HYMANS ROBERTSON

Briefing note

What a difference 5 days makes: DLUHC consult on changing the date on which CARE benefits are revalued in the LGPS

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Key messages:

- DLUHC consult on moving the CARE revaluation date from 1 April to 6 April
- If implemented, many more members will avoid an Annual Allowance tax charge
- Very short time scales to implement changes

Having been heavily trailed, it was no surprise to see DLUHC announce a consultation on changing the date on which Career Average pensions are revalued from 1 April to 6 April. The move is designed to bring the revaluation of LGPS CARE benefits into line with the Pension Input Period (PIP) used for Annual Allowance tax calculations.

Why is the change being proposed?

The Annual Allowance calculation measures the increase in pension benefits over the PIP. If growth exceeds the Annual Allowance of £40,000[1] then a tax charge may be payable. The calculation of the growth allows for benefits to increase in line with a cost-of-living increase without being measured against the £40,000 limit.

The problem that has been identified is that this cost-of-living increase is different from the increase that is actually applied to CARE benefits, so a mismatch arises. In periods of fairly steady, low inflation this mismatch was shrugged off as just one of those things. However, the rapid increase in prices that occurred in 2022, resulting in a jump in the CPI measurement which is used to revalue pensions, has brought the issue to the fore.

If the changes outlined in this consultation were not applied, then the inflationary allowance allowed for in the 2022/23 Annual Allowance calculation would be 3.1% while CARE benefits would be increasing by 10.1%. This would see significantly more people breaching the Annual Allowance and paying a tax charge.

The consultation

This is a 'blink and you'll miss it' consultation, lasting only 2 weeks from 10 February 2023 to 24 February 2023. The tight timescale is likely to mean that, if the changes are implemented, pension administration systems will not be updated in time for April's increases to be applied.

[1] A different Annual Allowance figure can apply in certain circumstances.

We'll be replying to the consultation soon and will share our thoughts more widely, but in this Briefing Note we explore what the changes will mean for those individuals affected.

In the interests of simplicity these examples ignore pence and are rounded to the nearest whole number. This means that, from time to time, rounding discrepancies appear in the numbers.

Scenario 1 – the 2022-23 Pension Input Period assuming the consultation changes are not implemented

Opening value of benefits at 6 April 2022

Final pay	£60,056
1/80 service	12 years
1/60 service	6 years
Final salary pension	£15,014
Lump sum	£27,025
CARE pension	£8,000

Opening value (before inflation) = 16 * (£15,014 + £8,000) + £27,025 = £395,247

This value is then uplifted by the CPI figure for the previous September (i.e. September 2021) which was 3.1%

Total opening value = £395,247 * 1.031 = **£407,500**

Closing value of benefits at 5 April 2023

Final pay	£64,024
1/80 service	12 years
1/60 service	6 years
Final salary pension	£16,006
Lump sum	£28,811
CARE accrual up to 31 March 2023	£9,288
Revaluation to be applied to CARE accrual on 1 April 2023 (based on Sept 2022 CPI)	10.1%
5 days CARE accrual from 1 April 2023 to 5 April 2023	£18
Total CARE at 5 April 2023	£10,245

Closing value = 16 * (£16,006 + £10,245) + £28,811 = **£448,820**

Growth over the PIP = £448,820 - £407,500 = **£41,321**

In this example the individual has exceeded the Annual Allowance. Part of that growth is the result of an increase in pay that increases the value of the final salary benefits but a fair proportion of it (more than £10k) results from the fact that CARE benefits go up by 10.1% while the CPI allowance applied at the start of the PIP is only 3.1%.

Scenario 2 – the 2022-23 Pension Input Period assuming the consultation changes are implemented

If the changes outlined in the consultation are implemented, there will be no impact on the way that the 2022-23 opening value is calculated.

Starting value of benefits at 6 April 2022

Total opening value = **£407,500**

Closing value of benefits at 5 April 2023

Final pay	£64,024
1/80 service	12 years
1/60 service	6 years
Final salary pension	£16,006
Lump sum	£28,811
CARE accrual up to 31 March 2023	£9,288
5 days CARE accrual from 1 April 2023 to 5 April 2023	£18
Total CARE at 5 April 2023	£9,307

The revaluation date is now 6 April, meaning that the 2023 CARE revaluation does not fall in the 2022-23 PIP, so no revaluation is applied to the CARE benefits.

Closing value = 16 * (£16,006 + £9,307) + £28,811 = **£433,811**

Growth over the PIP = £433,811 - £407,500 = **£26,311**

In this example the fact that no revaluation has occurred to the CARE benefits during the 2022-23 PIP means that the closing value is markedly reduced. In this case there is no breach of the Annual Allowance.

Scenario 3 - the 2023-24 Pension Input Period assuming the changes are implemented

The opening value for 2023-24, will be the closing value of the 2022-23 PIP (ie the value of benefits accrued up to and including 5 April 2023) plus the cost of living increase based on CPI as at September 2022.

Starting value of benefits at 6 April 2023

Closing value of 2022-23 benefits = £433,811

September 2022 CPI = 10.1%

Total opening value = £433,811 * 1.101 = **£477,62**

Closing value of benefits at 5 April 2024

Final pay	£65,704
1/80 service	12 years
1/60 service	6 years
Final salary pension	£16,426
Lump sum	£29,567
CARE accrual up to 31 March 2023	£9,288
Revaluation to be applied to CARE accrual up to 31 March 2023 on 6 April 2023 (based on Sept 2022 CPI)	10.1%
CARE accrual from 1 April 2023 to 31 March 2024	£1,341
CARE accrual from 1 April 2024 to 5 April 2024	£18
Total CARE at 5 April 2024	11,586

Closing value = 16 * (£16,426 + £11,586) + £29,567 = **£477,759**

Growth over the PIP = £477,759 - 477,626

Growth over the PIP = **£133**

In this case the growth in the value of pension benefits over the PIP is very low at only £133. The reason for this is the significant cost of living increase that is applied to the starting value of 10.1%. This increase is applied to all benefits, final salary and CARE, however, it is only the CARE benefits that are actually increased by 10.1% on 6 April 2023. The final salary benefits actually increase in proportion to the increase in final salary over the PIP, which is closer to 2.6%.

Conclusions

The move to apply revaluation to CARE benefits on 6 April will have the desired effect of aligning the increase that is applied to the starting value for Annual Allowance purposes with the revaluation that is applied to CARE benefits. This will see fewer members affected by the Annual Allowance in 2022-23 than would otherwise be the case if the move was not made.