# Annual allowance pension tax

## Summary of trust approaches to 'alternative schemes'

### Introduction

Following the introduction of new pension tax rules earlier this decade, many senior NHS clinicians and managers have faced the imposition of large annual allowance tax bills. In order to counteract these charges, staff have been forced to consider alternative working arrangements, including reducing their hours or considering early retirement. As a result trusts are increasingly seeing these arrangements affect their ability to reduce waiting lists and provide timely and effective care for patients. With a formal national solution yet to be confirmed by government, providers across England have been considering the introduction of certain policies or "alternative schemes" to maintain senior clinical capacity within their organisations.

There is no doubt that government has heard the sector's concerns with both Prime Minister, Boris Johnson, and Secretary of State, Matt Hancock, pledging to solve the issue for the NHS earlier this week. Today, the Department of Health and Social Care has announced it will shortly release a new consultation presenting added flexibilities for scheme members, alongside a commitment for the Treasury to review the operation of the annual allowance taper. In the meantime, members have requested more information on the sector's response to this serious problem and this paper briefly summarises the main actions being taken or considered by providers. It is informed by feedback collated this month from over 100 member trusts who responded to a call out from NHS Providers.

PLEASE NOTE: This paper is for information and has not been circulated to provide guidance or advice to trusts. It is not informed by legal opinion or analysis and none of the contents should be interpreted as recommendations to individual organisations. All trusts will want to consider approaches that best suit their individual circumstances, comply with contractual and legal frameworks, and may also be informed by external professional advice.

### The annual allowance issue

Between 2010 and 2015, the coalition government introduced a range of reforms to tackle the "spiralling costs of public sector pensions", including wide-ranging and contentious plans to bring an end to 'final salary' pension schemes. Further significant policy change was brought about through targeting pension tax relief from 2011. The Finance Act – introduced in July that year – dramatically reduced the annual allowance of individual tax-free pension growth from £255,000 to £50,000 and this was further reduced to £40,000 in 2014. The changes were made as "an integral part of the government's deficit reduction programme" and 2014 amendments to both the annual and lifetime allowance (the latter reduced from £1.8 million to £1.25 million) were predicted to "reduce the cost of tax relief to the public purse by an extra £1 billion a year by 2016-17".

Perhaps the most significant reform to pensions for senior NHS staff came through the introduction of an annual allowance "taper" under the conservative government in 2016. A commitment in the Conservative Party's 2015 election manifesto, the taper was designed to further reduce pension tax relief by decreasing the annual allowance by £1 for every £2 earned by an individual over the "adjusted income" threshold of £150,000. The policy would also only apply to people with total income (not including pension growth) over £110,000, which the government said would affect less than 1% of taxpayers.

However, the changes to the annual allowance have created a significant – and seemingly unintentional – disproportionate impact on the NHS. Following a two year period in which affected staff could "carry over" their annual allowance tax charges, senior consultants, managers and some other clinical staff have been hit by large tax bills. A report prepared for NHS Employers by First Actuarial in June 2019 indicated that around 1/3rd of staff earning over £60,000 have received an annual allowance charge and more than half expect to receive one in the future. The average tax bill has been £22,000, but trusts have reported to us charges for senior doctors and managers as high as £60,000.

The greatest problem for trusts has been the incentive created by the annual allowance cap and taper for senior staff to reduce their working hours. This is particularly the case for consultants who have a base contractual requirement to work 10 "programmed activities" (PAs) but commonly agree to take on additional work, including at the weekends or in unsocial hours. As this additional activity typically leads to greater taxable pension growth, consultants have been cutting back their work to protect their pensions and avoid punitive tax bills, causing trusts considerable difficulties filling rotas, reducing waiting lists and maintaining access to timely and effective care. The First Actuarial report found that 40% of those affected have already reduced their workload, while also highlighting an issue with senior staff avoiding promotions (20% of those surveyed have done so), given pensions growth is exacerbated by large increases in pay between years. This underlined the fact that the pension tax issue does not only affect senior consultants, but can capture staff at many levels throughout the service, including those who are seeking to move into leadership roles.

## Summary of trust approaches – local schemes

The table below sets out the most common approaches trusts are taking to mitigate the annual allowance tax issue affecting senior clinicians and managers, broadly broken down into three types. These scheme descriptions are taken from member submissions in the period of 10-27 July. Of the 93 detailed responses we received, 24% have developed or are developing alternative schemes, 32% are currently considering a range of options, while 44% have decided not to pursue any form of local, regional or system-wide scheme at this time.

This table should not be read as a comprehensive cost-benefit analysis of these different approaches, but does provide key considerations based on feedback from providers.

| Scheme type | What's involved? | Potential benefits | Other considerations |
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| 1) Contribution recycling "pension restructuring payment" | The trust puts in place a policy to pay affected staff the equivalent of their locally administered employer pension contribution (14.3%) as additional salary, minus national insurance contributions and potentially some administration costs.<br><br>This may be paid in one ore more equal instalments, or monthly as salary top ups or additional allowances.<br><br>The payments would only ever be made available to staff who have opted out of the NHS pension scheme of their own volition. | • Staff are compensated significantly for their loss of pension earnings and no longer subject to annual allowance taxes unless they join alternative pension schemes<br>• May be cost neutral for trusts as employer pension contributions flow through national tariff<br>• Often available to all staff (including senior managers) who can show an actual or anticipated tax charge, regardless of grade/profession<br>• Relatively simple compared to other schemes. | • May have an adverse equalities impact, as policy is more likely to apply to high earners, who are in turn more likely to be senior consultants, and male, according to a DHSC equalities impact assessment. Potential to be unpopular with ineligible lower paid members of staff who may struggle to afford their pension contributions<br>• Some potential cost implications involved, including applying policy to those who have opted out at an earlier date, and if mass opt-outs change tariff calculations in the longer-term<br>• Risks being viewed as an 'inducement' for staff to opt out of the NHS pension scheme, in contravention of s.54 of Pensions Act<br>• Mass opt-outs would devalue the NHS pension scheme and could present a risk to the benefits it provides to members of the scheme overall and in the longer term. |
| 2) Increase non-pensionable pay and reward | The trust makes arrangements to convert a higher proportion of an affected employee's pay into non-pensionable pay or another type of reward. These arrangements might include:<br>• Splitting roles into two separate assignments, potentially with two contracts of employment, so that one of these roles is non-pensionable | • Allows staff to stay retain the benefits of NHS pension scheme membership while reducing their annual pension growth<br>• Non-pay related benefits – e.g. additional study leave , childcare, cycle to work – have the potential to benefit affected staff, and promote a culture which is supportive of well being in the organisation as a whole<br>• Potential to provide more choice to staff on | • May not have a significant impact on those affected by the annual allowance taper. While greater non-pensionable pay will reduce input growth, it will still count towards the £110,000 taxable income threshold<br>• Responsibility payments, allowances or bonuses outside of contractual pay may still be counted as pensionable by the NHS Business Services Authority (NHS BSA) depending on the reason |

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| | (potentially on the trust's locum bank terms & conditions)<br>• Offering non-pensionable bonuses or responsibility allowances for staff taking on work beyond their core contractual requirements<br>• Offering a "salary sacrifice" scheme which converts a proportion of salary into a range of non-pay related benefits, e.g. study leave budget, childcare benefits, cycle to work, gym discounts, car benefit schemes. | how they'd like to be rewarded. | for and frequency of the payment, and how it is structured. We've also heard reports of inconsistent or erroneous estimates of pensionable vs non-pensionable pay by national agencies<br>• This type of policy is likely to be more complicated to devise and administer than some other schemes<br>• This type of policy is more likely to be unpopular, or in the case of salary sacrifice be seen as a "pay cut", by affected staff<br>• Non-pay benefits may be taxable, and employees in receipt of them would need to be aware of this. |
| 3) Deferred additional leave | Essentially a time off in lieu (TOIL) approach, with staff awarded additional leave or a sabbatical/career break at an agreed time instead of pensionable salary above their core contracted pay.<br><br>Could also enable affected staff to more easily bring forward retirement. | • Retains senior clinical capacity in the short-term and affected staff retain membership of the NHS pension scheme<br>• Additional leave and/or career breaks may have positive medium to long-term benefits for staff morale and could lead to extended working lives. | • Capacity concerns, issues filling rotas and potential agency spend are simply deferred to a later date<br>• Complex local contractual negotiations on deferred leave could become a factor<br>• Some members reported that the trust could be at risk of being involved in a tax avoidance claim by taking this approach. |

## Other considerations

Trusts are exploring all possible options to ensure staff wishing to work additional hours are not faced with punitive tax bills. The three approaches outlined above are the most common members have reported to us, though some others have been considered. For example, a handful of trusts have explored the potential to pay for services from consultants who have formed a limited liability partnership (LLP), as they believe it allows more flexibility for the staff in question to manage their pension savings. Additionally, some trusts are signposting to alternative pension schemes for those who have opted out, for example, the government's National Employee Savings Trust Scheme (NEST).

From our information, it appears that the LLP approach is not being widely considered as a solution at the current time. This may be due to compliance considerations around IR35 tax rules. NEST is available to staff who do not qualify for membership in the NHS pension scheme but does not provide a similar level of benefit for members. From the feedback we've received, trusts providing information on NEST are likely to continue considering other interventions in parallel to compensate for this loss in benefit.
As stated above, trusts will want to seek external legal or other professional guidance when considering the development of alternative schemes.

# Government consultations and guidance

Earlier this month, the Department of Health and Social Care released a long awaited consultation on flexibility in the NHS Pension Scheme. However, the changes offered within this document were limited in scope, proposing only one key policy to address the issue, known as the 50:50 option, which would enable clinicians to half their pension contributions in exchange for halving their rate of pension growth.

In the lead up to the consultation release, trust boards and medical professionals expressed a clear view that this option would not solve the problem. Specifically, we were told by our members that it would not provide the necessary flexibility for senior clinicians to avoid annual allowance tax bills across multiple years, and that it would likely serve to incentivise the practice (known as 'hokey cokey') of NHS pension scheme members frequently opting in and out at calculated times to avoid being penalised. Disappointingly, the government's proposal was designed only to apply to senior clinicians who are affected by pension taxation, and not senior managers.

The government's announcement today outlines new and welcome proposals to increase flexibility in scheme members' contributions. The Department's statement says these changes will give staff "the flexibility to control their pension growth without changing their work patterns", specifically by allowing any level of contribution and growth combination (i.e. 30:30 or 70:70) to reflect different individuals' risk of breaching pension tax thresholds.

It also commits to creating guidance for organisations on "how existing discretionary flexibilities could be used to maintain the value of clinicians' total reward packages". Though further detail is needed in the coming days and weeks, it appears some, if not all of the local alternative schemes this briefing has highlighted above will be examined within this guidance.

## Comprehensive national solutions – tax policy changes

Through the feedback received from over 100 trusts this month, a number of common alternative national solutions have been suggested to us. Below we've provided a short overview of the most popular options government could take to genuinely tackle this issue. A key element of today's announcement is a commitment from the new Chancellor to "review how the annual allowance taper operates to support the delivery of public services". The two comprehensive solutions listed below are the most popular examples of what will be hoped for from this review:

### 1) Remove the annual allowance taper

This is seen as the simplest and most effective action government could take. Removing the taper would nullify a complex and confusing system for tax liability calculation which can introduce an effective 100% marginal rate on people earning above the threshold income of £110,000, presenting the disincentive for senior staff taking on additional work or promotions. An annual allowance system without the taper would still have the affect of taxing high earners, however they would more easily be able to prepare for charges against a flat pensions 'cap', and not be penalised for undertaking additional NHS work.

### 2) Increase thresholds for taper, adjusted income and annual allowance

If the taper is retained, an alternative solution would be to increase the various thresholds or caps on earnings and pensions growth that bring these policies into play for senior clinicians and managers. It is worth reiterating that the annual tax free allowance for pensions growth prior to initial policy change in 2011 was £255,000 and it may be concluded that the reduction to £40,000 (down to a minimum of £10,000 with tapering) has gone too far and affected people who were not intended to be captured. The taper threshold, and adjusted income threshold of £150,000 could also be raised. The latter figure is particularly misleading: reports on this issue often fail to highlight that the £150,000 mark is a calculation of total income + pension contributions + "deemed pensions growth", meaning senior staff earning significantly below £150,000 will be considered to have breached the adjusted income threshold.

## Partial solutions – NHS pension scheme amendments

The partial NHS-specific solutions listed below have been suggested to us by members should government refuse to revise tax policy. The additional flexibility provided through today's announcement fits within this bracket, but could also feasibly be complemented by the following changes:

### Review and adjust the pensions growth calculation method

There are some oddities involved in the calculation of annual pension growth or "pension input amount", for instance, taxable pension growth is determined by initially identifying any increase in pensionable pay for the member from the previous year, which makes pay increases through annual increments or promotions particularly sensitive to annual allowance impact. Trusts have suggested two possible changes in this area: first of all, a revision of the adjusted income allowance calculation method to only include pensionable pay and not "deemed pension growth", and secondly, a change to the multiplication factor of 16 which leads to very high pension input amounts.

1) Increase flexibility around non-pensionable pay

Trusts are seeking to find ways to increase non-pensionable pay and other reward for staff to limit the impact of annual allowance tax charges (see table above), but the rules around what is and isn't pensionable income appear to be complex. If staff could choose to be remunerated through non-pensionable income above a certain point of activity (for consultants, proposals include any work above 10 programmed activities as the standard contractual requirement, or 7-8 PAs as the level of work highlighted as the ideal long-term commitment purely to minimise the effect of pension taxes), the incentive to work fewer hours would be reduced. This change would ideally take place in combination with an amendment of the taper threshold, as the current £110,000 mark includes non-pensionable income. A separate consultation from DHSC on this option is due to be released shortly.

2) Introduce a defined contribution element to NHS pensions

While highly paid individuals across the economy are often able to avoid the worst affects of the annual allowance by reducing their pension contributions, this is not an option for NHS staff in the defined benefit scheme. The initial 50:50 option proposed by DHSC would add some flexibility to contributions – allowing a scheme member to reduce their accrual rate by 50% by paying 50% fewer contributions – but trusts have told us that it does not go far enough. We understand that the refreshed consultation to be offered by government will include, welcome, greater flexibility in this regard meaning in the longer term, local schemes of this nature may not be required..

3) Amend the loan and interest arrangement in the scheme pays facility

The scheme pays facility is clearly a useful option for many staff, who can choose to deduct the value of a pensions tax bill from their virtual pensions 'pot'. However, it does not resolve the financial benefit for senior staff to reduce their working hours, and trusts have expressed some frustration with the way it is administered. Scheme pays might be a more popular option for staff if the interest rate was reduced – it has been as high as 5.8% due to the combination of CPI and the SCAPE rate this year – or indeed if it was not set up as a "loan" as it is currently. It would likely be simpler, and less costly for scheme members to have their tax bills applied as a debit from their virtual pensions pot rather than essentially building up a large debt if using scheme pays over several years.

## Government accountability, advice and scheme accuracy

It should be emphasised that the 'comprehensive solutions' listed in the section above and proposed to us by NHS trusts would impact people across the economy, and would not be an NHS-only solution. It is NHS Providers firm view that this is not just an NHS issue, but a problem with a tax policy leading to serious unintended consequences. Media reports have indicated that more than 20 organisations from a variety of sectors have met with the Treasury in an effort to address this issue.

The NHS is particularly badly affected given its staff are members of one of the largest defined benefit schemes in the world, and given the unfortunate interaction of the annual allowance when applied across several versions on the scheme (1995, 2008, 2015), the effect of tapering, and the multiplication of pensionable pay by 16 to calculate pension input. However, this does not mean the health and social care sector should be held responsible for finding an isolated solution to a poor tax policy. The partial NHS pension scheme-related solutions listed above are worth exploring, but are unlikely to meaningfully resolve this issue in the long-term for all those affected by the tax changes.

In the short-term, policy amendments from the government's new consultation will not be implemented before April 2020, leaving trusts to manage operational issues caused by this issue in the meantime. Guidance on local schemes issued within this financial year will help to mitigate this impact however.

Separately, it is worth noting that trusts have shared examples of staff members being given inconsistent accounts or 'estimates' of their pension accrual by the NHS pension agency, or a lack of assurance over the processing of applications for scheme pays. This has been reflected in media accounts of consultants being confronted by debt collectors after previously taking action to address tax bills. Outside of efforts to implement a comprehensive solution to this issue, there is clearly an administrative task to be undertaken to ensure these faults are eliminated.

Finally, we have heard frustration from several members over the quality of NHS pension scheme-specific advice provided by independent financial advisors to their staff. We have received some suggestions that the NHS set up a framework of approved advisors which is surely another complementary option worth exploring.

## NHS Providers view

Trust leaders overwhelmingly favour a national solution to the impact of current pension rules on senior staff capacity and patient care. While this briefing details the local arrangements some providers are putting in place to mitigate the problem, it is important to note that they are doing so out of necessity. Trusts have told us that they have been driven to respond by a rising impact on their ability to provide safe and effective care, while government had previously been slow to take action. Many of the messages we've received this month from providers express hope that a national solution will be presented before their organisation is absolutely forced to make a decision on time-limited local policy actions.

With this in mind, and as the government consults with the sector on its approach, we are deliberately becoming much more vocal on this issue on behalf of trusts, and we continue to discuss possible solutions with national policy makers and parliamentarians, and engage a number of expert partners on this issue including NHS Employers and the BMA.

### NHS Providers response to today's pension proposals

Responding to today's announcement on NHS pensions, the chief executive of NHS Providers, Chris Hopson said:

*"We welcome the government's commitment to fixing an NHS pensions issue that frontline leaders say is having a significant and direct negative impact on patient care. The new Government is bringing a welcome pace and focus to this issue that was previously lacking.*

*"These proposals are helpful next steps. But we won't enable key staff to work the extra hours needed and put off ideas of early retirement until we have a clear, definitive, solution fully in place. So we have to move fast.*

*"The welcome new consultation on extra flexibility around pensions contributions and Chancellor's review of the annual allowance taper both need to be completed quickly. The Government needs to listen carefully to the views of those affected – for example, there is a strong argument that income for extra work beyond normal contracted issues should not be counted in annual allowance taper calculations. It's also important that Government recognises these issues don't just affect doctors – nurses and managers are impacted too, and any solution must cover them.*

*"Frontline leaders have rightly taken a number of immediate steps to manage the impact of this problem so their trusts continue providing safe, high quality, care. They will welcome the Government's recognition that these local flexibilities are a legitimate option in the short term".*