

# Commentary on the Public Service Pension Schemes (Rectification of Unlawful Discrimination) (Tax) Regulations 2023

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## Background

On 6 February 2023, HM Treasury laid [The Public Service Pension Schemes \(Rectification of Unlawful Discrimination\) \(Tax\) Regulations 2023](#).

The regulations apply to relevant public service pension schemes in the UK.

The regulations address various tax consequences because of McCloud recalculations. The regulations aim, as far as possible, to put individuals in the tax position they would have been in had the McCloud discrimination not happened.

The regulations do not cover all potential tax consequences. For example, the regulations do not cover the tax consequences for members of the Teachers' Pension Scheme who retrospectively move to the LGPS. We expect further regulations / guidance in due course.

The regulations take effect from 6 April 2023. However, they only have practical effect once the LGPS regulations setting out the remedy come into force.

Meanwhile, administering authorities may wish to start:

- identifying all pension savings statements for annual allowance calculations that included the underpin
- identifying all previous individual protection 2016 calculations which may need to be recalculated, and
- identifying members who had Fixed Protection 2016 but lost it because of the underpin.

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## Guidance from HMRC

HMRC has produced [guidance explaining the regulations](#). HMRC has yet to update the guidance to reflect the final version of the regulations. We expect HMRC to publish updated versions on the [pension scheme administration: detailed information](#) page of [www.gov.uk](http://www.gov.uk).

HMRC intends to provide further information in newsletters. They published the first [Public service pensions remedy newsletter](#) in November 2022.

HMRC has also confirmed that it intends to publish member guidance, setting out the different actions they may need to take.

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## Commentary on the regulations

In this section, we provide a commentary on the regulations that may be relevant for the LGPS.

We have raised queries with HMRC. We will update this commentary when HMRC replies.

### Benefit crystallisation events

[The HMRC guidance](#) confirms that where an existing LGPS pension increases due to the remedy, the extra pension counts as a new scheme pension. So, a new benefit crystallisation event (BCE) occurs. Authorities should not need to revisit previous BCEs.

The BCE date is the date on which the member acquires an actual right to the extra pension. This is normally the date on which they have a right to the benefits without having to fulfil any further conditions or take any further actions. For more information, see [PTM088200](#).

For the new BCE, administering authorities must:

- give the member the option to commute some extra pension for lump sum
- test the lifetime allowance
- send a lifetime allowance statement to the member.

### Annual allowance (regulations 5, 6, 7, 14 and 15)

Regulation 14 confirms that administering authorities must ignore underpin additions for annual allowance calculations. Both actual underpin additions awarded to pensioner members and potential underpin additions for other members must be ignored.

We understand that authorities have not been including potential underpin additions in annual allowance calculations.

We also understand that administering authorities have been including actual underpin additions awarded to pensioner members. Authorities need to identify these members and recalculate the pension input amount for the relevant year.

The annual allowance changes which we covered in [Bulletin 223](#) do not apply to these recalculations. This is because the recalculations are not caused by updated employer information or changes to LGPS rules. Ordinarily, therefore, administering authorities would be required to correct previously provided pension savings

statements as soon as is reasonably practicable. Regulations 6 and 7, however, give authorities more time. The regulations set a deadline of 6 October 2024. This applies to statements sent because the member exceeded the annual allowance and statements sent on the member's request.

Regulation 5 provides that administering authorities must tell HMRC on the relevant event report about corrected statements sent. This applies for members who, before the recalculation, exceeded the annual allowance. Authorities tell HMRC on the event report for the tax year in which they send the corrected statement. The normal deadline applies (ie after the end of the relevant tax year but no later than the following 31 January).

Regulation 15 sets out the method for reclaiming overpaid annual allowance charges from HMRC. Under this method, administering authorities apply to HMRC, including the information set out in regulation 15(5). Authorities must not amend the relevant accounting for tax return. The authority can apply to reclaim the amount by which the member's tax charge has reduced because of the recalculation, or, if lower, the amount the authority previously paid to HMRC. HMRC repays the overpaid amount by adding a credit on the scheme administrator's Managing Pension Schemes service account. HMRC intends to provide further details in due course.

HMRC will not refund an overpaid amount if it relates to an 'out-of-scope' tax year. See section – ['Out-of-scope' tax years](#).

There may be other situations where authorities recalculate pension input amounts. For example, transfer-in cases for members who were previously credited with final salary benefits which, as part of the McCloud recalculations, are changed to CARE benefits (with the notional final salary benefits included in underpin calculations). We wait for further guidance / regulations on how to treat these recalculations.

### **Lifetime allowance charge (regulation 27)**

Regulation 27 deals with reductions in scheme pensions because of McCloud recalculations. In particular, reductions caused by retrospective lifetime allowance charges arising. Regulation 27 ensures that such reductions do not cause the pension to become unauthorised.

Though the regulation extends to the LGPS, we do not foresee it being needed in many cases. This is because, when an authority increases a pension because of a McCloud recalculation, the extra pension is treated as being a new scheme pension for tax purposes.

## **Individual protection 2016 (regulations 38 and 39)**

Regulation 38 clarifies that underpin additions are included in Individual Protection 2016 (IP16) calculations.

The additions that are to be included are those calculated under the LGPS regulations that remedy the McCloud discrimination. It is assumed that those regulations were in place for any BCEs that occurred between 1 April 2014 (2015 for Scotland) and 5 April 2016. This impacts Amount B (pre-6 April 2016 benefit crystallisation events) calculations. It is also assumed that those regulations were in place as at 5 April 2016 when calculating Amount C (uncrystallised rights at the end of 5 April 2016).

Once the LGPS regulations setting out the remedy come into force, administering authorities need to identify and review previous IP16 calculations. Where the amount it previously calculated changes, the authority needs to update the member. The member then liaises with HMRC, who will provide further details on the process in due course. Consequentially, where a pensioner member's protection changes, administering authorities may also need to revisit past lifetime allowance calculations.

Where a member made a request in writing before 6 April 2020 for an IP16 calculation, administering authorities had to provide it within three months of receiving the request. Regulation 39 removes the 6 April 2020 deadline for members with underpin protection. The requirement does not depend on whether any underpin addition would actually be included in the calculations.

## **Fixed protection 2016 (regulation 41)**

Regulation 41 confirms that any underpin addition is not included when considering whether the member has had benefit accrual for Fixed Protection 2016 (FP16) purposes. Members therefore do not lose their protection because of an underpin addition.

Once this takes effect, it is treated as always having had effect. This means that, where a member previously lost their protection because of an underpin addition, they may be able to regain the protection.

Once the LGPS regulations setting out the remedy come into force, administering authorities should identify any affected members and update them accordingly. The members would then liaise with HMRC, who will provide further details on the process in due course. Where a member regains protection, authorities may also need to revisit past lifetime allowance calculations.

## **Pension commencement lump sum (regulations 18, 24 and 29)**

Due to McCloud recalculations, members may be due extra pension. They may decide to elect to commute some for extra tax-free cash ('pension commencement lump sum').

Regulation 18 applies to extra lump sums paid to members due to McCloud recalculations over a year after the relevant benefit crystallisation event (BCE).

The lump sum is treated as being a pension commencement lump sum:

- if it could not reasonably have been paid within a year of the BCE, and
- if it had, it would have been a pension commencement lump sum.

Regulation 24 deals with extra lump sum payments where the member died before receiving it and the payment is made later than 12 months after the date the member became actually entitled to the extra lump sum. The payment to the member's personal representatives is an authorised payment. This is providing it would have met the conditions to be a pension commencement lump sum had it been paid to the member within the 12-month time limit. The payment is taxed as if it was a pension commencement lump sum (ie tax-free) and the amount paid is tested against the member's lifetime allowance. The BCE date (BCE 9) is the date the extra lump sum is paid to the personal representatives.

Though regulations 18 and 24 apply to LGPS lump sums, we do not expect them to apply to many cases. This is because new BCEs occur when the member becomes entitled to the extra LGPS pension and extra lump sum. We expect administering authorities to be able to pay the extra sum within the normal time limit.

Regulation 29 covers previously paid pension commencement lump sums that exceed the relevant limits after recalculation. For example, because the scheme pension has retrospectively reduced. The regulation provides for unrecovered overpaid lump sums to be authorised payments.

Though regulation 29 extends to LGPS lump sums, we do not expect it to apply to many cases. This is because, in the main, McCloud recalculations will not retrospectively reduce member pensions.

## **Trivial commutation lump sums (regulations 19, 20 and 25)**

Regulation 19 ensures that previously paid trivial commutation lump sums (TCLS) do not become unauthorised due to McCloud recalculations.

Regulations 20 and 25 provide for cases where a TCLS has been paid and, due to McCloud recalculations, an additional amount is due.

The additional amount is treated as a TCLS payment provided:

- the additional amount does not exceed £10,000 or
- if the additional amount does exceed £10,000, the aggregate of the additional amount and the value of the member's rights on the nominated date (for the original TCLS) do not exceed £30,000, and
- on paying the additional amount:
  - it extinguishes all rights to non-AVC benefits in the LGPS, excluding survivor benefits,
  - the member has all or part of their lifetime allowance available, and
  - the member has attained the normal minimum pension age (currently 55) or the ill health condition (as defined in paragraph 1 of schedule 28 to the Finance Act 2004) is met.

It is unclear how to treat the additional amount if the member does not meet the above conditions. For example, because they re-joined the LGPS and the new benefits are still held in the Scheme.

Regulation 20 applies where the additional amount is paid to the member.

Regulation 25 applies where the additional amount is paid to a deceased member's personal representatives.

The regulations do not cover members who have previously received a small pot payment or survivors who have previously received a trivial commutation lump sum death benefit.

### **Scheme pension (regulations 23 and 28)**

Regulation 23 ensures that pension arrears from the McCloud recalculations paid for deceased members to their personal representatives are authorised payments.

Administering authorities tax the arrears as pension income. They treat the arrears as accruing in the tax year in which the arrears are paid. The payment is not a benefit crystallisation event.

Where authorities pay the arrears to the member, the normal tax rules on arrears apply. See [PTM142000](#) for more information.

Regulation 28 deals with retrospective reductions to existing scheme pensions due to McCloud recalculations. The regulation provides for unrecovered overpayments to continue to be authorised. The overpayments are treated in the same way as overpayments authorised under regulations 13 or 14 of the Registered Pension

Schemes (Authorised Payments) Regulations 2009. See [PTM062800](#) for more information.

Though regulation 28 extends to the LGPS, we do not expect it to apply to many (if any) cases. This is because, in the main, McCloud recalculations will not reduce existing pensions.

The regulation does not apply to survivor pensions.

### **Death grants (regulation 31)**

Due to McCloud recalculations, administering authorities may have to pay extra death grant amounts.

Under existing rules, the extra amount qualifies as a 'defined benefits lump sum death benefit'.

Regulation 31 provides that where the original death grant was paid within the 'relevant two-year period', but the extra amount is not, the extra amount is treated as if it had also been paid within this period. The 'relevant two-year period' begins on the earlier of:

- the day on which the administering authority first knew of the death; and
- the day on which the administering authority could first reasonably be expected to have known of it.

Therefore, where regulation 31 applies, the extra amount is not taxable, unless it exceeds the member's lifetime allowance. Payment of the extra amount is a benefit crystallisation event (BCE) 7. See [PTM088680](#) for more information.

Administering authorities need to provide updated lifetime allowance information to the personal representatives about the extra payment. See [PTM165000](#) for more information.

Where regulation 31 does not apply and the extra amount is not paid within the relevant two-year period, the extra amount is taxable. The tax rate depends on who the extra amount is paid to. For more information, see [PTM073010](#). Payment of the extra amount is not a BCE.

Whether the administering authority has discretion as to who to pay the extra amount, or whether it must pay it to the personal representatives, depends on the relevant LGPS regulations.



## **Compensation payments (regulation 44)**

Due to McCloud discrimination, in certain situations where members have lost out, administering authorities may pay compensation in accordance with the following provisions:

- sections 82 and 83 of the Public Service Pensions and Judicial Offices Act 2022
- part four of The Public Service Pensions (Exercise of Powers, Compensation and Information) Directions 2022
- the LGPS Regulations that set out the McCloud remedy.

Regulation 44 provides that such compensation payments are not subject to income tax or capital gains tax.

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## **‘Out-of-scope’ tax years**

Due to McCloud re-calculations, HMRC may have been overpaid tax (for example, overpaid lifetime allowance or annual allowance charges). The member or administering authority, as the case may be, may apply to HMRC to reclaim the overpaid amount.

However, HMRC will not refund the overpaid amount if it relates to an ‘out-of-scope’ tax year. A tax year is ‘out-of-scope’ where the member is no longer able to make a claim to recover it under the Income Tax Acts because the statutory time limit has passed. We have asked HMRC to clarify the time limit. In these cases, administering authorities may be able to compensate members in accordance with the following provisions:

- sections 82 and 83 of the Public Service Pensions and Judicial Offices Act 2022
- Part four of The Public Service Pensions (Exercise of Powers, Compensation and Information) Directions 2022
- the LGPS Regulations that set out the McCloud remedy.

HMRC has confirmed to us that they plan to deliver:

- a calculator for members to use to calculate their tax adjustments
- an application route for members to provide HMRC with their tax adjustments
- a compliance process for claims
- a secure way for HMRC to send administering authorities the data necessary for the authority to process compensation claims for ‘out-of-scope’ years.

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## Further information

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