EXPLANATORY MEMORANDUM TO

THE PUBLIC SERVICE PENSION SCHEMES (RECTIFICATION OF UNLAWFUL DISCRIMINATION) (TAX) REGULATIONS 2023

2023 No. 113

1. Introduction

1.1 This explanatory memorandum has been prepared by His Majesty's Revenue and Customs (HMRC) 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 provides for the tax treatment of the changes arising from the retrospective 2015 public service pension reforms remedy, set out in Part 1 of the Public Service Pensions and Judicial Offices Act 2022 (PSPJOA).

2.2 The provisions in this instrument aim, as far as possible, to put individuals in the tax position they would have been in had the discrimination being remedied not happened.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

3.1 This instrument sets out the tax treatment of the remedy to public service pension reforms dating back to 1 April 2014, which is set out in Part 1 of the PSPJOA. It contains the first use of the powers in section 11 of the Finance Act 2022 (c.3), subsections (1) and (2) of which enable the Treasury to make provision by regulations modifying relevant tax enactments in relation to a relevant person. This instrument contains provisions which are limited to this effect (see regulation 1(3)).

3.2 The remedy applies retrospectively and the tax treatment in this instrument reflects that. Section 11(4)(a) provides that regulations made under that section may make retrospective provision.

3.3 The modifications contained in the Regulations, apart from those dealing with procedural matters such as the provision of information, have effect so that, as far as possible, individuals are taxed as if they had always been in the remedied position.

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

"In my view the provisions of the Public Service Pension Schemes (Rectification of Unlawful Discrimination) (Tax) Regulations 2023 are compatible with the Convention rights."

6. Legislative Context

6.1 The government provides tax relief for pension saving under Part 4 of Finance Act (FA) 2004. An individual can have relief on their contributions 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 if their pension saving in a tax year is more than their annual allowance or if their total pension saving is more than their lifetime allowance. 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.

6.3 Part 1 of the PSPJOA remedies the discrimination arising from the public service pension reforms put in place in 2014 and 2015. The remedy applies retrospectively and makes consequential changes to the tax position.

6.4 This instrument makes changes to tax legislation so that as far as possible the tax treatment applies as if the remedy had always applied.

6.5 Section 188 of FA 2004 provides for tax relief on contributions by active members of registered pension schemes.

6.6 If the amount saved into a pension scheme during a tax year is more than £40,000, regulation 14A of the Registered Pension Schemes (Provision of Information) Regulations 2006 requires the scheme administrator to provide the member with information to enable them to calculate their own annual allowance charge and under regulation 3 of those Regulations the scheme administrator must report this issue to HMRC.

6.7 Where a member has not been automatically provided with the information, under regulation 14B of those Regulations the member can ask the scheme administrator to give them the information needed to calculate their annual allowance charge.

6.8 Section 237B of FA 2004 provides for the scheme administrator to be jointly and severally liable for the member's annual allowance charge where the member asks them to pay all, or part, of their annual allowance charge.

6.9 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.

6.10 Detailed tax treatment of lump sums is set out in Schedule 29 to FA 2004 and section 636AA of the Income Tax (Earnings and Pensions) Act 2003. For the pension and lump sum payments to be authorised the member must have reached the normal minimum pension age or, under paragraph 22 of Schedule 36 to FA 2004, be able to receive benefits at a lower age.

6.11 When members start to take their pension benefits, their rights are tested against their lifetime allowance. As section 217 of FA 2004 provides that scheme administrators are jointly and severally liable for lifetime allowance charges, under section 254 of FA 2004 they usually report and pay any lifetime allowance charge that arises before paying pension benefits to the member.

6.12 If scheme administrators could not have been aware of a lifetime allowance charge, under section 267 of FA 2004, they can apply to HMRC to be discharged from the liability. A member may have a higher lifetime allowance than the current standard amount due to the protection provided by Schedule 4 to FA 2016.

6.13 Those who receive any of the types of compensation set out in Schedule 15 to FA 2020 do not pay income tax or capital gains tax and in certain circumstances inheritance tax on those payments.

6.14 This instrument will have effect from 6 April 2023 where the provisions do not apply retrospectively.

7. Policy background

What is being done and why?

7.1 At Tax Policies and Consultations 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 (commonly referred to as 'McCloud').

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 changes to pension saving in earlier tax years. However, the remedy set out in the PSPJOA makes retrospective changes to the public service pension provision, creating tax anomalies in relation to that provision.

7.3 This instrument modifies existing pensions tax legislation to make a number of technical changes to the tax treatment of those impacted by the remedy only. It aims to put them, as far as possible, in the tax position they would have been in had the discrimination not happened. It does not amend pensions tax legislation and so does not apply more widely.

7.4 This instrument addresses the tax position following the implementation of the remedy by ensuring that members remain entitled to tax relief on their pension contributions made in relation to the pension provision being remedied.

7.5 This instrument also makes changes to how public service schemes calculate a member's pension input amount following the implementation of the remedy and gives them extra time to provide their members with the information they need to calculate their annual allowance charge. It also allows members extra time to make a request for their scheme to pay the charge where the standard time limits for making the request cannot be met.

7.6 Where a member's pension provision changes as a result of the remedy, and any joint liability for annual allowance charges or lifetime allowance charges moves from one scheme to another, this instrument provides for an exchange of information about those charges between the schemes. It also sets out how public service schemes will deal with lifetime allowance charges that are underpaid or overpaid as a result of the remedy.

7.7 This instrument ensures that when members consider whether they have lost their protection from lifetime allowance charges, they can take the remedy into account.

7.8 This instrument authorises payments of scheme pension and lump sums by public service pension schemes that arise as a result of the remedy and would not meet the standard conditions to be authorised. The instrument also allows additional payments of lump sum death benefits to be paid tax free where the original payments were made tax free.

7.9 This instrument exempts compensation payable under the PSPJOA from income tax or capital gains tax and, in certain circumstances, inheritance tax.

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 makes changes to modify how existing legislation applies to public service pension schemes only. It does not amend how existing 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 schemes, their members and the pensions industry with an opportunity to comment and check the regulations meet the policy intent.

10.2 HMRC received 28 responses and have extended provisions in relation to reporting and paying annual allowance charges so that they apply more widely as well as making minor amendments to the regulations to clarify the policy intent.

11. Guidance

11.1 Guidance which explains how this instrument will work was published to coincide with the technical consultation on this instrument. The guidance can be accessed at www.gov.uk/government/publications/the-public-services-pension-schemes-rectification-of-unlawful-discrimination-tax-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 recalculate how much lifetime allowance is used by members who are also members of public service schemes. If the member started to take benefits from their public service scheme which is now subject to the remedy and then accessed their private sector scheme, the private sector scheme administrator will have to recalculate how much lifetime allowance was used when the member took their benefits and report to the member.

12.2 Private sector scheme administrators will be liable for any lifetime allowance charge arising from this change, but they can apply to HMRC to be discharged from the liability.

12.3 The impact on the public sector is that public service pension scheme administrators will be required to revisit pension input amount calculations and issue pension savings statements to members for the tax years covered by the remedy period. They will have to tell HMRC using the Event Report. They will also have to accept any requests for the scheme to pay annual allowance charges arising as a result of the remedy and pay the tax charges on the Accounting for Tax return. This instrument simplifies the reporting by allowing public service pension scheme administrators to use the latest Accounting for Tax return rather than correcting past ones.

12.4 Where the remedy leads to an overpayment of annual allowance charge or lifetime allowance charge that was paid by a public service scheme, public service pension scheme administrators will have to make a claim to HMRC rather than using the Accounting for Tax return.

12.5 Public service pension scheme administrators will also have to pay additional pension benefits ignoring the standard time limits and conditions.

12.6 A Tax information and Impact Note covering this instrument was published on 27 October 2021 at https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins and it remains an accurate description of the measure.

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 tax 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: pensionspolicy@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.