - \pounds 5,750 = \pounds 10,350$$

³ <https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm063240>

FPS 2006 and Special section of FPS 2006

The rules of FPS 2006 and the Special section of FPS 2006 **do not** allow members to commute for a lump sum which is more than the permitted maximum. So, any lump sum is unaffected by unauthorised payments and is deemed as an authorised payment.

FPS 1992

The rules of FPS 1992 allow some members to receive a lump sum payment which is **more** than the permitted maximum. If you choose to take a commutation lump sum from FPS 1992, you will have a choice about how much lump sum to take. This means that members with this membership will be able to choose one of four options:

Option One:

Do not commute for a lump sum

Option Two:

Commute for a lump sum within the permitted amount (HMRC limits)

Option Three:

Commute for a lump sum within the scheme limits

Option Four:

Commute for a lump sum value of a specific amount

Typically, taking the maximum scheme lump sum (option three) is likely to be higher than the permitted maximum (option two) if the commutation factor is higher than 20 (up to the age of 59 and 6 months).

If you take the permitted maximum lump sum whilst this will provide a lower lump sum value, you will receive a higher annual pension than taking the maximum scheme lump sum (option three).

Unauthorised payment charge

You will have a choice about how the charge is paid, you can choose:

- the scheme to deduct the tax charge from your lump sum and pay it over to HMRC on your behalf (known as mandating), or
- to pay the charge directly to HMRC yourself.

The most common practice is for this to be deducted for your lump sum, you will therefore need to make your administrator aware if you wish to pay the charge yourself directly to HMRC.

Calculation of the FPS 1992 HMRC maximum lump sum

Within the Pensions Tax Manual⁴, HMRC have provided an explanation of the formula that is to be used to calculate the permitted maximum which also enables the calculation of the pension after commutation to be identified.

The calculation is set out as follows:

The formula to be used is: **$20fg/(20 + 3f)$**

Where:

20 = HMRC revaluation rate

f = commutation factor

g = annual pension (after reductions or increases but before commutation)

Example of how this might look:

Where:

f = 24.30 and **g** = £27,500

Permitted maximum example calculation:

$$\frac{20 \times 24.30 \times \pounds 27,500}{20 + (3 \times 24.30)} = \pounds 143,864.37$$

The amount of pension that would need to be commuted to provide this lump sum can be calculated as:

$$\frac{\pounds 143,864.37}{24.30} = \pounds 5,900.59$$

The amount of annual pension after commutation can be calculated as:

$$\pounds 27,500 - \pounds 5,900.59 = \pounds 21,599.41$$

The HMRC permitted amount is calculated using a factor of 20, in 2011 the FPS 1992 commutation factors rose above 20, and have remained above 20 ever since, so when a commutation factor of more than 20 is used the lump sum is above the HMRC permitted amount.

⁴ <https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm063240 - commute>

How does the age discrimination remedy affect unauthorised payments?

Current position

Members will have received a warmup letter from their FRA to let them know that they are eligible for pension remedy, the letter set out an indicative timeframe as to when they can expect to receive further information on their options - more details relating to the timetable is available on the [FPS member](#) website.

Some Immediate Choice members i.e. members who currently have benefits in payment but are yet to make a choice about their service in the remedy period, were then written to explaining that there were ongoing policy issues on the correct application of tax. These members were told that their case could not progress until this matter had been resolved.

The issue only affects members who, at the point of their original retirement, elected for a lump sum in excess of HMRCs permitted maximum and paid an unauthorised tax charge. Clarification is required from HM Revenue & Customs (HMRC) on how schemes are expected to offset tax previously paid against tax arising now. HMRC have confirmed that the sectors understanding of how you would offset the original unauthorised payment does not align with current HMRC policy. Currently there is no provision within HMRC legislation that allows an offset approach for individuals who have made an unauthorised payment through the mandating process (which you would have done when you originally retired). This position, if left without a solution, will mean that you become liable for more tax which is not currently reclaimable either via HMRC or the compensation mechanism in the Public Service Pensions and Judicial Offices Act 2022.

The Local Government Association (LGA) continue to liaise with HMRC and HM Treasury (HMT) on this matter and there is an agreement in principle from all parties to put in place a resolution to address this. However, it is likely that any resolution will need new legislation which will take time. In the interim, LGA colleagues are in discussions with HMT to establish whether there could be formal assurances issued from central government which will allow cases to proceed ahead of legislation coming into force.

Members who are affected

As mentioned in the current position section above, the offsetting issue **only** affects members who, at retirement, elected for a lump sum above the permitted maximum and paid an unauthorised tax charge i.e. a member with legacy FPS 1992 membership.

There are several cohorts of members which remain unaffected and can receive details on their remedy. Administrators have started work on these cases and will be in contact with you soon.

Arrears of annual pension payments

Where an affected member makes their choice of remedy benefits which results in an increase in annual pension, the arrears that are due will be treated as authorised payments and therefore the interest that is due on these amounts will also be treated as authorised payments. The tax treatment of your interest will depend on your specific circumstances. HMRC have confirmed that interest received in respect to authorised pension arrears should be taxed in the same way that interest is taxed on savings.

Each person has a Personal Savings Allowance which means that you could earn a set amount of interest before there is a requirement to pay tax, the amount you are eligible for is dependent on which [Income Tax band](#) you are in. To work out your tax band, add all the interest you have received to your other income and then use the table below to establish your eligible allowance:

Income Tax band	Personal Savings Allowance
Basic rate	£1,000
Higher rate	£500
Additional rate	£0

If you go over your allowance, you are eligible for tax at your [usual rate of Income Tax](#).

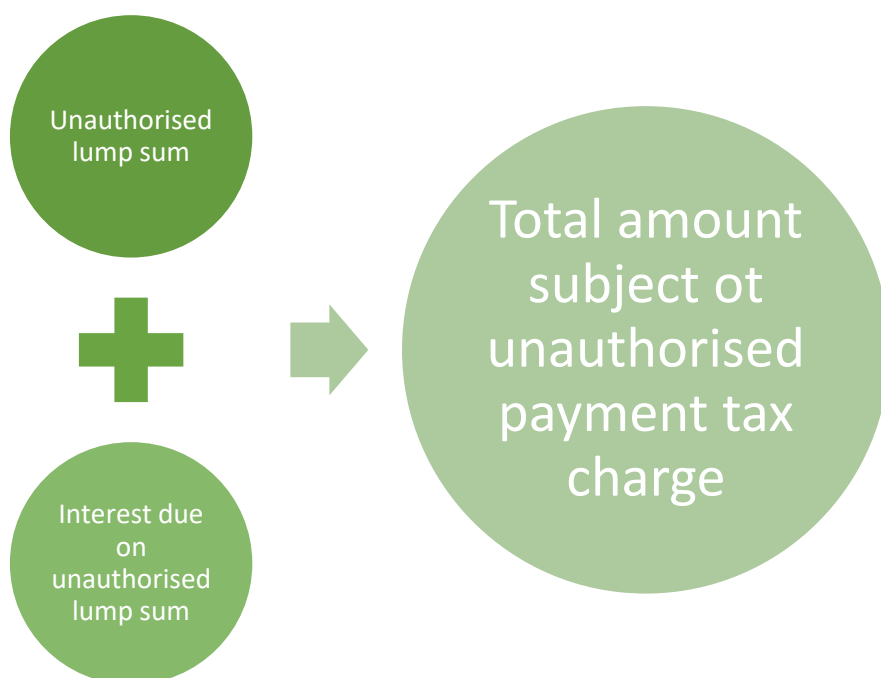
Authorised payments do not incur a tax charge. However, members should note that the arrears of annual pension are income and will be taxed in line with PAYE and your current tax code.

Arrears of lump sum payments

Where an affected member makes their choice of remedy benefits which results in an increase in the lump sum when compared to the original lump sum that was paid at retirement, this will create an additional “top-up lump sum” to be paid to the member.

This additional “top-up lump sum” will need to be tested to see whether it is authorised or unauthorised, and where it is unauthorised a further calculation will be made to work out the precise amount that is an unauthorised payment.

Where any part of the additional “top-up lump sum” is unauthorised, then the interest that is due on this amount will also be an unauthorised payment.



Changing your commutation decision

As part of the choice of remedy benefits members may also have a further option to amend their original commutation decision. Where any such amendment brings the lump sum to within HMRC permitted maximum it will make the payment authorised and will remove the unauthorised payment charge.

Choosing this option would however mean that a member is likely to have been: -

- Overpaid lump sum which will need to be repaid to the Scheme, and,
- Underpaid annual pension which will be due to the member. There will also be additional income tax issues to consider because of the increased annual pension.

This factsheet has been prepared by LGA using the regulations as they stand in July 2024.

This factsheet will be reviewed, referencing any changes to the scheme regulations and policies that might be needed.

This factsheet should not be interpreted as legal advice.

Please only address any queries on the content of this factsheet to bluelightpensions@local.gov.uk

For any queries you have regarding your own personal circumstances, you will need to contact your FRA directly. We are unable to answer any questions relating to your benefits.

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