

PENSIONS IN 30 PODCASTS

12 ONGOING SCHEME FUNDING - refunds of surplus to employer

Key points

- There are circumstances in which a defined benefit pension scheme may have a funding surplus.
- Refund of surplus to an employer is permitted if certain requirements are met, which differ depending on whether the scheme is ongoing or in wind-up. The requirements include:
 - Ongoing scheme: power in the rules, refund within limit specified by actuary, in members' interests to exercise power, 3 months' notice to members.
 - Scheme in wind-up: power in the rules, scheme liabilities fully discharged, any power to pay surplus to others considered, 3 months' notice to members.
- Section 251 of the Pensions Act 2004 provides that, for an ongoing scheme, the refund or surplus power is lost unless the Trustees pass a resolution meeting the requirements of section 251 to retain the power by 5 April 2016. In practice, this means Trustees must have given written notice of their intention to make such a resolution to members and employers by 4 January 2016.
- Under the Finance Act 2004, a refund of surplus payment will attract a 35% tax charge payable by the Trustees, which should be deducted from the surplus payment before it is paid.

Main sources

- Pensions Act 1995 – refund of surplus requirements
- Pensions Act 2004 – retaining refund of surplus powers
- Finance Act 2004 – tax on surplus
- Occupational Pension Schemes (Payments to Employer) Regulations 2006

Funding a pension scheme

Employers have a number of legal obligations to support their occupational pension scheme. In a defined benefit (DB) pension scheme, the sponsoring employer will usually agree with the trustee the level of contributions it is required to make in order to fund the scheme to a level that will allow it to meet its liabilities. Most DB schemes have a funding deficit and so a recovery plan is put in place and the employer will make additional deficit reduction contributions.

Occasionally a DB scheme may have a funding surplus, for example, where a scheme's investments exceed expectations for a number of years. Where this occurs an employer will be keen to ensure that any excess contributions it has paid to the scheme can be returned.

Refunding surplus

Until 6 April 2006, if a pension scheme had a surplus the trustees were required to eliminate that surplus. One way to do this was to repay the surplus to the employer. Certain requirements must have been met before the surplus could be repaid, including the requirement to apply a specific increase to all pension benefits.

More information

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The obligation to eliminate a surplus was removed on 6 April 2006 (under the Finance Act 2004) as a result of tax simplification measures to remove out-dated HMRC restrictions on over-funding of pension schemes. A refund of surplus to an employer is still permitted, but only if certain legislative requirements are met. The requirements differ, depending on whether the scheme is ongoing or in wind-up.

1. Refunding surplus in an ongoing scheme

For an ongoing scheme set up prior to 6 April 2006, the requirements include:

- there must be a power to pay a refund to an employer in the rules of the scheme;
- the refund must not exceed the maximum amount specified in an actuarial certificate; and
- the trustees must be satisfied that it is in members' interests to exercise the power and must have given members at least 3 months' notice.

Section 251 of the Pensions Act 2004 provides that any pension scheme with a power to return surplus to an employer will lose that power unless the trustees pass a resolution to retain it by 5 April 2016 (this deadline was extended from 6 April 2011). Any such resolution must meet the specific requirements of section 251.

Where there is no power to pay a refund of surplus in the rules of the scheme the power cannot be added unless the scheme's power of amendment is wide enough to permit this. If the power of amendment prohibits such a change the power cannot be added and the surplus cannot be paid to the employer.

But in any event, a resolution would have had to be made as above.

Where the Trustees of an ongoing scheme pay a refund of surplus they are required to notify The Pensions Regulator of the payment within one week of making it.

Note that for schemes set up after the introduction of Pensions Act 2004, Section 251 does not apply and it is still possible for a payment to an employer from scheme funds without a Section 251 resolution.

2. Refunding surplus on wind-up

The legislative requirements for a refund of surplus to an employer where a scheme is in wind-up include:

- there must be a power to pay a refund to an employer in the Rules of the scheme;
- the scheme's liabilities must be fully discharged;
- the scheme's power (if there is one) to distribute assets to a person other than the employer must have been considered, and either exercised or not; and
- the trustees must have given members at least 3 months' notice.

The notice given to the members of a scheme in wind-up must invite them to make representations in relation to the proposal to the Trustees, the employer, or ultimately to The Pensions Regulator if the member does not consider that the legislative requirements are met. The Pensions Regulator may issue a notice to the Trustees or the employer that the payment must not be made until it has confirmed it is satisfied that the legislative requirements are met.

A refund of surplus payment from an occupational pension scheme (including both an ongoing scheme and a scheme in wind-up) will attract a 35% tax charge, payable by the Trustees (as the administrators of the scheme). This is a free standing tax charge and so no off-sets can be made from it. The Trustees should deduct the tax charge from the surplus payment before it is paid.

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