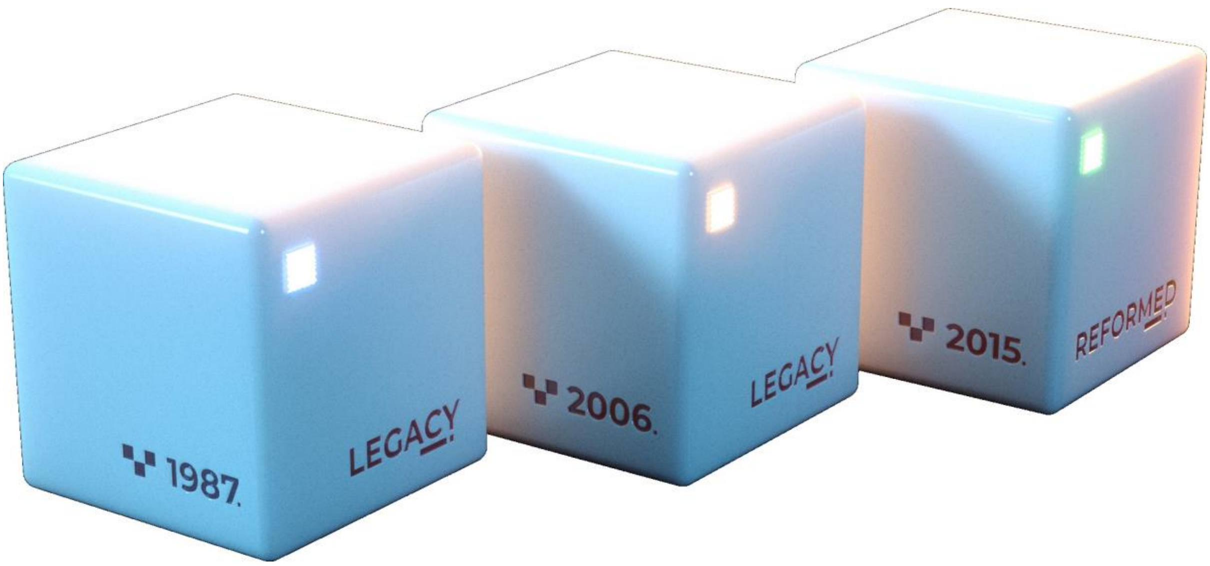
# Member Remedy Factsheet Unauthorised Payments



# Contents

Introduction ..... 2
What is an authorised payment? ..... 3
What is a Pension Commencement Lump Sum? ..... 3
What is the permitted maximum? ..... 3
How to calculate the capital value of benefits ..... 3
What is an unauthorised payment? ..... 4
Unauthorised payment charges ..... 4
The scheme sanction charge ..... 5
The unauthorised payments surcharge ..... 5
What is commutation? ..... 5
How is commutation affected by an unauthorised payment? ..... 6
PPS 2015 ..... 6
Calculation of the PPS 2015 maximum lump sum ..... 6
PPS 2006 ..... 7
PPS 1987 ..... 7
Calculation of the PPS 1987 HMRC maximum lump sum ..... 8
How remedy affects unauthorised payments ..... 9
Members not affected ..... 9
Members affected ..... 9
Arrears of annual pension payments ..... 9
Arrears of lump sum payments ..... 10
Legislation ..... 12
Disclaimer ..... 12

# Introduction

This document is for members of the Police Pension Scheme to provide an explanation of what an unauthorised payment is and also to provide information about how that occurs for members of the 1987 Police Pension Scheme on retirement lump sums.

The document also briefly explains for members affected by remedy why they might have a new unauthorised payment and what that means.

## What is an authorised payment?

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

Authorised member payments include pensions, lump sums, death benefits and scheme administrator member payments.

The tax rules set out the conditions for a payment to be authorised and where a payment does not fall within these rules, it becomes an unauthorised payment and triggers tax charges.

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?

The Police Pension Scheme (PPS) 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: -

$$(20 * annual\ pension) + lump\ sum = capital\ value$$

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

$$25\% * capital\ value = permitted\ maximum$$

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

## What is an unauthorised payment?

Where a payment is made to a member that does not fall within any of the categories of an authorised payment, then it is deemed to be unauthorised.

The most common reason within the Police Pension Scheme for an unauthorised payment to occur is where a lump sum payment is made which is more than the permitted maximum. The amount above the permitted maximum cannot be paid as a PCLS and will therefore, in HMRC terms, be treated as an unauthorised payment.

If you have a tax charge on your lump sum it will have been treated as unauthorised.

## Unauthorised payment charges

In the Police Pension Scheme, 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 Police Pensions the two most common unauthorised payment charges can be summarised as follows: –

**Unauthorised payments charge**

- Levied on member
- Flat rate of 40%

**Scheme Sanction charge**

- Levied on Police Authority
- Flat rate of 15%

More details about the unauthorised payment charges can be found in the Pensions Tax Manual, with the relevant links provided in the Legislation section of this document.

### The scheme sanction charge

As the PPS 1987 pension scheme rules do not allow for the scheme sanction charge to be charged to the member, it is a charge payable by the Police Authority.

Historically, some Police Authorities have incorrectly passed this charge to the member due to a lack of clarity in the rules. Where Police Authorities have done this, they are in the process of correcting the position where they have not already done so.

### The unauthorised payments surcharge

This is the third type of unauthorised payment charge, but it does not occur very often within the Police Pension Scheme.

- It will apply where a member has membership of the PPS 1987 and retires before age 55 and, with less than a one-month break, returns to work with an employer who is also able to employ a police officer[1].
- If 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.

Where these circumstances do apply, then all pension payments including the lump sum are deemed to be unauthorised and therefore a 15% unauthorised payments surcharge, levied on the member, will apply to all payments made.

## What is commutation?

Commutation is giving up part of the pension benefits in exchange for more of something else. For example, giving up annual pension for more lump sum.

Commutation works by multiplying a £1 of pension or lump sum by the relevant factor and each of the three Police Pension Schemes have different commutation factors.

- The PPS 2015 has a fixed factor of 12.
- The PPS 1987 and PPS 2006 has variable factors that are based on age at the date of retirement.

Commutation factors for PPS 1987 and PPS 2006 are provided by the Government Actuary Department (GAD).

---

[1] This refers to the conditions about a loss of a Protected Pension Age as set out in the HMRC Pensions Tax Manual - [https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm062230](https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm062230)

# How is commutation affected by an unauthorised payment?

## PPS 2015

The rules of the PPS 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.

The 2015 scheme commutation rate is a fixed factor of 12.

### Calculation of the PPS 2015 maximum lump sum

Within the Pensions Tax Manual[2], HMRC have provided a clear 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. More details and relevant links can also be found in the Legislation section.

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

i. Permitted maximum example calculation

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

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

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

iii. The amount of annual pension after commutation can be calculated as

$$£16{,}100 - £5{,}750 = £10{,}350$$

[2] https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm063240

## PPS 2006

The rules of the PPS 2006 do not allow members to receive benefits which are more than the permitted maximum, so any lump sum or commuted annual pension taken from these scheme benefits are unaffected by unauthorised payments.

The PPS 2006 provides an automatic lump sum, which you can choose to commute to increase your annual pension. Any increased annual pension payable would be treated as an authorised payment.

## PPS 1987

The rules of the PPS 1987 allow members to receive a lump sum payment which is more than the permitted maximum. If you choose to take a commutation lump sum from the PPS 1987, 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 and receive annual pension only

### Option Two

- Commute to stay within HMRC limits (the permitted maximum)

### Option Three

- Commute to the maximum scheme lump sum

### Option Four

- Commute a specified amount which is different to the other options

Typically, taking the maximum HMRC lump sum (option two) will provide a lower lump sum value but a higher annual pension than taking the maximum scheme lump sum (option three).

If you choose the maximum scheme lump sum, this is likely to exceed the permitted maximum and will be subject to an unauthorised payment tax charge. You will therefore 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, or
- to pay the charge directly to HMRC yourself.

## Calculation of the PPS 1987 HMRC maximum lump sum

Within the Pensions Tax Manual, HMRC have provided a clear 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 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

i. Permitted maximum example calculation

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

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

$$\frac{£143{,}384.37}{24.30} = £5{,}900.59$$

iii. The amount of annual pension after commutation can be calculated as

$$£27{,}500 - £5{,}900.59 = £21{,}599.41$$

The HMRC maximum lump sum is calculated using a factor of 20, in 2011 the PPS 1987 commutation factors rose above 20, so when a commutation factor of more than 20 is used the lump sum is above the HMRC maximum lump sum.

# How remedy affects unauthorised payments

## Members not affected

There are certain groups of members, who are in scope for remedy, that are not affected by unauthorised payments, this is because all payments that have been made to them are authorised.

a) Deferred Choice members (active and deferred members)

b) Immediate choice members who: –

   a. Retired as a fully protected member
   b. Retired and could only commute 2 ¼ times their annual pension
   c. Retired and chose to keep their lump sum within HMRC limits
   d. Retired with membership in the PPS 2006

## Members affected

There are certain groups of members, who are in scope for remedy and will be affected by unauthorised payments.

a) Immediate Choice members who received a maximum scheme lump sum and either: –

   a. Retired as a PPS 1987 tapered protected member
   b. Retired as a PPS 1987 unprotected member

### 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.

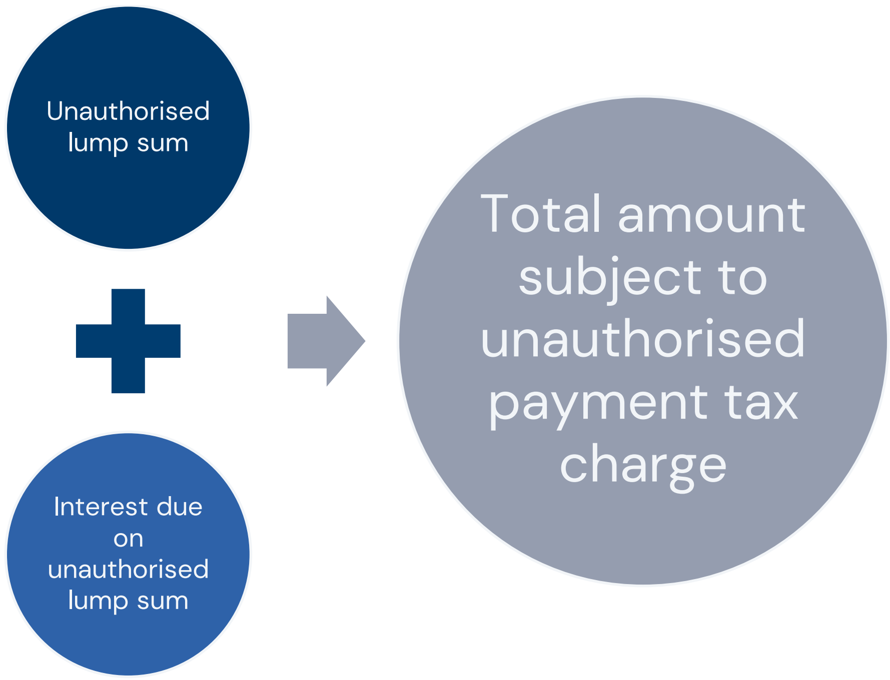
Authorised payments do not incur a tax charge. However, members should note that the arrears of annual pension are income and will be taxed in line with PAYE and your current tax code.

## 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 the original commutation decision*

As part of the choice of remedy benefits members will have a further option to amend the original commutation decision. Where any such amendment brings the lump sum to within HMRC limits it will make the payment all authorised and therefore remove the unauthorised payment tax 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.

*Current position June 2024*

There is currently a lack of clarity from HM Treasury and HMRC over the exact calculations required to determine precisely how much of these payments are to be treated as unauthorised payments.

HMRC's current view is that all of the additional "top-up lump sum" payment is to be treated as an unauthorised payment and therefore all of the interest due on that amount is also all an unauthorised payment.

Unauthorised payments incur a tax charge of 40%, which means that all of this additional payment will be taxed at 40%.

## Legislation

The legislation that applies to dealing with unauthorised payments is: –

1. **Pensions Tax Manual**
   - Authorised and Unauthorised payments – PTM131000
   - Unauthorised payment charges – PTM134100
   - Member benefits, lump sums, pension commencement lump sum, applicable amount – PTM063240
   - Example calculation of the applicable amount
   - Example calculation of the permitted maximum
2. **Finance Act 2004 (as amended)**
   - Payments by registered pension schemes – Chapter 3
   - Registered pension schemes tax charges – Chapter 5
3. **The Public Service Pension Schemes (Rectification of Unlawful Discrimination) Tax Regulations 2023**
   - Timing of payment condition for additional lump sum payment – Regulation 18
4. **The Public Service Pension Schemes (Rectification of Unlawful Discrimination (Tax) (No.2) Regulations 2023**
   - Administration – Part 6

## Disclaimer

This factsheet has been prepared by NPCC using the regulations as they stand at June 2024, however they should be used only as an informal view of the interpretation of the Police Pension Scheme as only a court can provide a definitive interpretation of legislation.

This factsheet should not be interpreted as legal advice.