Salary Sacrifice and Shared cost AVCs - Scotland

1. Where an employee opts to pay Additional Voluntary Contributions (AVCs) under regulation 17 of the Local Government Pension Scheme (LGPS) (Scotland) Regulations 2014 (the 2014 Regulations), an employer can decide to also contribute to that employee's AVC arrangement. This is known as a shared cost AVC (SCAVC).

2. This could be done under a salary sacrifice arrangement.

3. How would this work? Well, let's assume that an employee is paid £20,000. The employer says to the employee:

   "If you give up £1,000 of your salary, I'll put that £1,000 into a Shared Cost AVC and all you'll have to do is put in a direct contribution of £1 a month. You'll save tax and National Insurance (NI) and I, as your employer, will save NI too."

   "Sounds good", says the employee. "I could have got the tax relief anyway by paying that same £1,001 into the AVC pot myself, without doing it via salary sacrifice, but via salary sacrifice I'll get the bonus of saving on NI contributions too. However, I'm only prepared to do this if my main pension benefits are not affected. If I and the employer only contribute LGPS contributions on the post sacrifice salary, the resultant benefits from the SCAVC would be uncertain (as they are based on investment returns), so why would I wish to forego salary and thereby potentially reduce my pension benefits?"

   "Hmm", thinks the employer, "I can see the employee's point, but if I agree to make the pre salary sacrifice level of pay pensionable will this add to my costs? Well, pre salary sacrifice I'd have paid £20,000 salary, plus Employer's NI and Employer's LGPS contributions on that £20,000 salary. Post sacrifice, I'll pay £19,000 salary, £1,000 into the SCAVC, Employer's NI on the £19,000 and Employer's LGPS contributions on £20,000. So I'll save Employer's NI on £1,000. Sounds good, so if the LGPS Regulations and the tax rules allow it, and the administration costs don't outweigh the Employer's NI saving, I think I'll offer this as an option."

4. So, do the LGPS Regulations and tax rules allow this? Yes, they appear to do so.

5. As already stated, regulation 17 of the 2014 Regulations permits an employer to contribute to a shared cost AVC.

6. Employer and employee LGPS contributions can continue to be paid on the pre salary sacrifice level of pay provided the employer specifies in the employee's contract of employment that the contribution the employer makes to the SCAVC will be a pensionable emolument (in accordance with regulation 20(1)(b) of the 2014 Regulations.

7. The requirement in regulation 20(2)(a) of the 2014 Regulations which states that pensionable pay does not include "any sum which has not had income tax liability determined on it" does not appear to be a problem as:

a) section 307 of the Income Tax (Earnings and Pensions) Act 2003[1] (death or retirement benefit provision) says:

(1) No liability to income tax arises by virtue of Chapter 10 of Part 3 (taxable benefits: residual liability to charge) in respect of provision made by an employee's employer under a registered pension scheme or otherwise for a retirement or death benefit.

(1A) Subsection (1) does not apply to provision made for insuring against the risk that a retirement or death benefit under an employer-financed retirement benefits scheme cannot be paid or given because of the employer's insolvency.

(1B) In subsection (1A) "employer-financed retirement benefits scheme" has the same meaning as in Chapter 2 of Part 6 (see section 393A).

(2) In this section "retirement or death benefit" means a pension, annuity, lump sum, gratuity or other similar benefit which will be paid or given to the employee or a member of the employee's family or household in the event of the employee's retirement or death.

and

b) section 308 of the Income Tax (Earnings and Pensions) Act 2003[2] (exemption of contributions to registered pension scheme) says:

(1) No liability to income tax arises in respect of earnings where an employee's employer makes contributions under a registered pension scheme.

"Earnings" are defined in section 62 of the Income Tax (Earnings and Pensions) Act 2003 as:

(1) This section explains what is meant by "earnings" in the employment income Parts.

(2) In those Parts "earnings", in relation to an employment, means—

[1] S.307 exempts an employee from tax (under s.201 ITEPA) on employer contributions as a benefit in kind
[2] s.308 exempts an employee from tax (under s.62 ITEPA) on the employer contributions as earnings

(a) any salary, wages or fee,

(b) any gratuity or other profit or incidental benefit of any kind obtained by the employee if it is money or money's worth, or

(c) anything else that constitutes an emolument of the employment.

(3) For the purposes of subsection (2) “money's worth” means something that is—

(a) of direct monetary value to the employee, or

(b) capable of being converted into money or something of direct monetary value to the employee.

(4) Subsection (1) does not affect the operation of statutory provisions that provide for amounts to be treated as earnings (and see section 721(7)).

8. So, it seems that an employer contribution to a SCAVC is initially a benefit that is taxable but is then exempted from tax by section 307 and 308 of the Income Tax (Earnings and Pensions) Act 2003. ‘Income tax liability’ as referred to in regulation 20(2)(a) of the 2014 Regulations will therefore have been determined on the value of the employer contributions.

9. Furthermore, if a member has pre-April 2014 final salary membership, the pre-salary sacrifice level of pensionable pay would be used for the purpose of calculating the member’s final pay if the member leaves the scheme or retires whilst still participating in the SCAVC.

10. Where an employee and their employer contribute to a SCAVC, it is important that the employer informs their local administering authority of this and whether the employer contribution is paid under a salary sacrifice arrangement or not. If a member with a SCAVC leaves the LGPS with an entitlement to a refund, the administering authority will need to know this information in order to calculate the refund correctly. Under regulation 18(1)(c) of the 2014 Regulations, a member is entitled to a refund of their own contributions to a SCAVC, but is only entitled to a refund of their employer’s contributions to a SCAVC where the employer contribution is paid under a salary sacrifice arrangement.

11. For those employers in the LGPS who trade and have taxable profits, a salary sacrifice SCAVC contribution will be allowable as a deduction in arriving at the employer’s taxable profits – see http://www.hmrc.gov.uk/manuals/bimmanual/bim46075.htm.

12. It is also worth noting that if a member already has an active AVC arrangement in place and enters into a SCAVC with their employer, this would be a new arrangement for the purposes of the LGPS (Scotland)

Regulations 2014. The member would have to cease paying into their previous AVC arrangement and could choose to either:

a) leave their previous AVC as a separate pot (this may be something an individual would wish to do if they want their original AVC to remain governed by the regulations under which they started that AVC), or
b) transfer their prior pot into their new SCAVC, in which case the whole of their pot would be governed by the regulations in force at the time the SCAVC was entered into (for SCAVCs entered into after 1st April 2015, the LGPS (Scotland) Regulations 2014).

13. One last, but important, point to mention about a SCAVC salary sacrifice is that it could result in tax implications for the scheme member if the member breaches the Annual Allowance – see the HMRC Pensions Tax Manual for more information, or the LGPC annual allowance factsheet for members.

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