ASSOCIATION OF CONSULTING ACTUARIES

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To: HM Revenue & Customs pensions.policy@hmrc.gov.uk

Dear All

Consultation: draft tax regulations relating to the McCloud Remedy

I am writing on behalf of the **Association of Consulting Actuaries (ACA)** in response to the technical consultation on draft legislation published (with some accompanying draft guidance) on 24 November 2022 (https://www.gov.uk/government/publications/the-public-services-pension-schemes-rectification-of-unlawful-discrimination-tax-regulations-2023.

The ACA welcomes the opportunity to provide input and (as well as comments we made at a workshop yesterday) we set out detailed comments on the draft legislation in the Appendix.

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, including the experience we have from some of our member firms providing administration services to such schemes.

Our response has particularly focussed on the knock-on impacts created for private sector schemes by the legislation, because we believe this will be subject to least scrutiny by typical respondents.

We do have some general comments, on which we will write separately.

We would be happy to discuss this matter further. Please contact me (on 020 7432 6621 or karen.goldschmidt@lcp.uk.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 from the Association of Consulting Actuaries

Our observations on the draft legislation are set out below.

NOTE THAT THE FOLLOWING HAS NOT BEEN FULLY TECHNICALLY REVIEWED TO OUR USUAL LEVELS (AND IS ALSO LIMITED), GIVEN THE VERY TIGHT DEADLINES FOR RESPONSE ON THIS COMPLEX LEGISLATION.

Introduction: We believe the typical consultation respondent will have focussed on the impact of the remedy and draft tax regulations for the affected public sector schemes.

We have instead mostly focussed on the impact on "other" schemes ie where the individual involved has benefits in a public sector scheme directly impacted by the McCloud remedy and has benefits in another scheme (typically a private sector one). This other scheme benefit may have accrued before or after the remedy-scheme service; and may involve the benefits from the private sector being crystallised before or after those from the rectifying public sector scheme.

Our technical focus has been on where the rectifying public sector scheme is Chapter 1 (so not for LGPS or the judiciary scheme).

1) As an overall comment on guidance

We would suggest that a tranche of guidance is written specifically from the perspective of the "other scheme" faced with issues arising from the knock-ons of remedied benefits elsewhere. This could focus on the special powers and provisions the schemes are being given in such a situation - saving them from having to attempt to pick them out from the full tax guidance on the remedy.

2) Lifetime Allowance usage changed retrospectively – impact on other schemes' BCEs

We have looked at the approach where rectification retrospectively changes a public sector scheme BCE (a "rectified BCE") for a member, focussing specifically how this has knock-on impacts for the LTA process and charge management if the member had benefits in an "other scheme" (typically not public sector) with BCE date after the remedy BCE but before rollback ("non-remedy BCEs").

Consequently, this is an issue for members who have already had BCEs by the time the remedy is implemented (we assume that it will not be an issue for future BCEs as here any LTA scope will in theory reflect the "right" remedy benefits).

Regulation 33 relates to actions required or available specifically to the public sector scheme with the rectified BCE where the LTA charge it has previously paid reduces because of the remedy; it does not refer to a similar knock on for "other schemes". Regulation 35 is relevant to "other schemes" where the charge increases. In the next subsections we comment in further detail on both situations.

As a general point, we welcome the fact that para 6.8.2 of the guidance makes clear that responsibility is placed on the member to notify other registered pension schemes (including both private and public sector schemes) of changes to the amounts of BCEs as a result of the remedy. This member-centric approach seems the only possible way forward - but we do note that members might fail to make such notification, or there may be material delays in them carrying this out (with the liability to extra tax or reclaimed tax not being dealt with but nevertheless existing).

Where members do give correct new information to the "other" scheme, that scheme has to deal with the complexity: in theory the "other" scheme has to reopen and retrospectively check whether their own BCEs took the member over [or further over] the remaining LTA as adjusted for the change in BCE caused by the rectification – with the possibility that there could be yet another scheme also using up

LTA. In the scenario that benefits have reduced, the "other" scheme may now find that it has overpaid the LTA charge in the past, as a consequence of the change to rectified BCE reducing the LTA usag frp, the "other scheme" BCE. There seems to no way to avoiding that the fact that the "other" scheme will need to carry out the calculations to establish the LTA charge due or overpaid.

2.1 Underpayment of LTA charge because of rectifications (Reg 35/para 6.8 guidance)

We support the draft provisions in Reg 35 that if a rectified BCE leads to extra LTA charge for a subsequent BCE in an "other" scheme, that "other" scheme can seek a discharge from joint and several liability, which would then fall back to the scheme where the rectified BCE occurred, so the member would not necessarily be left to find funds to pay the charge themselves.

We believe that most "other" schemes in such a situation would indeed use this provision. (This is not least because there are real challenges to a scheme processing such a late Lifetime Allowance charge and trying to apply a reduction to the member's benefit. We note that reg 26 does resolve some aspects of these issues, for affected public sector schemes.)

Consequently these discharge provisions are important. In an ideal world we would seek blanket reassurance that the discharge application will always be granted; however we appreciate that HMRC cannot fetter itself in this way so we hope for any reassurance statement you can make in guidance.

There is a time limit to discharge applications in "Registered Pension Schemes (Discharge of Liabilities under Sections 267 and 268 of the Finance Act 2004) Regulations 2005, SI 2005/3452" of *"no later than five years after the 31st January next following the year of assessment to which it relates".* (See also PTM158000). We believe this is too short for this sort of case where there may be a very long lead in before the member gets the revised information, understands the process, and contacts the "other" scheme.

Indeed we would ask for deadline extensions, in the remedy context, for discharge applications for other tax charges too.

2.2 Overpayment of LTA charge because of rectifications (Reg 33)

In the (rarer) case where the rectified BCE is lower than before (which might arise eg from staggered drawing), an LTA charge previously identified for a subsequent non-rectified BCE in the "other" scheme may reduce or disappear.

We see that Regulation 33 spells out the process for the public sector scheme itself if the past LTA charge that it has paid should reduce because of the rectified BCE. The regulation does not cover the position where the consequential "drop" in LTA charge happens in the "other" scheme (whether this is instead of the public sector scheme or in addition). If so:

- Is the intention to follow the same lines as Reg 33 (ie the "other" scheme has to manage reclaiming the LTA charge from HMRC) in which case does this need legislation parallel to Reg 33?
- Or (our preference) could the reclaim process be passed back to the public sector scheme to manage, with the "other" scheme's position left unchanged.

[If the intended approach is in line with Reg 33, the scheme would then presumably have to neutralise the reduction made to benefits. We assume that the way forward would not be to unwind the benefit reduction, but to use the practice and regulations set out at the end of PTM 086000 (under the heading 'Where a lifetime allowance charge is deducted incorrectly') calling upon the provisions under "The Registered Pension Schemes (Meaning of Pension Commencement Lump Sum) Regulations 2006 — SI

2006/135 as amended by SI 2007/3533", to pay the member a benefit that is the same value of the refunded tax. However we have not tested the technicalities of this, nor how it fits with typical scheme rules or whether it puts the member back in the correct overall position in all cases (one of our committee members suggests that the numbers work if the LTA charge was 25% but not if it was 55% but we have not checked this).]

Further, if the "other" scheme does have to treat this situation as a correction to the LTA available when it processed its original BCE, we note that the "other" scheme may have allowed the member to draw benefits in the form of excess of LTA lump sum – which we believe would no longer count as valid if coming from benefits that are (retrospectively) now found to be still within remaining LTA. This may need legislative remedy.

We note that a change in the LTA charge position might arise not just from a BCE revision, but potentially from the retrospective changes in IP16 registerable value under the draft legislation as written. We would therefore ask that reg 35 (and anything introduced on dealing with overpaid LTA charge) be extended to cover all retrospective changes in LTA charges as a result of McCloud remedies and not just revisions to BCEs.

We read (although we are not certain of this) the draft legislation (reg 22 and 23) to mean that, where the member has died since the original BCE being remedied, uplift from the remedy does not cause retrospective changes to the original BCE. If that is a correct reading then it is welcome in relation to the above issues which would otherwise apply.

3) Individual Protection 2016

This is relevant only for a limited subset of the whole remedy group, being those members who already have had a quotation as at 5.4.2016 of the "IP 16 registerable" benefit value of their remedying public sector scheme benefits, or ask for this in the future. (We assume that schemes did not proactively quote the IP 16 registerable figure to all members without request.)

The draft legislation deals with possible changes to IP16 registrable values because of remedy processes/elections. We note that since the remedy period only starts on 1 April 2015, at most one year of accrual (up to 5 April 2016) would be impacted.

We think the current drafted provisions approach for the remedy group could lead to complexity and uncertainty for a long time.

- To date, individuals with IP16 would have had the figure quoted to them on the basis of the remedy period reflecting:
  - legacy scale benefits - for protected members (and some tapered members);
  - 2015 scale benefits -for other members.

- We think that the default response for a IP16 registerable value request timed after rollback implementation and before any retirement election, is to reflect the legacy scheme scale – and indeed there may be an obligation to correct any previous quotes given on a different basis.

- But we note that the draft legislation then provides that at retirement from the remedy scheme, the relevant IP figure is re-set retrospectively to match the member's final choice of retirement benefit. So if they choose 2015 scales then the IP16 figure is retrospectively re-set to reflect the 2015 scale for the one relevant year of accrual in the remedy period from 1.4.2015 to 5.4.2016.

- Our suggestion (for more certainty upfront, less administration and less confusion at the point of retirement and less scope for retrospective BCEs) is that the IP16 registerable value is re-set to the better of the legacy and the 2015 scales. We would expect that key components for both figures will anyway be worked out substantially for 2015/16 or 2016/17 AA PIA calculations.

We appreciate that your decision on the draft structure may have been modelled on some practical aspects - for example how widely or proactively IP16 registerable values may already have been quoted; or perhaps assumptions that protected members will mostly have already retired and might stick to legacy scale benefits so for that group a "better of" approach creates additional work; and that many unretired members may not yet have applied for IP16 and might not think of doing so until close to retirement date – but for the latter the alternative approach above removes uncertainties and potential extra revisions for other BCEs that might happen before.

The member's prime decision on whether to make a 2015 election will be driven by the resulting gross benefit at retirement. However, as drafted, a knock-on consequence would be that the IP16 registerable value would change (reflecting where the 2015 election would have taken the member retrospectively by 5.4.2016) potentially in a different direction or quantum to the retirement benefit so making an unexpected and potentially unintuitive change to the LTA position.

4) Trivial commutation lump sum (regulation 18)

For context we note that a test for whether a TCLS label can be used works globally in the sense that the £30,000 limit test looks to all pension savings made across all the member's schemes. We welcome the provision in regulation 18 which we read to mean that that any increase in benefit "value" above £30,000 because of application of the remedy neither loses the label of TCLS for the remedy scheme nor for any other scheme (including private sector schemes) from which a TCLS had been paid (even if no TCLS was paid from the affected public sector scheme).

5) Annual Allowance usage

We would hope that the AA interaction between the remedy scheme(s) and "other scheme" savings should be relatively limited.

This would be the case particularly if the remedy regulations successfully preserve the AA deferred member carve out (AA DMCO). We note that there is specific provision (regulation 12 and 13, guidance 4.6.14-4.6.16) that a new scheme benefit election does not lose an existing AA DMCO and this is welcome both for preventing incurring unfair AA charges for a deferred pensioner from the remedy benefit "accrual", and the complexity it would cause for ongoing accrual in another scheme.

We note that where the AA DMCO would not apply ie for an active member, the approach to AA PIA for the tax year in which the member retires (from guidance 4.6.9-4.6.13 – we have not considered the draft legislation itself) is such that if they make a 2015 election, then the PIA is calculated on the lower of the legacy benefit outcome and 2015 election outcome – ie members are protected not just from the "concentrated timing" impact of a 2015 election but from any AA usage at all from accruing the higher benefit. This does put members into a better position than if 2015 scale applied ab initio (ie better even than had the remedy period always been on the reformed scheme benefits), but we assume this is intentional to simplify matters.

6) Scheme Pays to meet AA charges

We have been looking at how the legislation deals with the process if a member has used Scheme Pays for an AA charge that retrospectively reduces subsequent to roll-back (or immediate election). – (Reg 10 and 11 and guidance 4.11.1-5).

As far as we can see from the regulations and guidance, if Mandatory Scheme Pays (MSP) has been used, the scheme reclaims the AA charge that now counts as "overcharged" and the lower remaining AA charge overwrites the original election. So our conclusion is that the scheme must then revise its

MSP Scheme Pays reduction to benefits to match this. It would be helpful if the guidance could spell this out. Where this is done for a pensioner, we assume that this would typically involve retrospectively changing the benefits that had been put into payment at BCE – so may be an additional reason why BCEs increase and impact the processes noted earlier.

It is less clear to us what happens where the member used VSP. Para 4.11.3 of the guidance moves the already-agreed VSP arrangement to the legacy scheme; but there is no indication in the guidance on the actions to be taken in relation to overpayments that need refunding – does the scheme or the member approach HMRC? If the scheme, what happens about reductions that have to be made to benefits? We understand that VSP would not normally be addressed in law because on the whole VSP does not have a "presence" in law and is an arrangement by the scheme to take an action for the member. The exception is that explicit reference is made in SI2011/1791) to allow the necessary reduction to benefit to recoup tax paid by a scheme – whether MSP or VSP. A number of AA charges will have been made using a VSP process (eg because PIA was split between two schemes and the neither part in isolation exceeded 40K).

If the member who has used VSP has to make the AA charge reclaim themselves, with no disruption to the scheme arrangements already in place, that would be welcome from an administration point of view. (This does have the risk of "double refund" eg where it overlaps with the compensation scheme for 2019/20 AA charges, by which the member's Scheme Pays benefit reduction is made good by the employer.)

Issues arising about access to VSP for revised AA charges, and the tight deadline for paying AA to HMRC using VSP, have already arisen elsewhere in relation to the Scheme Pays legislation changes in FA22 and associated regulations.