

# Paying severance into a pension scheme

## Pension Guide – Information for members

The purpose of this guide is to provide **pension scheme members** with a brief explanation of paying severance into a BAE Systems pension scheme. Severance pay can be offered to employees who are terminated, either involuntary or voluntary. You can find a summary of the process on page 3 of this guide.

Members of a BAE Systems pension scheme may choose to pay part or all of their severance payment (with the exception of any Statutory Redundancy Pay) in exchange for an employer pension contribution into their scheme's Additional Voluntary Contribution (AVC) fund. Employer contributions into a pension scheme are tax and National Insurance (NI) free. The contribution is deducted from the total severance payment and is paid as an employer pension contribution into the AVC fund. Any remaining severance will be paid to you subject to any tax/NI deductions as required under the normal tax rules on severance payments.

### Tax treatment of severance – post employment notice pay

Up to £30,000 of your severance package *may* be tax and NI free. It will depend on whether you have any Post Employment Notice Pay (PENP) under tax rules from April 2018. Any part of a severance payment that relates to unworked notice will be taxable as PENP. If you have worked all of your notice period there will be no PENP.

**Example:** An employee has a three-month notice period and it was agreed with their employer that they would only work two months of this. This will mean there is one month's unworked notice and therefore the portion of the severance payment equal to one month's pay will be PENP and is automatically subject to tax and NI. This simple example is in months, but in practice, it is calculated by reference to days and starts from the date the notice is given.

If you have an element of PENP, any balance of severance over the amount of PENP will be exempt from tax and NIC up to £30,000. Statutory Redundancy Pay (SRP) is always tax free, forms part of the £30,000 tax-free limit and is not treated as PENP.

The table below contrasts the impact to tax and NI where an employee has no PENP and where they do.

No PENP (all notice is worked)	With PENP (not all notice is worked)
<p>£50,000 severance package:</p> <ul style="list-style-type: none"><li>£10,000 is SRP</li><li>£40,000 is compensation</li></ul> <p>The first £30,000 is tax and NI free The remaining £20,000 is taxable but not subject to NI deductions</p>	<p>£50,000 severance package:</p> <ul style="list-style-type: none"><li>£10,000 is SRP</li><li>£24,000* is PENP</li><li>£16,000 is compensation</li></ul> <p>£24,000 is subject to tax and NI £26,000 is tax and NI free</p>

\*The £24,000 PENP is an arbitrary number just by way of example. The actual amount will depend on your basic pay and the number of days of unworked notice you have since the date you leave the company.

If you are employed by BAE Systems and are unsure if your severance payment includes any PENP, please check your individual circumstances with HR Services on **01772 677277**. If you are employed by a participating employer other than the Company, please contact your HR team for further assistance.

**How PENP affects any pension contribution made from severance into AVCs**

**Example:** An employee decides to pay £20,000 of their severance payment in exchange for an employer contribution into AVCs. No tax or NIC is due on this amount. The employee has an £87,000 severance package:

£20,000 into AVC fund	= No tax or NI
This leaves £67,000 severance of which:	
£10,000 is SRP	= No tax or NI
£25,000 is calculated to be PENP	= Tax and NI
Of the remaining £32,000:	
£20,000 is tax free (this + SRP = £30k)	= No tax or NI
£12,000 balance	= Tax (but no NI)

As you will see from the example, the pension contribution is taken off first and then the tax rules are applied to what remains.

In theory, you can give up all of your severance payment, except for any SRP element, in exchange for an employer pension contribution. However, the tax status of this will be subject to the pension limits on Annual and Lifetime allowances.

The **Annual Allowance** is the value of pension benefits that an individual can build up each year in a pension scheme(s) registered with HMRC without incurring tax charges (currently £40,000). A different Annual Allowance, called the Tapered Annual Allowance applies to high earners whereby the standard £40,000 allowance will reduce by £1 for every £2 of income you receive over £240,000, until it reduces to £10,000 for individuals with incomes of around £300,000. After £312,000 it reduces to a fixed £4,000. Individuals who exceed these allowances (for example because of a large AVC payment) may be able to offset such excess contributions against their unused allowances from up to three previous tax years.

The **Lifetime Allowance** is a limit on the value of benefits from your pension schemes – whether lump sums or retirement income – that can be made without triggering an extra tax charge. If your total pension benefits from all sources are above the Lifetime Allowance, any excess benefits will be subject to an additional tax charge when they are paid. Please refer to your pensions estimate or annual benefit statement for the estimated amount of Lifetime Allowance used up by your BAE Systems pension benefits.

For further information about these allowances, please refer to the pension website at: [baesystems.com/en-pensions/more-info/how-are-my-benefits-taxed](https://baesystems.com/en-pensions/more-info/how-are-my-benefits-taxed). You should consider taking independent financial advice prior to making a decision to pay part or all of their

severance to AVCs (please refer to the separate *Independent Financial Advice Pension Guide* for more information).

### **The severance / AVC process**

1. If you are employed by BAE Systems the Company will confirm your date of leaving to HR Services who will produce your leaving paperwork. You are required to return the signed paperwork including the application to pay severance as an AVC form. If you are employed by a participating employer other than BAE Systems, your HR team will produce your leaving paperwork.
2. The application form to pay severance as an AVC needs to be returned as soon as possible for prompt processing of your severance and pension benefits, and before your final working day. Please refer to the application form which will be provided by HR for full details.
3. On receipt of your completed paperwork, HR will instruct pensions and payroll that you will be leaving. Approximately eight weeks after leaving your pension benefits will be calculated.
4. Details of your pension entitlement will be sent to your home address. If you have any questions, please contact the pension scheme administrator details of whom will be included in the paperwork.
5. You are required to return the requested paperwork which includes:
  - Pensions forms
  - Birth, marriage and spouse's birth certificates (official copies or photocopies verified by Site HR or a Pension Representative)
6. On receipt of the completed paperwork, and once all pay and contribution details have been received, pension benefits are recalculated. Pension benefits will usually be paid within two weeks of receipt of all of the necessary information. This includes receipt of AVCs from payroll. Your pension will be backdated to your retirement date.