

Hampshire Fire and Rescue Authority

Finance and General Purposes Committee

Item: 9

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Temporary Promotions – Pension Decision

Report by Chief Financial Officer

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1 Summary

- 1.1 This report deals with a regulatory issue that has arisen following investigations carried out by Officers in respect of pension tax problems created for some firefighters when acting up into temporary promotions.
- 1.2 In examining a potential solution to this issue it was discovered that it had in fact been addressed by new Regulations that were introduced in July 2013. However at that point Fire Authorities were required to make a formal decision on the pension position for temporary promotions, which was never carried out for Hampshire.
- 1.3 As a result, irrespective of the decision that Finance and General Purposes Committee makes today, it means that the pension and tax position of all firefighters who have had temporary promotions since July 2013 will be incorrect.
- 1.4 This report therefore seeks a decision in respect of the pension position of temporary promotions and outlines the steps that will need to be undertaken to apply this decision retrospectively to correct the position. It also considers whether or not the error constitutes a breach in the regulations that should be reported by the Authority to The Pension Regulator (TPR). This decision is within F&GP's remit as the Manager of the scheme for HFRA.

2 Recommendations

- 2.1 That the Committee agrees that for HFRA, temporary promotions will be pensionable, where permitted by the rule of the scheme.
- 2.2 In order to minimise the pension impact on individuals in temporary promotions since 1 July 2013, the Committee agrees that any temporary promotions that existed on or have been granted since 1 July 2013 will be treated as pensionable Additional Pension Benefits.
- 2.3 That authority is given to the Chief Financial Officer to take the steps set out at section 5 below to correct the position in respect of temporary promotions since 1 July 2013.
- 2.4 That based on advice from the Head of Legal and the Chief Financial Officer that

this error be reported formally to The Pension Regulator together with details of the action that will be taken to correct the position.

3 Background

- 3.1 In the past, temporary promotions that result in a significant increase in a Firefighter's salary can create a major tax liability for the individual if they exceed their annual allowance for contributing to their 'pension pot'.
- 3.2 This mainly arises because previous schemes (prior to the 2015 scheme) are a defined benefit scheme linked to final salary and a large increase in salary in one year translates into a significant increase in the virtual 'pension pot' which can lead to a tax liability often into 10's of thousand of pounds. This can happen even if the temporary promotion ends and the Firefighter returns to their normal salary (and therefore potentially never sees any benefit from what has been paid by them, both in tax and contribution terms).
- 3.3 It was reported to the Pension Board last September that some Authorities have alleviated this position by treating the pension element of temporary promotions as an Additional Pension Benefit (APB) and an action was given to the Head of Finance to find out more about this issue.
- 3.4 Following discussions with a senior colleague at Oxfordshire FRS (who has a national lead on pensions) it has come to light that the regulations around the pension treatment of temporary promotions were changed in July 2013 after the Government recognised the tax problems being caused for Firefighters. At this time all Fire Authorities were required to make a decision about whether or not temporary promotions would be treated as pensionable.
- 3.5 If the Authority decided they were pensionable then ALL future pension contributions made by Firefighters when on temporary promotion have to be treated as an Additional Pension Benefit (APB). APB's are treated separately for tax purposes in that they count against annual allowances as an absolute sum rather than through a calculation relating to final salary and defined benefits. This helps to significantly reduce any tax liability and some pension benefit is earned irrespective of whether or not the temporary promotion ends.
- 3.6 If the Authority decided that temporary promotions were not pensionable then no additional contributions were due from the individual on the additional salary they earned but no pension benefit or tax liability was created.
- 3.7 The new Firefighters Pension Scheme for 2015 treats ALL temporary promotions as non-pensionable and therefore members of that scheme will not gain any additional pension benefit. However, depending on the decision of the Authority, those firefighters that are protected in the 1992 or 2006 schemes (either completely or on a taper date) would still be able to earn pension benefits as would any firefighter in the pension scheme from July 2013 to March 2015.
- 3.8 Although the Authority did not make the required decision in July 2013, since that time both HFRA as employer and Pension Services as the pension administrator have been treating temporary promotions as pensionable in line with the position that existed prior to July 2013. This means that members of the pension scheme on temporary promotions have been treated as if they are earning defined final salary benefits, whereas they should have been earning benefits as an APB or, if

HFRA had decided not to treat temporary promotions as pensionable, not earning any pension benefits at all on the extra amount of salary earned (for which they would have also not have made a pension contribution).

4. Decision and Retrospective Application

4.1 Even though the Regulations in respect of this changed in July 2013, HFRA is still required to make a formal decision which will then have to be applied retrospectively to ensure the pensions of affected staff have been dealt with in accordance with the scheme rules.

4.2 There were many flaws in the previous system where temporary promotions were pensionable :

- Firefighters made additional pension contributions during the period, but if they returned to a lower salary after the temporary promotion and retired some years later, they would not see any additional pension benefits for those additional contributions.
- The increase in salary on a defined benefits, final salary scheme could create huge tax bills for individual firefighters.
- The Authority itself was also required to contribute financially with no gain to the Authority or firefighter.

4.3 Most of these issues have been corrected with the new regulations as either no contributions are paid and no benefit is received or contributions are paid on the additional salary earned, but they go into a separate APB 'pot' which are retained as a benefit even if the firefighter returns to their previous salary level.

4.4 The use of the APB rather than the defined benefit also in most cases gets round the tax issues since it is only the value of the APB earned in the year that counts against the annual allowance rather than using a calculation based on the defined benefits, which significantly inflates the 'virtual pension pot' earned.

4.5 The only downside therefore to agreeing to make temporary promotions pensionable is that there is a cost to the employer in relation to the employer pension contributions paid on the extra pension. Clearly the amount paid will be dependent on how many temporary promotions are granted, but in general terms the cost to HFRA is around 18% of the Firefighters salary. The 'extra' cost would only apply to the increased salary that the firefighter was earning and in almost all cases, since the firefighter is acting up into an existing role, the full pension cost would be budgeted for anyway.

4.6 However, as any decision will need to be applied retrospectively the Committee also needs to take account of the impact on individuals who have been in temporary promotions since July 2013. For these individuals, they will have been paying contributions and would have been expecting to earn pension benefits for that. If the decision is made to make them non-pensionable, this will no longer be the case (although they will get their pension contributions back). For the avoidance of doubt, the individual employees will not be expected to pay any

additional contributions.

- 4.7 On balance, given the potential adverse pension impact on individual firefighters who have been paying contributions in good faith and in particular as the new Regulations have corrected the anomalies in the previous system, this report recommends that F&GP Committee agrees that all temporary promotions should be pensionable and this principle should be applied to all temporary promotions that existed or have been entered into from July 2013.

5 Correcting the Problem

- 5.1 As mentioned previously, irrespective of which decision is made there is a significant amount of administrative work to be undertaken to correct for the fact that the formal decision was not made in July 2013.
- 5.2 If the Committee agrees to make temporary promotions pensionable, then it will be necessary to :
- Identify every officer within the pension scheme that has been on temporary promotion since July 2013 (including those already on temporary promotion at that point)
 - Collect all relevant payroll and pension data during this period
 - Work out what their individual pension contributions have been
 - Calculate what APB they have earned and amend their pension record
 - Re-calculate any tax liabilities or changes since that point
 - Inform HMRC as necessary.
 - Inform the individuals and the impact on them from a personal point of view.
- 5.3 This issue has been reported to the Pension Board at its meeting in January and they will retain oversight of progress. They were also informed that dedicated project management and technical resource has been identified to carry out this significant and complex project.
- 5.4 At this stage it is unclear how long the project will take but given that temporary promotions have been used extensively over the last few years to manage the many workforce changes associated with different savings programmes, it is unlikely to be completed in less than six months.
- 5.5 In any event, the first step is to communicate with firefighters about this issue and provide as much information as possible to those that may be affected, given that this is a complex subject. A general communication will be sent out to coincide with the publication of the F&GP papers together with a dedicated email address and section of the web site where further information and FAQs can be posted.
- 5.6 Where firefighters have been on temporary promotion since July 2013, then it is possible some will have paid too much tax if they exceeded their annual allowance in any one year. It is also possible that HMRC will not provide a rebate, given that no decision was made in 2013. In these circumstances HFRA may need to reimburse any overpayments of tax. It is likely that only a very small number of firefighters will be in this position and all steps will be taken to try to secure any tax rebates from HMRC. Until the detailed work is undertaken to determine the full scale of the issue it is not possible to provide an indication of the temporary liability at this stage.

6. Potential Breach of Regulations

- 6.1 The Pension Regulator Code of Practice states certain people involved with public service pension schemes must inform them of breaches of the law where that breach is likely to be of material significance. This requirement extends to the Pension Board, employers and professional advisers.
- 6.2 It is clear in this case that HFRA has failed to comply with the regulations as it did not make a formal decision before the new arrangements came into force in July 2013 and as result the administration of pensions relating to temporary promotions has been incorrect.
- 6.3 An assessment must then also be made as to whether or not this is considered to be a material breach. In this regard, given that there is a potentially material impact on a large number of individual firefighters and the pension benefits they earn, it is the view of the Head of Legal and the Head of Finance that this is a material breach and should be reported.
- 6.4 In any event, in the interests of good governance and openness it seems sensible at this point to report the breach to the TPR and outline the steps that we are taking to correct the position. It would be unusual for the TPR to take any action on a reported breach where it is clear that it is being properly addressed by the Authority.

7. Conclusion

- 7.1 Based on the information set out in this report it is recommended that the Committee decide to make temporary promotions pensionable and agree to apply this to all temporary promotions that existed or have occurred since July 2013. Further, it is recommended that the Committee give authority to the Head of Finance to take the steps set out at section 5 above to correct the position since July 2013 and to report the breach to the Pension Regulator.

8 Supporting our corporate aims and objectives

- 8.1 F&GP Committee as local Scheme Manager for the firefighters pension scheme has a responsibility to make this decision and in the spirit of good governance, openness and transparency to report it to TPR.

9 Risk analysis

- 9.1 Not reporting this issue to TPR could potentially lead to reputational damage to the Authority. We must also be sure that there are not other regulatory or policy issues that may have been overlooked and a separate report will be presented to F&GP Committee on this at its April meeting.

10 People impact assessment

- 10.1 The proposals within this report are considered compatible with the provisions of the equality and human rights legislation.

11 **Consultation**

- 11.1 In addition to the advice received from the Head of Legal Services, the Pension Board have also been made aware of the position presented in this report and await the decision of the Committee.