EXPLANATORY MEMORANDUM TO

THE PUBLIC SERVICE PENSION SCHEMES (RECTIFICATION OF UNLAWFUL DISCRIMINATION) (TAX) (NO. 2) REGULATIONS 2023

2023 No. 912

1. Introduction

1.1 This explanatory memorandum has been prepared by His Majesty's Revenue and Customs (HMRC) on behalf of His Majesty's Treasury and is laid before the House of Commons by Command of His Majesty.

1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 This instrument makes similar provision to the Public Service Pension Schemes (Rectification of Unlawful Discrimination) (Tax) Regulations 2023 (S.I. 2023/113) - https://www.legislation.gov.uk/uksi/2023/113/contents/made - (the first instrument), which made provision for the tax treatment of the changes arising from the public service pension reforms remedy set out in Part 1 of the Public Service Pensions and Judicial Offices Act 2022 (PSPJOA), and modified certain administrative rules for pension scheme administrators.

2.2 Like the first instrument, this instrument contains provisions which, as far as possible, put individuals in the tax position they would have been in had the discrimination not occurred. This instrument also modifies administrative provisions in relevant tax enactments in their application to individuals whose pensions tax liabilities have been retrospectively impacted by provisions of the PSPJOA and have either paid too little or too much tax as a result, for earlier tax years from 2019-20 to 2022-23.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

3.1 This instrument makes retrospective provision, which is necessary in order to ensure that the public service pension schemes remedy set out in PSPJOA 2022 works effectively and that members of public service pension schemes do not pay too much or too little tax as a result of the remedy. The power for retrospection is provided by section 11(4)(a) of Finance Act 2022 (FA 2022).

3.2 This instrument also corrects an error in the first instrument that was reported as defective drafting by the SCSI in its Fourteenth Report of Session 2022-23. The free issue procedure has not been applied because the correction only accounts for a very small proportion of the instrument. The SI Registrar has been consulted in accordance with paragraph 4.7.6 of Statutory Instrument Practice.

4. Extent and Territorial Application

4.1 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is the United Kingdom.

4.2 The territorial application of this instrument (that is, where the instrument produces a practical effect) is the United Kingdom.

5. European Convention on Human Rights

5.1 Andrew Griffith MP, The Economic Secretary to the Treasury has made the following statement regarding Human Rights:

"In my view the provisions of the Public Service Pension Schemes (Rectification of Unlawful Discrimination) (Tax) (No. 2) Regulations 2023 are compatible with the Convention rights."

6. Legislative Context

6.1 Part 4 of the Finance Act 2004 (FA 2004) provides for tax relief for pensions saving. An individual can have relief on contributions made in respect of them to registered pension schemes and there are no limits on the amount of pension saving that an individual can have, but there are limits on the amount of tax relief available.

6.2 To limit the tax relief, an individual will be subject to a tax charge (the annual allowance charge) if their pension saving in a tax year is more than their annual allowance or, subject to changes made by the Finance (No. 2) Act 2023, if their total pension saving is more than their lifetime allowance (the lifetime allowance charge). Tax charges also apply if payments made out of tax-relieved pension saving do not meet the conditions set out in Part 4 of FA 2004 so that they are unauthorised payments (the unauthorised payments charge and the unauthorised payments surcharge).

6.3 Under the Taxes Management Act 1970 (TMA), individuals who are subject to the annual allowance, lifetime allowance or unauthorised payments charges for a tax year need to submit a self assessment return and either pay the relevant tax charge or, where their pension scheme has paid the charge or agreed to pay it, indicate that the scheme will pay or has paid it. Members have to report and pay these charges within statutory time limits (by the 31 January after the end of the tax year in respect of which the charge arose). Members have up to four tax years to claim back an overpayment of these tax charges.

6.4 If these tax charges are not reported or paid by the time limit then interest will apply and penalties may be due depending on why and how long after the due date the charge is reported or paid. The time limits HMRC has to collect tax can be extended if a member carelessly or deliberately provides an inaccurate return or self assessment, or fails to notify HMRC about their tax liability.

6.5 Part 1 of PSPJOA remedies discrimination arising from the public service pension reforms put in place in 2014 and 2015. This is commonly known as "the McCloud remedy". The McCloud remedy retrospectively changes the treatment of pension contributions by individuals and makes consequential changes to their tax position. Part 1 of PSPJOA makes differing provision for judicial schemes (in Chapter 2), local government schemes (in Chapter 3) and other public service pension schemes (in Chapter 1).

6.6 This instrument, firstly, modifies tax legislation so that, as far as possible, an individual impacted by the McCloud remedy is treated for annual allowance purposes as if the changes had always applied when making calculations in relation to voluntary contributions, pension-sharing orders on divorce and partnership pension accounts.

6.7 Almost all public service pension schemes are defined benefits pension schemes. Sections 234 to 236 FA 2004 set out how the pension input amount for this type of scheme is calculated. There are specific provisions to adjust the calculation for where a transfer has been made, pension debits or credits are created under a pension sharing order or if an individual is a deferred member.

6.8 An individual who has rights they have not yet taken under a pension scheme but is no longer paying into, or building up rights in, that pension scheme is a deferred member. Where the increase in their amount saved into that pension scheme in a year does not exceed a certain percentage, under section 234(5B) of FA 2004 the member has a pension input amount of nil. This means that the pension rights do not come within the calculation to work out whether the individual has an annual allowance charge, even where the remedy means that there is a change to a member's rights.

6.9 Sections 236(4A) and (5A) of FA 2004 make adjustments to the pension input amount calculation where a transfer has been made out of or into a registered pension scheme during the tax year so that the individual does not have too little or too much value taken into account for annual allowance purposes.

6.10 As a result of a pension sharing order part of an individual's pension rights may be given to their ex-spouse or civil partner. The reduction to the individual's rights is called a pension debit. The increase to the rights of the ex-spouse or civil partner is called a pension credit. Sections 236(2) and (3) of FA 2004 make adjustment to the calculation of the pension input amount where there has been a pension debit or pension credit. This ensures that the individual does not have too little or too much value taken into account for annual allowance purposes.

6.11 Almost all public service pension schemes are defined benefits pension schemes and their members can receive scheme pension and certain lump sums as authorised payments under section 164 of FA 2004, as well as transfers from other registered pension schemes. Detailed tax treatment is set out in Schedule 28 (pensions) and Schedule 29 (lump sums) to FA 2004, and in regulations 11 and 12 of S.I. 2009/1171 and Part 9 of the Income Tax (Earnings and Pensions) Act 2003.

7. Policy background

What is being done and why?

7.1 At the Tax Policies and Consultations fiscal event in Spring 2021, the government announced its intention to make technical updates to pension tax rules to remove anomalies that were identified as part of finalising the remedy to the age discrimination found in litigation on the 2015 public service pension reforms.

7.2 Pensions tax legislation provides an individual with tax relief on their pension saving in the current tax year and generally does not allow for retrospective changes to pension saving in earlier tax years. However, the McCloud remedy makes retrospective changes to the treatment of pensions savings made in earlier tax years, which leads to tax anomalies.

7.3 This instrument modifies the tax treatment of pensions where, as a result of the remedy, an individual would have less advantageous tax consequences compared to if the discrimination had not occurred. Where the McCloud remedy retrospectively changes the nature of the payment, the tax treatment also applies retrospectively. This instrument aims, as far as possible, to put individuals in the tax position they would have been in if the discrimination had not happened.

7.4 Part 2 of this instrument makes changes to how public service pension schemes (apart from local government pension schemes, which do not need these changes) calculate a member's pension input amount following the implementation of the remedy in relation to voluntary contributions, pension-sharing on divorce orders and partnership pension accounts which are treated differently under PSPJOA to the main pensionable service. It ensures that pension input amounts are counted only once and that there is not more than one opportunity for an individual to receive a pension commencement lump sum in relation to a pension in payment where the amount of that pension changes as a result of the remedy. Although this instrument makes changes to pension credits or pension debits under judicial schemes, it only requires scheme administrators of the reformed judicial 2015 schemes to make the adjustments to pension input amount calculations, as other (legacy) judicial schemes are not registered for tax purposes so no pension input amount calculations are required.

7.5 Part 3 of this instrument authorises payments of scheme pension and lump sums, including lump sum death benefits, where increases and reductions arise as a result of the remedy and would prevent the payments from being authorised. Where a member pays back an overpaid lump sums that was an unauthorised payment, it also authorises a reduction in unauthorised payments to ensure that members and scheme administrators can be repaid unauthorised payments and scheme sanction charges where this is claimed within the time limits.

7.6 Part 4 of this instrument provides for the procedure by which scheme administrators can reclaim a scheme sanction charge that they have paid previously that is no longer due as a result of the remedy.

7.7 Part 5 of this instrument amends the first instrument. Amendments to regulations 8 and 9 of the first instrument clarify that pensioner members can elect for a pension scheme to pay an annual allowance charge arising as a result of the remedy but such an election cannot be made in relation to deceased members of pension schemes. An amendment to regulation 13 of the first instrument allows that regulation to cover benefits from voluntary contributions, in addition to basic scheme benefits, where an individual partially retires having chosen reformed scheme benefits. This allows for partial retirees to be treated as deferred members when calculating the pension input amount for post-retirement periods under the legacy scheme. Amendments to regulations 24 and 26 of the first instrument align with amendments to FA 2004 made by sections 18 and 19 of Finance (No. 2) Act 2023. An amendment to regulation 34 of the first instrument provides a deadline by which an application for a repayment of lifetime allowance charge resulting from the remedy must be made to ensure that a scheme administrator can claim back lifetime allowance charge that has been overpaid as a result of the remedy.

7.8 Part 6 of this instrument also disapplies the self assessment and reporting requirements in Part 2 of TMA 1970 for pensions tax charges in the tax years 2019-20 to 2022-23 where these charges are affected by the McCloud remedy. These are tax years which, at the time this instrument was made, were "open" so that HMRC could assess tax in respect of them. However, by the time that individuals receive the right information from their pension schemes about those tax years, they could be "closed" for HMRC to assess any unpaid tax. This instrument therefore provides that, instead of providing a full self-assessment return, individuals will be required to provide specified information about affected pensions tax charges within an extended time frame. The instrument also modifies existing tax enactments to provide for powers for HMRC to issue assessments and repay overpaid tax, as well as providing for penalties and interest to apply to failures to provide information or to pay tax in the same way as they do to self-assessed income tax. Where an individual may have paid too much tax on pensions savings in tax years affected by the McCloud remedy earlier than 2019-20, this will be dealt with separately via a compensation scheme.

7.9 The instrument also modifies existing tax enactments to allow HMRC to issue assessments and repay overpaid tax, as well as providing for penalties and interest to apply to failures to provide information or to pay tax in the same way as they do to self-assessed income tax. Relevant provisions in the TMA will apply to set the assessing procedure (section 30A) and time within which assessments must be paid (section 59B), as well as providing the same rights of appeal (section 31(1)(d)).

7.10 While the 2022-23 tax year is not part of the remedy period, it has been included within the modified reporting rules in order to ensure that individuals are not adversely affected if their tax position in 2022-23 changes as a result of the remedy. This ensures that all members whose pensions tax position changes as a result of the remedy are subject to changes for the same tax years regardless of when their pension scheme provides the information on their remedied pension rights.

7.11 The modified reporting rules in this instrument apply only to pensions tax charges impacted by the remedy and any other charges are to be dealt with in the normal way by an individual amending their self assessment return or contacting HMRC to make the change, within the usual statutory time limits.

7.12 The modified reporting rules in this instrument also apply to personal representatives, who will be obliged to report specified information to HMRC on behalf of a specified individual who has died. Personal representatives are also entitled to apply for repayments of overpaid relevant pensions tax charges on behalf of a specified individual’s estate, whether or not specified information was provided by that, or another, personal representative, or by the specified individual.

7.13 This instrument modifies the Income and Corporation Taxes (Electronic Communications) Regulations 2003 to allow electronic communication by HMRC about the changes made to pensions tax charges as a result of the remedy. There will be a direction made under section 43E of TMA to allow for electronic communications by individuals on this issue but this will not apply to personal representatives. However, HMRC will provide an electronic form that both individuals and personal representatives of deceased members can use but its use will not be mandatory.

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

9.1 Consolidation is not required as this instrument modifies the application of existing legislation that applies to public service pension schemes in the context of the McCloud remedy. It does not affect how that legislation applies more widely.

10. Consultation outcome

10.1 The draft regulations were published on GOV.UK for a short technical consultation to provide public service pension schemes, their members and the pensions industry with an opportunity to comment and check the regulations meet the policy intent.

10.2 HMRC received 24 responses and have used those responses to refine this instrument, to ensure that voluntary contributions are unable to attract tax-free lump sums more than once, to clarify how certain benefits are to be taxed and to clarify certain points about how the modified reporting and administration requirements will apply to individuals.

11. Guidance

11.1 Guidance which explains how this instrument will work was published in relation to the technical consultation on this instrument. The guidance can be accessed at https://www.gov.uk/government/publications/the-public-service-pension-schemes-rectification-of-unlawful-discrimination-tax-no-2-regulations-2023.

11.2 The guidance will be updated at https://www.gov.uk/topic/business-tax/pension-scheme-administration.

12. Impact

12.1 The impact on business, charities or voluntary bodies is that pension scheme administrators in the private sector may have to adjust the tax treatment of a lump sum paid to a member where their lifetime allowance was exceeded and the remedy means that the member has lifetime allowance available retrospectively. Private sector scheme administrators may also have to make changes in relation to lifetime allowance, annual allowance and unauthorised payments charges they have paid for tax years outside of the standard statutory time limits.

12.2 The impact on the public sector is that as well as being subject to the same impacts as for private sector scheme administrators, where public service pension scheme administrators have made scheme regulations under the PSPJOA in relation to voluntary contributions, pension credits and pension debits for pension-sharing orders on divorce and partnership pension accounts, they will be required to make adjustments to the pension input amount calculations as a result of the remedy. Where the remedy leads to an overpayment of unauthorised payments charge, public service scheme administrators will have to make a claim to HMRC for the proportionate amount of scheme sanction charge they paid that is now overpaid as a result of the remedy. Public service pension scheme administrators will also have to pay additional pension benefits ignoring and where they require members to pay back overpaid benefits ignore, standard time limits and conditions.

12.3 A Tax information and Impact Note covering section 11 of FA 2022 (under which this instrument is made) was published on 27 October 2021 alongside the Finance Bill and is available at https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins. It remains an accurate summary of the impacts that apply to this instrument.

13. Regulating small business

13.1 The legislation does not apply to activities that are undertaken by small businesses.

14. Monitoring & review

14.1 The approach to monitoring of this legislation is that it will be monitored through communications with public service pension schemes and taxpayer groups.

14.2 The instrument does not include a statutory review clause due to the exemption in section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015.

15. Contact

15.1 Beverley Davies at HMRC Telephone: 03000 512336 or email: policypensions@hmrc.gov.uk can be contacted with any queries regarding the instrument.

15.2 Andrew Edwards, Deputy Director for Pensions Policy, at HMRC can confirm that this Explanatory Memorandum meets the required standard.

15.3 Andrew Griffith MP, Economic Secretary to the Treasury can confirm that this Explanatory Memorandum meets the required standard.