**Defined Benefit Arrangements**

**Assignment 2**

*(Part 3 – Taxation and Governance of Defined Benefit Schemes)*

*Recommended Time: 3 hours*

1. **Outline how members are taxed on the authorised payments made from the scheme. In what way is this different to the taxation of other authorised payments?**

**20 marks**

Relevant section of the manual is Part 3 Chapters 1.4.1 and 1.4.2.

Format: descriptive, in distinct paragraphs/sections

Answer should cover:

* PAYE – types of payments and rate of tax charged:
  + Pensions
  + Trivial commutations
  + Lump sum death benefits
  + Serious ill-health lump sums
  + UFPLS
* Tax charged on scheme administrator – types of payments and rates of tax charged:
  + Refunds
  + Benefits transferred to a QROPS subject to the overseas tax charge
  + Taxable lump sum death benefits not paid to an individual
  + Accounting for Tax return

1. **In your capacity as an appointed trustee adviser, the trustees have asked you to provide advice on how they can manage risk. Write a paper for the trustee, advising why risk management is necessary and outlining the various steps in the risk management process.**

**20 marks**

Relevant section of the manual is Part 3 Chapter 2.5.6.

Format: formal report, introduction, key information, summary/conclusion, recommendation

Answer should cover:

* Why risk management is necessary
* Regulatory guidance
* Brief description of the 7 steps in a risk management process-

Set objectives When undertaking a risk management review, trustees should have a clear understanding of what the process is aiming to achieve.

Identify Risks Trustees will need to consider all the key operations of their scheme and identify actual or potential risks which could be detrimental to their performance. The regulator expects trustees to use a formal risk register.

Define Success Criteria Trustees need to take a proportionate approach to managing risk and recognise that risk cannot be completely eliminated. Trustees need to consider to what extent risks can be absorbed by the scheme and which risks they must manage.

Assess Risk Trustees need to evaluate each risk identified and categorise it depending on its impact (e.g., financial) and likelihood of occurrence.

Produce Action Plan After evaluating the different classes and categories of risk, trustees need to decide on the best approach for managing (or controlling) these. This will include identifying responsibilities and time scales for delivering internal controls. Whilst this could be recorded in an action plan, the risk register could also capture this information.

Implement Action Plan Trustees need to ensure that performance against the action plan is monitored and those responsible for certain activities deliver within agreed timescales.

Monitor and Review The design and implementation of an internal controls’ framework is not a one-off exercise. Trustees need to continually monitor the effectiveness of controls to ensure they are still adequate, and periodically review their scheme’s exposure to new and emerging risks.

1. **What are the key principles of good governance?**

**5 marks**

Relevant section of the manual is Part 3 Chapter 2.5.

Format: list

* Professional/motivated trustee board
* Appropriate policies
* Transparent accountability
* Regular reviews
* Formal information flows and communication channels

1. **You are an in-house Pensions Manager and Secretary to the Trustees of the Company’s pension scheme. One of the member-nominated trustees has resigned. Briefly outline the considerations necessary when appointing a new trustee.**

**10 marks**

Relevant section of the manual is Part 3 Chapter 2.5.1.

Format: descriptive

Answer should cover:

* Legal requirement – one third member nominated
* Effective process to identify and appoint
* Selection process
* Standards of suitability
* Collective skills of trustee board – any gaps/avoid duplication?
* Consideration of Independent trustee

1. **The Company is concerned that its higher earning employees are at risk of incurring an annual Allowance Charge. Prepare a letter to the high earners explaining how the Annual Allowance operates and how the Tapered Annual Allowance could impact them from a taxation perspective.**

**20 marks**

Relevant section of the manual is Part 3 Chapters 1.3.1, 1.3.2 and 1.3.5.

Format: letter, formal

Answer should cover:

* Finance Act 2004
* What is the AA and the threshold- the maximum increase in the value of a member’s benefits that can occur in each tax year before a tax charge (the ‘Annual Allowance charge’) arises.
* AA has reduced over time -. The allowance was initially set at a high level, but from 6 April 2011 it was significantly reduced to £50,000 and was further reduced to £40,000 from 6 April 2014.The value of the AA for 2023/24 is now £60,000 and remains this for 2024/25
* Carry forward
* Tapered AA introduced April 2015. The amounts were revised by the Finance Act 2023. From 6 April 2023, individuals who had income for a tax year of greater than £260,000 have their AA for that tax year restricted. For every £2 of income, they had over £260,000, their AA was reduced by £1. Anyone with adjusted income of above £360,000 would have an AA of £10,000.
* Income and adjusted income and the respective thresholds
* A simple worked example of a tapered AA calculation
* Money Purchase Annual Allowance. From 6 April 2015 a Money Purchase Annual Allowance (MPAA) of £10,000 applies to all future money purchase contributions once a member has accessed any DC funds flexibly. The MPAA was reduced to £4,000 with effect from 6 April 2017, but rose to £10,000 from 6th April 2023. Remains this in 2024/25.

1. **You are a Third-Party Administrator. Your client has asked for information about the requirements of a Scheme Administrator in relation to the overseas transfer charge and overseas transfer allowance when a member requests a transfer to a qualifying recognised overseas pension scheme. Write a short paper to send to your client.**

**20 marks**

Relevant section of the manual is Part 3 Chapter 1.3.7.

Format: formal, short report, short introduction and conclusion, 3 main headings

Answer should cover:

* Overseas transfer charge and tax rate
* Overseas transfer allowance and provisions
* Information to be provided to member within 90 days of the transfer date
* Required information if overseas tax charge applies
* Required information if overseas tax charge does not apply-the date of the transfer
* • the fact that the transfer was not chargeable to tax
* • why the transfer was not chargeable and any actions that will mean the transfer subsequently becomes chargeable
* Required information if overseas tax charge is repaid to scheme administrator-within 90 days after the date of repayment provide the member with a notice stating:
* • the date of the repayment
* • the amount of the repayment, and
* • the reason for the repayment

1. **Give a brief summary on the legal requirements of Trustee Knowledge and Understanding**

**5 marks**

Relevant section of the manual is Part 3 Chapter 2.4.1.

Format: descriptive

Answer should cover:

* Pensions Act 2004
* Knowledge and Understanding
* Conversance with scheme documents