ANNEXE 9

TAXATION

Occupational pension schemes are subject to tax laws. This Annexe explains how they affect the Firefighters' Pension Scheme

Tax Law

The legislation which governs the treatment of occupational pension schemes is contained in Chapter 1 Part XIV of the Income and Corporation Taxes Act 1988 as amended by section 75 and Schedule 6 of the Finance Act 1989 and subsequent Finance Acts.

Inland Revenue

The Inland Revenue is responsible, under the overall direction of Treasury Ministers, for the efficient administration of income tax, tax credits, corporation tax, capital gains tax, petroleum revenue tax, inheritance tax, National Insurance contributions and stamp duties. Tax laws are administered by the Board of Inland Revenue. Inland Revenue's policy relating to occupational pension schemes (including the FPS) is carried out by –

Inland Revenue Savings, Pensions, Share Schemes
Yorke House
PO Box 62
Castle Meadow Road
Nottingham NG2 1BG

Telephone: 0115 974 1480

(The Inland Revenue department responsible for these matters has been through a number of name changes. Many may still remember it as the Superannuation Funds Office (SFO). On 1 April 1992 the Superannuation Funds Office was renamed the Pension Schemes Office (PSO). Then, with effect from 1 April 2001, the Pension Schemes Office ceased to be an executive office and became part of the larger Inland Revenue Group called Inland Revenue Savings, Pensions, Share Schemes.)

Inspector of Taxes

If you have a tax problem relating to your pension, it will be dealt with by the Inspector of Taxes responsible for your personal tax affairs, who will determine the amount of tax payable, subject to your normal rights of appeal under tax law.

Tax year

The tax year runs from 6 April in any year until 5 April in the next year.

How the tax laws affect the FPS

Funded pension schemes (including the Local Government Pension Scheme which is a funded, statutory scheme) need Inland Revenue approval in order to qualify for the tax relief allowed on an approved scheme's investment income.

The FPS is an unfunded, statutory scheme, as defined in the Finance Act, and as such does not require "approval" by the Inland Revenue.

How the tax laws affect the FPS (continued)

Although unfunded statutory schemes do not require formal Inland Revenue approval, this does not mean they are treated any more favourably. It is Government policy that all pension schemes, public and private, should be treated similarly as regards –

- the maximum benefits which they may provide for their members, and
- the tax relief allowable on members' pension contributions.

The terms of the FPS take account of this policy and therefore conform generally to the Inland Revenue conditions laid down for approved schemes. Exceptionally, however, firefighters have retained a long-standing right to commute up to one quarter of their pension in certain circumstances. This provision can provide a lump sum greater than that normally allowed by Inland Revenue.

Contributions

Tax relief on FPS pension contributions is given by statute under section 592 of the Income and Corporation Taxes Act 1988

The same section allows relief on contributions of up to 15% of remuneration. Taking into account the basic contribution rate of 11% this allows 4% to accommodate additional contributions due under Rule G4 (additional and further contributions for widow's benefit uprating) and Rule G7 (purchase of increased benefits).

Lump sum payments for purchase of benefits do not attract tax relief.

Refunds of contributions

Section 598 of the Income and Corporation Taxes Act 1988 requires tax, currently at the rate of 20%, to be paid by the fire authority on a refund of contributions under Rule B6. Rule B11 gives the fire authority the power to deduct this sum from the refund of contributions before it is paid to the firefighter.

If, however, part or all of the contributions are paid on the firefighter's death to his/her personal representatives, tax is not deductible under Section 598 because the refund is not made during the employee's life time.

Repayment of refunds to count earlier service on re-employment

If you rejoin your former brigade and count earlier service again under Rule F4, your fire authority, on receiving a repayment in respect of a refund of aggregate pension contributions made to you earlier, may deduct the tax which they paid when they refunded your contributions to you from their tax liability in respect of other refunds under the FPS during the current tax year.

If you join another brigade and count earlier service again under Rule F4, your fire authority, on receiving a repayment in respect of a refund of aggregate pension contributions made to you by your previous fire authority, may deduct the tax which your previous authority paid when they refunded your contributions to you, from their tax liability in respect of any other refunds under the FPS during the current tax year.

Repayment of refunds to count earlier service on re-employment (continued)

Your previous fire authority will become liable under Rule F8 to pay a transfer value to your new fire authority. From this transfer value they may deduct the payment you made to your new fire authority under Rule F4 and any deduction of tax made from the refund of contributions paid to you. These deductions ensure that your former authority gets back the contributions they refunded to you and the tax they paid.

Your pension

As a general rule all pensions and allowances are taxable income and, as, such, are liable for income tax in the same way as other income.

If you are a resident abroad there is no general exemption from income tax but you may be able to claim exemption. Check the position with your local Tax Office before you leave the United Kingdom.

You may find that the PAYE tax on your FPS pension goes up when you start to receive your State pension. This is because tax due on your State pension is collected through PAYE on your FPS pension.

Widows pensions and children's allowances

A widow's pension is taxable as income through PAYE. As in the case of a firefighter, HM Inspector of Taxes will issue a tax coding which the Scheme administrator must operate against the pension.

Where a child is entitled to an allowance this, too, is potentially taxable under PAYE. The Scheme administrators must notify their Tax Office that the pension has come into payment and a tax coding will be issued. If the annual pension plus any other annual income received by the child is less than the single person's tax allowance, no tax would normally be due.

Lump sums

The lump sum benefits payable under the FPS not currently liable to income tax are –

- a lump sum payable on commutation of pension (Rule B7)
- a short service gratuity (Rule B2)
- a death grant (Rule E1)

Lump sum benefits other than retirement benefits which may be granted relief or exemption from income tax by your Inspector of Taxes include –

- an ill-health gratuity (Rule B3)
- a spouse's special gratuity (Rule C2)
- a spouse's ordinary gratuity (Rule C7)
- a child's special gratuity (Rule D3)
- a dependent relative's gratuity (Rule E3)

Commuted pensions

If your pension is a small pension which is totally commuted under Rule B8 then tax is chargeable at 20% under section 599 of the Income and Corporation Taxes Act 1988. If only part of it is commuted, no tax is chargeable. (Since the option of commutation is to avoid the necessity of making small payments it would be unusual for the whole pension not to be commuted.) The tax, however, would be paid by the fire authority and there is no provision in the FPS which allows it to be deducted from the payment made to you.

Tax is chargeable on the excess of the commutation payment over the maximum lump sum payable on commutation of pension under the FPS rules.

If a spouse's pension or child's allowance is small and commuted under Rules E5 or E6 no tax is charged. This is because Section 599 of the Income and Corporation Taxes Act requires a tax charge to be levied only where the **employee's** entire pension is being commuted.

Injury pensions

An injury pension under Rule B4 which is payable where permanent disablement results from a qualifying injury would not normally be taxed.

Certain ill-health pensions are not normally taxed if they are, in effect "injury awards". These would be –

- the ill-health pension paid to a firefighter with **less** than two years' service where the infirmity was occasioned by a qualifying injury (Rule B3(2)(a), and
- the ill-health pension paid with an injury pension to a retained firefighter under Rule J4.

This tax-exempt status is referred to in Inland Revenue Assessment Procedures – AP1180:

"The position with regard to the fire service is . . . ordinary, short-service and ill-health pensions are taxable, "injury" pensions are not. Pensions awarded to fire service personnel solely on the grounds of injury whilst on duty, even if they are called ill-health pensions, are not treated as income for tax purposes . . . These individuals will either not be regular firefighters or will not have served two . . years."

Pension credit pensions (pension sharing orders)

A pension credit member of the FPS (i.e. the ex-spouse of a firefighter under a pension sharing order issued by a court on divorce or annulment of marriage) will be liable to income tax on the pension credit pension although any commutation lump sum derived from the pension credit pension would be tax-free.

Payments made under "earmarking" orders

If a court makes an "earmarking" order on divorce, annulment of marriage or judicial separation it could require a portion of the firefighter's pension, when it becomes due, to be paid directly by the fire authority to his/her ex-spouse.

Payments made under "earmarking" orders (continued)

The amount due under the order will be deducted **after** tax has been paid on the full pension by the firefighter. So, for the ex-spouse, it is a tax-free payment.

If the court directs that a portion of the firefighter's lump sum by commutation should be paid to his/her former spouse, no tax will be due, the payment of commuted lump sum being tax-free, whoever the recipient.

Re-employment

When testing the level of benefits which can be paid to a pension scheme member under Inland Revenue rules, pension scheme managers must take account of any earlier benefits from previous employments/pension schemes. These earlier benefits are known as "retained" benefits (which are nothing to do, and should not be confused, with benefits payable to retained firefighters!).

If a re-employed pensioner becomes eligible to receive retirement benefits on leaving his/her further employment, the fire authority must take note of the Inland Revenue rules regarding retained benefits.

Retained benefits can be disregarded if, in the first year of (renewed) membership of the FPS, the person's earnings are less than one quarter of the "Earnings Cap" set by Inland Revenue. (For tax year 2000/2001 the tax cap is £95,400 so if the person's earnings were less than £23,850 the benefits from his/her earlier membership of the FPS would be disregarded.)

If the person's earnings are greater than one quarter of the Earnings Cap then retained benefits need to be taken into account only if the accrual rate for benefits for the second employment is greater than 1/60th of final pay for each year of service. Consequently, if you would not qualify for the fast accrual rate of 2/60ths of final pay in respect of your second employment you would be OK. If 2/60ths **are** relevant, however, your retirement benefits from the second employment could be restricted.

If your re-employment is with a fire authority but not as a firefighter then you would probably become a member of the Local Government Pension Scheme (LGPS). Because the accrual rate of LGPS benefits is not greater than 1/60th of final pay a year* account need not be taken of your FPS pension as a "retained benefit" when your LGPS benefits are assessed.

*This assumes you do not elect to pay additional voluntary contributions to improve your LGPS benefits. If you do, then retained benefits may need to be taken into account on your retirement.