the law of unintended consequences

Even the Guardian shouted "NHS consultants turning down work to avoid huge pension tax" (24 June 2019). All the press ran the same story. On 9 July 2019 one Rachel Clarke wrote this in that paper.

> Everyone loves to hate a fat cat. And so, in 2016, when former chancellor George Osborne decided to reduce pension tax relief for very high earners, he must have thought he was on to a sure thing. After all, with a UK average household income of only £26,000, who would ever complain about the fate of people so indecently well paid they could afford to set aside up to £40,000 a year in pension contributions?
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> Three years on, Osborne's slam-dunk strategy for bolstering the exchequer's coffers is wreaking havoc on the NHS. Something as arcane and tedious as pension tax law is threatening to increase waiting lists, lengthen delays in starting cancer treatment and endanger the lives of NHS patients.

The Finance Act (No 2) 2015, s23 and schedule 4 were not, of course, aimed at the NHS's highly paid medical staff, but apply to all highly paid members of all registered pension schemes, whether in the public or private sector, whether defined benefits (eg final or career average salary) or defined contribution (money purchase). The impact on NHS (mainly consultants and GPs) was caused not from the change in the law alone, but from a combination of, on the one hand, the rigidity of the NHS's employment terms and its pension scheme rules and, on the other, the flexibility of working hours and commitment enjoyed by the NHS's senior medical staff.

tapered annual allowance

The Finance Act 2004 reformed pension scheme taxation from 6 April 2006. Members and employers enjoy tax relief on contributions up to the member's annual allowance ("AA"), which is the amount of the member's taxable pay capped at £40k pa. Initially the cap on the annual allowance was £215k (and by 2010/11 had risen to £255,000), but the Government policy has since been to reduce the tax reliefs available to highly paid persons, most recently by the Finance (No 2) Act 2015, which inserted s228ZA and s228ZB into the FA 2004.

From 6 April 2016 for every £2 of income (whether pensionable or not) over £150k pa, £1 of the taxpayer's AA is lost up to a maximum of £30k, so anyone earning over £210k pa has an annual allowance of £10k. This is called tapered AA.

If the contributions paid by and for a member exceed his AA, he (or she, but I keep to "he" etc for short) is chargeable with a tax called the AA charge. The calculation is relatively straightforward in the case of DC scheme, because the chargeable amount is the amount of the contributions in the tax year. It is complicated in the case of a DB scheme, because the chargeable amount is reached by a formula, which takes account of the increase in the calculated value of a members DB (final or average salary) pension over the year, and so the increase and not the contributions actually paid is the chargeable amount. The problem for a DB member is that the value of his pension can be increased merely by the additional year of pensionable service, and is likely to be increased more substantially by any salary increase or bonus or both paid in the year.

Initially the carry-forward of previously unused annual allowances has mitigated the annual allowance charge, but now any such relief is likely to have been exhausted.

The short term impact of this tax can be mitigated by the "scheme pays facility". Sections 237A to 237E of the FA 2004 enable a member with this liability to require the scheme to discharge this tax and reduce the member's benefits accordingly.

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the NHS and consultation

The NHS Pension Scheme is a registered defined benefits scheme with different types of final and career average salary pensions in different sections. Lump sums, ill-health pensions and pension benefits for dependants are provided in all sections. Membership is automatic for eligible persons. Members may opt out, but, if they do, they lose both ill-health benefits and dependant's benefits on death in service.

In the words of the Department of Health & Social Care ("DHSC"), "senior clinicians, particularly consultants and GPs, have a unique degree of flexibility over their workloads and can vary their commitments. Consultants can reduce or increase the number of additional sessions undertaken, and many GPs are self-employed. This can create perverse incentives for clinicians to seek to control their income and pension growth by limiting or even reducing their NHS work to avoid breaching their annual allowance."

The consequent serious disruption to the provision of NHS services has prompted the DHSC to negotiate with the medical profession to introduce some flexibility into the NHSPS with the intention of enabling members to control their accrual of pension and contributions order not to exceed the AA and to aim for the maximum lifetime allowance ("LTA") (£1,055,000 in 2019/20) to be reached at a time which matches their target retirement dates. Its first proposal, a 50:50 option by which members could reduce their pension contributions and pensions accrual by 50%, was found to produce insufficient flexibility, which led to a new consultation paper (11 September 2019), suggesting a two stage process to control pension accrual and contributions.

First Before start of each scheme year, the member can choose an accrual and contribution rate as percentages of the standard rates, in multiples of 10%.

Secondly Towards the end of the year, when the member will have a good idea of his total earnings, he will be able to update the accrual and contribution rates with retrospective effect to match the optimal accrual and contribution rate for the year.

Employers may pay unused employer contributions to the members as salary, but in a lump sum at the end of the year.

conclusion

Whilst the proposals should help to alleviate the problem, they might not be sufficient. The DHSC "has form" for its unwillingness or inability to adapt the NHS Pension Scheme to changing circumstances: see, as an example, my article at www.law-office.co.uk/art_24-hour_retirement.pdf about its bureaucratic and arguably unlawful 24-hour retirement arrangements. I end with three possible weakness in the DHSC's present proposals, and doubtless other will find many more.

The DHSC in its consultation paper rejects the suggestion of a zero accrual option for members, who have reached their LTA and do not wish to accrue any more pension rights, but wish to remain in the scheme for ill-health and death in service benefits. It says "Without pension accrual taking place, it would be inappropriate for tax-relieved contributions to purchase insurance products." It is commonplace in the private sector to provide insured benefits in either stand-alone insurance schemes or in insurance only sections of occupational schemes.

While not directly related to the tapered AA, it is relevant to the wider tax issues to suggest that responsible employers (including the NHS) should not provide death in service lump sum benefits for dependants out of a registered pension scheme, where the amount is likely to cause the LTA of highly paid staff to be breached: see www.law-office.co.uk/art_lifetime_allowance_risks_2016.pdf.

Seriously for members, but not surprisingly, the DHSC appears to have made no proposals to compensate members, who have already incurred tax liabilities as a result of its failure to have acted earlier to introduce the kind of flexibilities only now being proposed.