

HMRC Technical Analysis of the Operation of the tax rules for a Protected Pension Age (“PPA”), with particular regards to the Police Pension Scheme (“the PPS”)

The legislation – paragraphs 21 and 22 of Schedule 36 to the Finance Act 2004 (as amended)

There are 2 basic requirements for an individual in a registered pension scheme that was, inter alia, an approved occupational pension scheme or a relevant statutory scheme (such as the PPS) if they are to have a PPA under paragraph 22.

These requirements are set out in paragraph 22(1) and are that:

(a) The scheme is a protected pension scheme. Paragraph 22(2) – (6) then provides that broadly this means that the member and the scheme must satisfy the entitlement condition (or there is block transfer from such a scheme). The entitlement condition requires that, on 10 December 2003, the scheme rules provided an unqualified right to benefits from an age less than 55 and that under the scheme rules the particular member qualified for such a right as at both 10 December 2003 and 5 April 2006.

(b) The retirement condition is met in relation to the scheme and the member.

The detail of retirement condition is set out in paragraph 22(7)-(7J). This is a complex condition and to meet it:

(i) The member must become entitled to all benefits under the scheme on the same date (excluding any benefits where the member’s actual entitlement to them arose before 6 April 2006). This is unlikely to occur in the PPS.

(ii) The member’s becoming entitled to the benefits must not have been part of an arrangement to avoid payment of tax or NICs. It is not anticipated that such arrangements will occur in relation to PPS members.

(iii) Where the member has a right to take benefits under the scheme from an age between 50 and before reaching age 55 then, after becoming entitled to their benefits, the member must not be employed by any person who was

- a sponsoring employer in relation to the pension scheme at any time the 6 month period ending with the day on which the member became entitled to their benefits and who employed the member at any time during that same period, or
- any person connected with such a person, or
- any person who is a sponsoring employer in relation to the scheme and with whom the member is connected.

The only exception is where after becoming entitled to their benefits a member of the armed forces is employed by such an employer as a result of compulsory recall.

“Connected” in this context means “connected” in the manner set out in section 1122 Corporation Taxes Act 2010.

It is accepted in the context of the PPS that the sponsoring employers of the scheme are not connected with each other and that a police officer is not connected with any PPS sponsoring employer.

(iv) If (iii) is not satisfied because the member returns to employment with one of the types of persons set out therein, (iii) is to still be regarded as satisfied (and so the member meets the retirement condition) if one of 3 re-employment conditions is met.

The 3 re-employment conditions are that:

- the member not employed within the terms of (iii) above until at least 6 months after they became entitled to their benefits under the scheme
- the member is employed within the terms of (iii) above within 6 months but after a break of at least 1 month but the pension scheme is a public service pension scheme and the member's benefits under the scheme include a scheme pension which is liable, until at least attaining age 55, to abatement whilst the member is so employed
- the member is employed within 6 months but after a break of at least 1 month in an employment(s) which is(are) materially different in nature from the employment in which the member was employed immediately before becoming entitled to their benefits.

[In RPSM, for convenience the exception for compulsory recall by the armed forces is treated as though it were a re-employment condition, so the guidance at RPSM03106065 refers to and details 4 re-employment conditions.]

HMRC's interpretation of the operation of the legislation

Effectively, requirement (a) sets out the circumstances in which a member can establish an entitlement to a PPA.

Requirement (b) then operates to set out the circumstances in which that entitlement applies.

For those entitled to a PPA between age 50 and before reaching age 55, the retirement condition is effectively two pronged. First there is an initial requirement which is that the member must both take all their benefits under the scheme at the same time and cease their employment with every employer who employed them in the preceding 6 months. If they do not then they do not meet the condition so do not have a PPA.

But if this initial requirement is satisfied, there is then a further requirement that is satisfied for so long as the person does not return to employment after becoming actually entitled to their benefits within the period of at least 6 months generally or at least 1 month in cases where either abatement may apply to the pension or the re-employment is in a materially different employment.

Once the 1 or 6 month timeframe has passed, the member's PPA cannot be lost. If a member is re-employed in the intervening period the member has a PPA until such time as the date of re-employment, only losing their PPA from that date.

Although it is not entirely clear in the wording of the legislation itself, HMRC's view that a PPA is only lost from the date of re-employment - where the re-employment condition is not met because the re-employment occurred before the expiry of the required time gap between employment and re-employment - consistent with the intention behind the legislation. This is set out in the following extract from

paragraph 56 of the Explanatory Note for Clause 162 and Schedule 23 to Finance Bill 2006 which inserted the re-employment conditions into paragraph 22.

“One of the conditions of the transitional protection applying to someone taking benefits from a registered pension scheme before normal minimum pension age is, as originally provided for, that they do not become re-employed by a sponsoring employer of the same scheme. This is provided for at sub-paragraph 22(7)(b). If the individual does become so re-employed, the consequence is that the transitional protection is lost and all payments of benefits between the date of re-employment and the individual reaching normal minimum pension age will be treated as unauthorised payments, and subject to the range of tax charges applying to unauthorised payments. Paragraph 39 amends the condition so as to allow re-employment in certain circumstances. It also provides a new condition in certain circumstances that the individual must not become re-employed by an employer that is associated with their original employer.”

The idea that a form of protection is not lost unless and until a certain event happens and so prior benefit crystallisation events are not re-visited or overturned is not limited to the PPA legislation. It also applies in relation to both enhanced protection and fixed protection. And most other forms of protection (such as primary protection) cannot be lost all, or at least not within the protected scheme. So HMRC’s approach is both consistent with the intention evidenced in the Explanatory Note and the operation of other forms of protection.

It is HMRC’s view therefore that any payment made before the date of re-employment which was made as an authorised payment by virtue of the member’s entitlement to a PPA at the time of payment remains an authorised payment, even though the member may subsequently lose their entitlement to a PPA by becoming re-employed in circumstances which do not meet any of the re-employment conditions.

It is only payments that are made on or after the date the member loses their PPA and before the date they reach normal minimum pension age (age 55) that are unauthorised payments.

For the avoidance of doubt, HMRC confirm that all benefits paid on or after reaching age 55 will be authorised payments.

With regard to whether a retirement lump sum is an authorised or unauthorised payment, one of the requirements for a lump sum to be a tax-free pension commencement lump sum for tax purposes is that the lump sum must be actually paid to the member on or after reaching normal minimum pension age (or PPA where appropriate) - paragraph 1(1)(d) of Schedule 29 to Finance Act 2004. It is not enough for the entitlement to the lump sum to have arisen before that date if it is paid later. So where a member has lost their PPA from the date of date of re-employment (so that authorised payments will only occur if they are paid on or after the date on which the member reaches age 55), a retirement lump sum will only be a pension commencement lump sum if it is paid to the member before the date on which they were re-employed.

HMRC's view is that where a lump sum is paid by the scheme directly into the member's bank account the date the lump sum is paid is the day on which it is credited to the recipient's account not the day on which it is debited from the payer's account.

What does being employed after becoming entitled to benefits mean?

Provided an individual who meets the other requirements ceases employment at the time they become entitled to their benefits, they initially satisfy the retirement condition so can rely on their PPA to payments of benefits as authorised payments.

There is no definition of employment so we must look to employment law for the answer. Continuous employment is built up on a weekly basis, a week being a period of 7 days ending on a Saturday. Where there is a break in continuity, the weeks beforehand do not count towards continuous employment.

To protect employees' entitlement to certain employment rights where a period of service is required, employment law treats employment as continuous in some circumstances even though there is a break in service.

So even though there is a week in which an employee has no contract of employment that week can count towards continuous employment and not break the continuity of employment if work ceases temporarily.

Where a person is re-employed in a different job (akin to a materially different employment) then continuity is broken immediately the contract of employment for first employment terminates. But if a person returns to the same employment then they must do so after a break of at least one week (that week being one ending on a Saturday) if the new period of employment is not to be treated as a continuation of the previous employment. Without such a break the employment has not ceased and the individual does not have a PPA at all.

Where a pension is paid before normal minimum pension age, is it a scheme pension?

In HMRC's view the answer is yes.

A scheme pension is defined by paragraph 2(2) of Schedule 28 to Finance Act 2004 as a pension payable to the member by the scheme administrator or an insurance company chosen by the scheme administrator, payable at least annually until the member's death and where the rate of pension payable does not reduce (except in the circumstances set out in paragraph 2(4)). There is nothing in paragraph 2(2) which provides that a pension is not a scheme pension if entitlement to it arises before the member has reached normal minimum pension age (so their protected pension age where this applies).

Section.164 Finance Act 2004 sets out in broad terms the payments a registered pension scheme is authorised to make with the fine detail provided in subsequent sections and supporting schedules.

Section 164 authorises, inter alia, a pension permitted by the pension rules in section 165.

Pension Rule 1 in section 165(1) says that, apart from ill-health pensions, no payment of pension may be made before the day on which the member reaches normal minimum pension age (so protected pension age where applicable).

Payments of pension which are outside Pension rule 1 are therefore unauthorised, but they are nonetheless payments of a pension. And so are payments of a scheme pension if the pension is within the definition of a scheme pension.

“Permitted” as used in s.164 should be read as meaning permitted to be paid as an authorised payment. The section does not permit some and prohibit other types of payment. If it did then schemes could not pay unauthorised payments at all.

This interpretation fits with one of the fundamental principles of the simplified tax regime, namely that tax legislation should not direct what payments a scheme can/cannot make. Instead it provides for how those payments should be taxed and this depends on whether the payment is authorised (and where this is the case the type of payment) or unauthorised.

So taken in the round, a member’s scheme pension can be paid from any age but any payment of that pension made before the member reaches normal/protected pension age is unauthorised.

Reducing or stopping a scheme pension when a PPA is lost with a view to unwinding and then re-starting the benefit process

This refers to any proposal (following re-employment that leads to loss of a PPA) that a scheme pension taken before age 55 using a PPA is stopped with the pension payments already paid plus any retirement lump sum paid as a pension commencement lump sum is recovered from the member with a view to re-instating the member as an active scheme member. The member rejoins the scheme then takes their benefits again ensuring that the re-employment condition is met second time around.

The pension tax rules provide that where a scheme pension is reduced or stopped it ceases to be a scheme pension from that point in time unless the reduction is one of the 8 circumstances set out in paragraph 2(4) of Schedule 28 to Finance Act 2004.

If the rate of scheme pension payable to an individual is reduced in any circumstance other than those allowed by the legislation, then all future payments of that pension are unauthorised member payments, and should be taxed as such rather than as pension income. In other words the pension falls outside of the scheme pension definition once the reduction occurs. In HMRC’s view the pension is incapable of recovering scheme pension status e.g. if/when the pension was re-started or the rate of reduced pension was increased to the original rate of pension.

In addition, there are also three circumstances, set out in paragraph 2A of Schedule 28, in which the scheme will be deemed to have made an unauthorised payment to the

member in an amount equal to the amount of any tax-free lump sum paid by the scheme to the member in connection with their becoming entitled to a scheme pension entitlement. These circumstances include those where the payment of a scheme pension is stopped entirely in the member's lifetime, and so contravenes the requirement that the scheme pension must be paid for life. This ensures that an excess tax-free lump sum can't be taken with a subsequent cessation or large reduction in pension aimed at rendering unauthorised payment tax charges on future pension pensions nil or negligible.

So pension cannot be stopped and then re-started or a fresh pension awarded without incurring tax charges.

The PPA re-employment rules are couched in employment terms. Is a police officer an employee, is there an employer/employee relationship and is there is an employment?

Yes to all.

S.279(1) FA04 says that "employee" and "employer" have the same meaning as in the employment income Parts of ITEPA 2003 (see sections 4 and 5 of that Act) but include (respectively) a former employee and a former employer (and "employment" is to be read accordingly).

ITEPA 2003 is the Income Tax (Earnings and Pensions) Act 2003. Section 4 ITEPA says "employment" (in the employment income Parts) includes inter alia "any employment in the service of the Crown". Section 5 provides for the employment income Parts provisions applying to employments to apply equally to offices unless otherwise indicated. So in those Parts, "employed", "employee" and "employer" have corresponding meanings.

So a police officer is an employee for the purposes of the PPA tax rules, the person under whom they hold the office is the employer and there is an employment for pension tax purposes.

Are police forces sponsoring employers?

Yes if they are the employer (see previous question) of police officers. And a "sponsoring employer" of a registered pension scheme is defined by s.150(6) as the employer, or any of the employers, to or in respect of any or all of whose employees the pension scheme has, or is capable of having, effect so as to provide benefits. So a police force/police authority (as appropriate) will be a "sponsoring employer" in relation to the PPS.

Tom Young
Technical Adviser
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