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19 June 2023

To: HM Revenue & Customs policypensions@hmrc.gov.uk

Dear All

Consultation: The Public Service Pension Schemes (Rectification of Unlawful Discrimination) (Tax) (No. 2) Regulations 2023

I am writing on behalf of the **Association of Consulting Actuaries (ACA)** in response to the technical consultation on draft legislation published on 22 May 2023 (https://www.gov.uk/government/publications/the-public-service-pension-schemes-rectification-of-unlawful-discrimination-tax-no-2-regulations-2023).

The ACA welcomes the opportunity to provide input. Members of the ACA are all qualified actuaries – mainly Fellows of the Institute and Faculty of Actuaries. All actuarial advice given by our members is subject to the Actuaries' Code. Members provide advice to thousands of employers and pension schemes – with total assets exceeding £1 trillion – including most of the country's largest schemes – and increasingly consulting actuaries are now involved in a wide range of additional areas. We are therefore responding in the capacity of a representative body for professional advisors who provide advice to a range of occupational pension schemes.

Our comments are set out in Appendix 1. Our response there has exclusively focussed on the impacts for private sector occupational pension schemes (OPSs) by the legislation, because we believe this will be subject to least scrutiny by typical respondents.

We do have some general comments, set out in Appendix 2– in particular that some of the measures now being proposed are needed for rectification exercises in the private sector schemes.

We would be happy to discuss this matter further. Please contact Kirsty Cotton on 01737 274496 or Kirsty.cotton@wtwco.com , or William Fitchew on william.fitchew@firstactuarial.co.uk.

Yours sincerely

Karen Goldschmidt FIA, Chair of the Pensions Taxation Committee
On behalf of the Association of Consulting Actuaries Limited

Appendix 1 from the Association of Consulting Actuaries

Our observations on the draft legislation as it impacts private sector OPSs are set out below.

NOTE THAT THE FOLLOWING COMMENTS ARE LIMITED AND HAVE NOT BEEN FULLY TECHNICALLY REVIEWED TO OUR USUAL LEVELS, GIVEN THE VERY TIGHT DEADLINES FOR RESPONSE ON THIS COMPLEX LEGISLATION.

Overpayment of lifetime allowance excess lump sum

We noted in our January 2023 response to "Draft regulations relating to the McCloud Remedy" that there could be knock-on effects on other schemes with BCE date after the remedy BCE but before rollback.

The matter being considered here is the outcome that can arise if a benefit (and benefit crystallisation) is reduced with retrospective effect: it is possible that a subsequent lump sum (from any scheme) that had been given the label of lifetime allowance excess lump sum (LAELS) will not count as one (whether entirely or partially) and therefore could otherwise become an unauthorised lump sum. This has been partially addressed (in the sense that it applies only where the reduction mentioned above is from a public sector scheme) by draft regulation 15, but we have some comments on that regulation within this limited scope.

1. We note that under Finance Act 2004 Section 227G (6) an individual flexibly accesses pension rights "immediately before the payment of the first uncrystallised funds pension lump sum paid to the individual." Will switching the treatment of (part of) the LAELS to an uncrystallised funds pension lump sum (UFPLS) mean that the Money Purchase Annual Allowance (MPAA) is triggered? If so, given that the individual (i) has not made a decision to receive funds in that way and (ii) might be penalised for making (indeed already having made) defined contribution savings which they reasonable believed to be within their Annual Allowance, the legislation should be amended. If the MPAA is not triggered, please could that be confirmed in the consultation response and guidance.

2. We welcome the solution of treating such overpayment of LAELS as an UFPLS, but we note that an UFPLS can only be paid in respect of a money purchase arrangement that is not a collective money purchase arrangement. Does any additional wording need to be added to the legislation to cover this (the scenarios being considered are more likely to be DB than DC arrangements)?

3. We note from HMRC's presentation on "what the regulation achieves", that the intention is that the *"Amount of LTA charge that can be reclaimed will be adjusted to take account of tax due on UFPLS".* Does this mean that the intention is that HMRC will repay to the scheme "overpaid LAELS x [LTA charge – 75% x marginal rate tax]"?
   For example, if the overpaid LAELS amounts to £10,000, and HMRC identify that the individual's marginal rate tax impacting the pseudo UFPLS is 40%, the repayment from HMRC to the scheme for onward transmission would be £10,000 x [55% - 75% x 40%] = £2,500? If so, we are struggling to see how 15(3) achieves that.

   In any event, we are unclear of the process for reclaiming the tax charge, but hope that will be covered by guidance.

The issues above would apply to both public and non-public sector schemes.

Guidance

We understand that a tranche of guidance will be written specifically from the perspective of the "other scheme" faced with issues arising from the knock-ons of remedied benefits elsewhere and we hope that will cover the issues outlined here and in our January 2023 letter (ACA response to draft tax regulations relating to the McCloud Remedy – ACA – Association of Consulting Actuaries).

Overall, we note that some of the matters in these regulations may need to be re-addressed - to the extent they count as benefits in real time rather than retroactively – in the light of any changes made as part of the government's project to remove the Lifetime Allowance from 6 April 2024

Appendix 2 from the Association of Consulting Actuaries

As noted in our https://aca.org.uk/follow-up-to-consultation-response-draft-tax-regulations-relating-to-the-mccloud-remedy/ response of 19 January 2023 in relation to the consultation on the "No 1" tax regulations, the operation of pensions tax incurs disproportionate administration complexity for schemes (and HMRC), associated costs for employers and negative impacts for members – particularly where action is being taken to rectify benefits. Some of the issues incurred in relation to McCloud also occur in respect to other retroactive benefit adjustments, including those arising from GMP equalisation, GMP rectification and scheme specific court judgments; they can also arise from administrative errors. We do understand that the way in which the McCloud remedy has been introduced in the law creates different subtleties and uniqueness, but the issues at stake are the same.

The intended abolition of the LTA (and indeed the abolition of the LTA charge as an interim measure) should take into account how errors have arisen (or can develop in the future) and need correction - and the legislative restructuring potentially gives an opportunity to streamline other aspects of pension legislation by using some of the solutions provided for the McCloud remedy to benefit more schemes and in more circumstances so that pensions tax issues are not a block to practical solutions.

In our response [on the technical consultation/above] we focussed on Regulation 15 (overpayment of a LAELS). We welcome the proposed solution that where part of a past lump sum that had apparently been an LAELS but because of retro-actions has fallen within the LTA, it will (retrospectively) be treated as an UFPLS – but currently this is only where the retro-action has been a McCloud remedy. Would it be possible to extend that easement to other situations where a LAELS label has (retrospectively "incorrectly") been used to justify paying a lump sum benefit? If HMRC were concerned about abuse, that could be limited to "LAELS" which had been subjected to a lifetime allowance charge at 55%. By definition, such an LAELS must have arisen prior to 6 April 2023 and so before anyone could have been aware of this option. If this approach was taken, we'd like to discuss with you the tax treatment and processes for "overpaid LAELS" for 2023/24.

There are other issues with LAELS which it would be helpful to address including those covered by regulations 16 and 17 in respect of McCloud.

Draft regulations 7 to 14 and 18 highlight that there are many other areas of tax law beyond LAELS which may not work well with benefit corrections. These issues, and others, can also arise when benefits are corrected in registered pension schemes.

With regard to GMP equalisation, HMRC has published helpful guidance which has been warmly welcomed by the industry. In other situations HMRC has included helpful guidance in PTM, such as PTM063700 on the requirement to extinguish benefits for the payment of small lump sums. And some issues are dealt with by guidance about genuine error.

It would be useful to have more information to understand the special nature of the legislative approach to the McCloud remedy, and how this is "read" by pensions tax law. This would aid analysis of whether further corresponding legislation would be helpful for registered pension schemes more widely, in relation to the issues like those covered in this draft legislation and the earlier Remedy tax regulation made in 2023 – or whether further guidance would be helpful (whether in relation to the McCloud remedy or other 'remedies').

We would be happy to discuss this further with you outside this specific consultation.