EXPLANATORY MEMORANDUM TO

THE FINANCE ACT 2004 (REGISTERED PENSION SCHEMES AND ANNUAL ALLOWANCE CHARGE) ORDER 2024

2024 No. 357

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.

2. Declaration

2.1 Bim Afolami MP, Economic Secretary to the Treasury confirms that this Explanatory Memorandum meets the required standard.

2.2 Andrew Edwards, Deputy Director for Pensions Policy, at HMRC confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Steve Darling at HMRC Telephone: 03000 562533 or email: pensions.policy@hmrc.gov.uk can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 This instrument provides for pensionable service in specified legacy (closed) public service pension scheme (PSPS) and service in a reformed (open) PSPS to be combined for the purposes of calculating an individual's pension input amount when determining their annual allowance (AA). This will allow individuals to offset negative pension input in a legacy scheme against positive input in a connected reformed scheme.

Where does the legislation extend to, and apply?

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

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

5. Policy Context

What is being done and why?

5.1 Public Service Pension Schemes (PSPS) are occupational pension schemes for employees of central or local government, a nationalised industry or other statutory bodies and are established by statute. They operate for specific public service workforces such as teachers or NHS employees. The main public service schemes are defined benefit schemes, which provide pension benefits based on salary and length of service. In 2015, most PSPS were subject to reform, replacing the existing (legacy) scheme with a new (reformed) scheme, often replacing pension entitlement based on final salary with entitlement based on career average earnings, and increases in the pension age. As of April 2022, all active members now accrue pension in reformed PSPS.

5.2 Many workforce- specific PSPS are set up and registered separately for pension tax purposes, and consequently are treated as separate arrangements under Finance Act 2004 (FA 2004). The total amount of an individual's pension savings for a tax year is the total of all the pension input amounts the individual has for each pension arrangement under a registered pension scheme. The amount by which the value of an individual's scheme benefits increases and can benefit from tax relief in any tax year is limited by the annual allowance (AA).

5.3 Where CPI (consumer price index) inflation revaluation is higher than current year pay growth the pension input calculation may result in a negative value. However, for AA calculation purposes, the pension input amount can only be zero or a positive amount, so a negative amount is automatically treated as zero. Where an individual's combined pension input exceeds the AA threshold, the individual may become liable to report and pay an AA tax charge. This charge is not at a fixed rate but will depend on how much taxable income the individual has and the amount of their pension saving in excess of the AA.

5.4 To incentivise and increase retention in the workforce of the public sector, legacy and reformed PSPS will be considered linked for the purposes of calculating the AA. The amendments made by this instrument will allow negative pension input in a legacy scheme to be offset against positive input within a reformed scheme as part of the AA calculation. This will result in individuals having more AA headroom overall and reduce the potential for AA tax charges.

What was the previous policy, how is this different?

5.5 There are no provisions previously that allow negative values to be used in the AA calculation. The amendments made by this instrument will only apply to individuals who have a legacy and a connected reformed PSPS. In all other circumstances, there are no changes to the AA calculation and the pension input amount will continue to be a zero or a positive amount.

6. Legislative and Legal Context

How has the law changed?

6.1 The annual allowance (AA) sets the maximum value an individual can benefit from tax relief in any tax year in a registered pension scheme. The amount an individual pays into a scheme or the amount by which the value of scheme benefits increases in a tax year is used to calculate their pension input amount (PIA). If an individual's PIA exceeds the AA, the individual may become liable to report and pay an AA charge (Section 227, FA 2004). The AA is currently £60,000 for tax year 2023-24 onwards.

6.2 This instrument amends FA 2004 by inserting a new Section 236ZA to provide that negative PIA in a legacy PSPS can be offset against a positive PIA in a connected reformed PSPS as part of the AA calculation. This will have effect in relation to pension input periods ending in tax year 2023-24 and subsequent years.

6.3 The Public Service Pensions Act 2013 (the 2013 Act) provides the power to make regulations establishing the relevant reformed schemes for the workforces listed in section 1(2) PSPA 2013. Under this power, regulations have been made establishing workforce specific reformed schemes, for example, The Public Service (Civil Servants and Others) Pension Regulations 2014. Schedule 5 PSPA 2013 lists the relevant predecessor legacy (closed) scheme for each of the relevant workforces. For example, in respect of civil servants, para 1, Schedule 5 lists legacy schemes made under Section 1 of the Superannuation Act 1972. Section 1 of the Public Service Pensions Act (Northern Ireland) 2014 (the 2014 Act) contains similar powers to establish reformed public service pension scheme arrangements in Northern Ireland; and Schedule 5 to the 2014 Act lists the relevant legacy schemes. The amendments made by this instrument apply to service in reformed and legacy public service pension schemes to which the 2014 Act applies.

Why was this approach taken to change the law?

6.4 The provisions within this instrument apply to PSPS only due to the reforms of those schemes and the lack of control public service employees have on their pension contributions. There is no risk of pension tax relief abuse or avoidance in PSPS due to the structure of those pension arrangements and the inability of individual public service employers to alter this structure.

7. Consultation

Summary of consultation outcome and methodology

7.1 This legislative change was announced at Spring Budget 2023 as part of a package of tax measures to incentivise and increase retention in the workforce of the public sector and the wider economy[1]. A draft statutory instrument was published for a four-week technical consultation on 29 January 2024[2]. HMRC received 9 consultation responses and no objections or substantive issues were raised in the responses and the instrument operates as intended. However, a minor amendment has been made to the instrument to provide further clarity on what is meant by a connected legacy and reformed pension arrangements in the context of this instrument. Schemes must be connected within the meaning of section 4(6) either the 2013 Act or the 2014 Act, and they must be in respect of schemes to which the final salary link provisions under paragraphs 1 or 2 of Schedule 7 to either the 2013 or 2014 Act apply.

8. Applicable Guidance

8.1 The HMRC Pension Tax Manual provides guidance and explains how the AA operates. Updates to include the new provisions for PSPS are required to this guidance and will be made to coincide with the regulations taking effect.

[1] https://www.gov.uk/government/publications/spring-budget-2023

[2] https://www.gov.uk/government/consultations/the-finance-act-2004-registered-pension-schemes-and-annual-allowance-charge-order-2024

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A Tax Information and Impact Note covering this instrument was published on 15 March 2023 on gov.uk[3].

Impact on businesses, charities and voluntary bodies

9.2 There is no significant, impact on business, charities or voluntary bodies. For businesses who administer public service pension schemes the impact is expected to be negligible. One-off costs will include familiarisation with revisions to calculations of the AA and could also include training or upskilling of staff because of these changes, as well as the provision of information and guidance to members and updates to the pension schemes' systems to reflect changes to the AA.

9.3 The legislation does not impact small or micro businesses.

9.4 There will be an impact on individuals who are members of public service pension schemes where they have a connected legacy and reformed scheme. This will result in individuals having more AA headroom overall and reduce the potential for AA tax charges.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The approach to monitoring this legislation will be to keep it under review through communication with affected pension scheme administrators.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

12.1 The Economic Secretary to the Treasury has made the following statement regarding Human Rights:

"In my view the provisions of The Finance Act 2004 (Registered Pension Schemes and Annual Allowance Charge) Order 2024 are compatible with the Convention rights."

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").

[3] https://www.gov.uk/government/collections/spring-budget-2023-tax-related-documents