

UK Pensions Briefing – Tax clarifications remove one of the key remaining obstacles to GMP equalisation

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On your marks for GMP equalisation!

Have you delayed a decision on how to equalise pensions for the effect of unequal guaranteed minimum pensions because you didn't know what the tax treatment of uplifts to pensions would be? HMRC has issued its guidance on how it will treat certain payments relating to GMP equalisation, which means most unequal past payments of pension can now be fixed.

This also means that pension scheme trustees should step up their project planning to ensure they can properly consider and start implementing their preferred method of GMP equalisation.

There remains significant uncertainty on tax and other areas where trustees wish to consider converting future GMP payments to other benefits but, at the moment, the Government seems to have other fish to fry. We look at the approach HMRC has taken so far to equalisation of GMPs and what you can and can't do now.

The problem

The High Court decision in *Lloyds Banking Group Pensions Trustees Ltd v Lloyds Bank plc* in 2018 confirmed that trustees must equalise overall pension benefits as between men and women to correct the effect of unequal underlying GMPs. That means trustees of formerly contracted-out schemes are currently in breach of trust for not having paid correct benefits in the past.

Many trustees and scheme administrators have been grappling with the practical application of that judgement amidst worries that actually fixing past payments, or changing future benefits, would create unwanted tax charges for members out of all proportion to the uplift for equalisation.

Over the past few months, HMRC has published two newsletters setting out its approach to the tax treatment of GMP equalisation. The guidance does not apply to any conversion of future benefits into something simpler, but does still cover all corrections for past underpayments. Mostly the guidance is helpful. However, HMRC's approach in relation to previous trivial commutation lump sums may pose significant complications.

Lifetime allowance and annual allowance

The [February 2020 newsletter](#) looked at the effect of GMP equalisation on scheme members who have lifetime allowance protections or who need to remain outside the annual allowance provisions (for example, members who fall within the deferred member carve-out).

The good news is that, even if GMP equalisation leads to members getting a higher pension at retirement, HMRC does not consider that this increase is a new entitlement for the purposes of the post-2006 tax regime. It results from a period of membership between May 17, 1990 and April 5, 1997. As a general rule therefore, GMP equalisation benefit adjustments, on their own, will not constitute a new accrual of benefit which needs to be tested for the purpose of the annual allowance or which might cause members to forfeit their lifetime allowance protections.

However, GMP equalisation adjustments may still affect the amount that trustees should declare for lifetime allowance purposes at the various benefit crystallisation events in a member's life. That means updating information given in BCE statements on previous benefit crystallisation events.

Past and future payment of lump sums

In its [July 2020 newsletter](#), HMRC looked at past and future payment of lump sum benefits. These are more complicated. There are two key statutory criteria applying to the payment of various different lump sums which HMRC has had to grapple with:

- Any requirement to extinguish a member's or dependant's rights.
- Any limits on amounts which apply to particular lump sums.

Tackling past lump sums that had to extinguish a member's or dependant's rights

Some types of lump sum can only be paid if the payment extinguishes the member's or dependant's rights under the scheme or arrangement. This applies, for example, to serious ill health lump sums, trivial commutation lump sums and "small lump sums" (various lump sums of £10,000 or less).

GMP equalisation benefit adjustments may result in a member getting a further entitlement in the scheme after having already had one of these lump sums. This could have rendered the previous payments unauthorised because the previous payment hadn't, in retrospect, wiped out all the member's rights.

However, HMRC has found a way out. HMRC expressly states that "*the lump sum will not stop being an authorised payment purely because, due to GMP equalisation, further entitlement is later identified that the scheme administrator could not reasonably have known about at the time of the lump sum payment*".

We have known GMP equalisation was required since October 2018, but HMRC takes the view that until the trustee has selected and adopted a particular GMP equalisation methodology, the scheme administrator still doesn't reasonably "know" what a member's entitlement is. So the administrator can continue to pay out these lump sums without equalisation until the point at which the methodology is selected and implemented. That said, paying out a second, even smaller, lump sum later to honour the member's equalisation rights will be fiddly and could be disproportionately expensive, so trustees may still prefer to hold back on small lump sums where there is a later equalisation uplift seems likely. Serious ill health lump sums remain the exception to that objection, where the priority is to support the member at a difficult time.

Tackling past lump sums which had payment limits

Some lump sums, for example small lump sums, winding up lump sums and trivial commutation lump sum death benefits, have a fixed limit on the amount that can be paid out. The exact limit depends on the type of lump sum and when the payment was made, as some of the statutory limits have changed over time.

HMRC's view is that the payment limit applies to the amount of lump sum that was actually paid. This means that provided the payment was within the statutory limits at the time, a payment will not become unauthorised just because further entitlement is identified later during the GMP equalisation process.

However, the position is different in relation to trivial commutation lump sums, where the limit isn't based on the amount of the payment, but rather on the value of the member's pension rights under all registered pension schemes on a certain date. Again, these limits vary depending on when the lump sum was paid. From March 27, 2014, onwards, the limit has been £30,000.

HMRC's approach is that, because GMPs accrued before April 6, 1997, the value of the member's pension rights under all registered pension schemes on the relevant date included the equalised GMP rights. This means that if, because of the GMP equalisation process, the administrator finds that, in retrospect, the value of the member's pension rights under all registered pension schemes was above the limit on the relevant date, the payment could not have been a trivial commutation lump sum. Unless the payment qualified as a different type of lump sum, the payment will have been unauthorised.

Exactly how you deal with this potentially some years after the fact is unclear. GMP equalisation uplifts may have been applied to the member from several schemes. Trustees and administrators may not have the necessary details to unpick previous trivial commutation lump sum payments to find out if they were unauthorised and deal with the tax implications, where relevant. It may have to be a case of contacting the member and asking them, as part of the process of delivering any uplift. Trustees should seek advice on how to approach this issue within the context of the GMP equalisation process.

Paying out "top up" payments

Where administrators identify further entitlements which they need to pay out, the "top-up" payment must satisfy the relevant conditions at the time the new payment is made. The conditions applying at the time of the original payment are not relevant. This may mean that the "top-up" payment cannot be an authorised payment or alternatively that it is a different form of authorised payment.

Trustees and administrators should ensure that any "top up" payment they make to members or dependants satisfies the relevant statutory conditions at the time they pay it out.

Where next?

HMRC's guidance is helpful in clearing away some of the potential issues arising from GMP equalisation. However the position concerning the past payment of trivial commutation lump sums is likely to create significant administrative issues for schemes which have routinely paid out this type of lump sum in the past.

Guidance on the tax treatment of conversion seems a long way off – trustees should take legal advice on ways to mitigate the risk for members if targeting conversion in the immediate future.

We are also currently waiting for the judgment in the further instalment of the *Lloyds Banking Group case*, which will hopefully tell us who is responsible for past transfers out and whether trustees are protected by the statutory discharge. It sounds as if the judgment may be some time off yet, but that doesn't stop trustees and administrators working through the equalisation process for members who do not have transfer credits, and for benefits unconnected to those transfers.



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