EXPLANATORY MEMORANDUM TO

THE PUBLIC SERVICE PENSION SCHEMES (RECTIFICATION OF UNLAWFUL DISCRIMINATION) (TAX) REGULATIONS 2025

2025 No. 419

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 (HM 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. Declaration

2.1 Torsten Bell MP, Minister for Pensions at HM Treasury confirms that this Explanatory Memorandum meets the required standard.

2.2 Gareth Cooper, Deputy Director for Public Service Pensions Remedy, Individuals Policy Directorate at HMRC confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Beverley Davies at HMRC telephone: 03000 512336 or email: policypensions@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 reduces the burdens on individuals and scheme administrators of public service pension schemes implementing the remedy to age discrimination that occurred when those pension schemes reformed their benefit structure. It prevents adverse tax consequences and broadly aims to put those individuals back in the position they would have been in if the discrimination had not occurred.

4.2 This instrument does not change the overall amount of tax an individual is liable to pay in respect of unauthorised payments made from a public service pension scheme. Instead, it provides for a process that enables the payment of top-up benefits and the deduction of tax to be streamlined into a single process from the member's viewpoint. It similarly streamlines to a single process, the tax recovery and payment of new tax processes that scheme administrators have with HMRC.

4.3 This instrument also makes miscellaneous changes for individuals affected by the public service pensions remedy. These include extending the deadline for applications to fixed protection 2016 and individual protection 2016, the most recent protections from lifetime allowance charges, and modifying the information that must be included in an election for the scheme to pay the annual allowance charge for a member and when that election can be amended.

4.4 Finally, this instrument updates references in The Public Service Pension Schemes (Rectification of Unlawful Discrimination) (Tax) Regulations 2023 (S.I. 2023/113) following the abolition of the lifetime allowance in 2024 and corrects errors in previous regulations (see paragraph 11.1 of this explanatory memorandum).

Where does the legislation extend to, and apply?

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

4.6 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 Part 4 of the Finance Act (FA) 2004 provides for tax relief for pensions saving. Although there are no limits on the amount of pension saving that an individual can have, there are limits on the amount of tax relief available.

5.2 To limit the tax relief, tax charges apply if payments made out of tax-relieved pension savings are not paid in line with the conditions in Part 4 of FA 2004, making them unauthorised payments. Where an unauthorised payment is made in respect of a member during their lifetime, the pension scheme member will be liable to the unauthorised payments charge at rate of 40% of the unauthorised payment. The scheme administrator will be liable to the scheme sanction charge at a minimum rate of 15% of the unauthorised payment.

5.3 Pensions tax relief is further limited by tax charges where an individual's pension saving in a tax year is more than their annual allowance (the annual allowance charge) or, before 6 April 2023, if their total pension saving were more than their lifetime allowance (the lifetime allowance charge).

5.4 Part 1 of the Public Service Pensions and Judicial Offices Act 2022 (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 members of public service pension schemes affected by the remedy. As the McCloud remedy is retrospective this can lead to adverse tax consequences, which have been addressed in S.I. 2023/113 and The Public Service Pension Schemes (Rectification of Unlawful Discrimination) (Tax) (No. 2) Regulations 2023 (S.I. 2023/912).

5.5 This instrument makes further changes to achieve the government policy that, as far as possible, individuals will be in the tax position they would have been in had the discrimination not occurred.

5.6 This instrument provides a process to allow for unauthorised payments charges that public service scheme administrators paid to HMRC on behalf of their members, to be offset against further unauthorised payments charges that arise from the remedy. Where charges in relation to historic unauthorised payments were made on or after 6 April 2019, this instrument allows for scheme administrators to reclaim overpaid charges from HMRC if they cannot be offset against a further unauthorised payments charge arising in respect of the same member. The same process applies to scheme sanction charges made in relation to these unauthorised payments charges.

5.7 This instrument also makes scheme administrators jointly and severally liable to the unauthorised payments charges in this case and creates a separate reporting and assessing process so that historical returns do not need to be amended. This simplifies the process for members so that they can be paid the correct amount of benefits and enables scheme administrators to complete their processes without further contacting members.

5.8 This instrument ensures that interest payments schemes are required to pay in accordance with The Public Service Pensions (Exercise of Powers, Compensation and Information) Directions 2022[1] or The Public Service Pensions (Exercise of Powers, Compensation and Information) Directions (Northern Ireland) 2023[2] (Treasury Directions) are not subject to the scheme sanction charge. This reflects that scheme administrators are required to make those payments in accordance with Treasury Directions and brings their tax treatment in line with similar payments of interest required by court judgments.

5.9 This instrument also makes miscellaneous administrative changes to ensure that the tax consequences of the McCloud remedy operate correctly. This includes ensuring scheme administrators can apply the tax provisions in this instrument, S.I. 2023/113 and S.I. 2023/912, extending deadlines for those impacted by the remedy, making tax processes work correctly and updating legislative references following the abolition of the lifetime allowance in 2024.

What was the previous policy, how is this different?

5.10 This instrument ensures that there are fair outcomes from the interaction of the payment of unauthorised payments under the remedy and the tax system. There is no legislation to support existing process of a scheme administrator paying the unauthorised payments charge to HMRC on behalf of an individual under what is known as the mandating process. Without this instrument the processes would be far more burdensome for both the impacted individuals and the scheme administrators. In addition there would be unfair outcomes as neither the member who was liable to the tax, nor the scheme administrator who paid the tax would be able to reclaim an overpayment of tax paid under the mandating process. The scheme administrator would also have to pay the scheme sanction charge on interest payments required by Treasury directions.

5.11 In addition the deadline to apply for lifetime allowance protections fixed protection 2016 or individual protection 2016 is 5 April 2025. Many individuals impacted by the McCloud remedy will not have the information they need to decide if they can or should apply for protection by this date. This existing legislation would disadvantage members impacted by the remedy. Additionally, members can amend an existing election for their scheme to pay their annual allowance charge provided they do so by 1 April 2027. Members may not have the necessary information to make the decision whether to amend their existing election by the deadline and so this would disadvantage members.

[1]The Public Service Pensions (Exercise of Powers, Compensation and Information) Directions 2022: https://assets.publishing.service.gov.uk/media/6399e9efe90e072aeeadb35b/The_Public_Service_Pensions__Exercise_of_Powers_Compensation_and_Information__Directions_2022.pdf

[2] The Public Service Pensions (Exercise of Powers, Compensation and Information) Directions (Northern Ireland) 2023: https://www.finance-ni.gov.uk/sites/default/files/publications/dfp/The-Public-Service-Pensions-Exercise-of-Powers-Compensation-and-Information-Directions-Northern-Ireland-2023.PDF

6. Legislative and Legal Context

How has the law changed?

6.1 FA 2022 provides the power to modify any enactment relating to income tax in relation to a relevant person who is impacted by provisions in PSPJOA. This ensures that regulations may be made that relate to the tax consequences of rectifying the discrimination arising from the public service pension reforms specifically. This instrument provides a legislative framework for scheme administrators who have paid unauthorised payments charges on behalf of their members and that tax position has changed as a result of the remedy. The framework includes offsetting overpaid tax against new tax due, the making of returns, assessments and repayments in relation to pension benefits that are unauthorised payments. It also makes amendments to S.I. 2023/912 to align with changes made in offsetting process under Part 2 of this instrument.

6.2 This instrument extends the deadline in paragraph 14 of Schedule 4 to FA 2016 to allow those impacted by the remedy to have the information they need before deciding whether to apply for lifetime allowance protections. Further changes update references following the abolition of the lifetime allowance.

6.3 This instrument also corrects errors in S.I. 2023/113 and 2023/912 as set out in paragraph 11.1 of this explanatory memorandum.

Why was this approach taken to change the law?

6.4 As the rectification exercise is retrospective for tax purposes, this is the only possible approach that would provide the required policy outcome of aiming to, broadly, put them in the tax position they would have been in had the discrimination not happened.

7. Consultation

Summary of consultation outcome and methodology

7.1 A series of informal technical consultation events were held with stakeholders from public service pension schemes where drafts of the regulations and guidance on the effect of the regulations were provided. In particular, these events were to ensure that the legislation setting out the new process allowing for the offsetting and reclaiming of unauthorised payments charges previously paid by the scheme administrator, work as intended. A more formal technical consultation was not considered necessary due to the limited number of public service schemes impacted and that the policy and approach was developed in conjunction with public service pension scheme stakeholders

8. Applicable Guidance

8.1 Guidance has been provided to scheme administrators explaining how the new framework for unauthorised payments charges paid by scheme administrators and other changes in this instrument will work on the gov.uk website[3].

[3] Guidance for scheme administrators: https://www.gov.uk/government/publications/public-service-pensions-remedy-newsletter-september-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 27 October 2021 alongside the Finance Bill and is available on the gov.uk website[4]. It remains an accurate summary of the impacts that apply to this instrument.

Impact on businesses, charities and voluntary bodies

9.2 There is no, or no significant, impact on business, charities or voluntary bodies because this issue arises within the relevant public service schemes.

9.3 The legislation does not impact small or micro businesses.

9.4 Part 2 of these regulations impacts only scheme administrator of public service schemes who have made a historic unauthorised payment and paid the tax charge on behalf of that member. As part of PSPJOA, they will be required to recalculate historic unauthorised payments and establish if further unauthorised payments are payable. In situations where a further unauthorised payment is due, the scheme administrator will become liable to that charge. They will be required to offset any overpaid unauthorised payments charge and, where applicable, obtain a refund for any overpaid charges. Representatives for the most impacted schemes requested this approach to simplify the process for the members and scheme administrators.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The approach to monitoring of this legislation is that it will be monitored through communications with the relevant pension schemes and taxpayer groups.

10.2 The instrument does not include a statutory review clause as it falls within section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 This instrument corrects errors in S.I. 2023/113 and 2023/912, which should have contained the provision in regulation 17(1) (insofar as it relates to them), and regulation 20(2) and (3). After discussion with the SI Registrar, in accordance with paragraph 4.7.6 of Statutory Instrument Practice, it is being issued free of charge to all known recipients of those instruments.

11.2 This instrument makes retrospective provision which is authorised by section 11(4)(a) of FA 2022. This is necessary to ensure that overpaid unauthorised payments charges can be offset against charges on additional unauthorised payments arising because of the remedy. Provision has been made in regulations 6(4), 9(3), 14(3), 17(2) and 18(2) in order to ensure that, where an obligation is imposed, this can nevertheless be met prospectively. In the case of regulation 17, this also prevents adverse consequences arising from the error addressed in paragraph 11.1.

[4] A Tax information and Impact Note can be found at: https://www.gov.uk/government/publications/taxation-of-public-service-pension-reform-remedy/taxation-of-public-service-pension-reform-remedy

12. European Convention on Human Rights

12.1 The Minister for Pensions 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 2025 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").