

MPs' pensions and McCloud: Mitigating adverse tax consequences

A consultation – October 2023

IPSA

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Background to the consultation

The McCloud judgment and IPSA's response

1. In 2014-15, the Government implemented reforms to public service pension schemes, such that they changed from providing benefits on a basis related to an individual's final salary (a 'final salary' or 'FS' scheme), to benefits related to 'career average revalued earnings' (a 'CARE' scheme). As part of the reforms, a set of transitional arrangements were put in place, whereby older members were allowed to stay in the FS scheme, while younger members were moved into the CARE scheme. This was intended to protect those closest to retirement against unanticipated changes to their pension benefits.
2. A Court of Appeal ruling known as the 'McCloud judgment' subsequently found these transitional arrangements in some public service schemes constituted unlawful age discrimination under the Equalities Act 2010. In light of that judgment, the Government consulted on and proposed changes¹ to various public service schemes in order to address differences in treatment arising from the transitional arrangements.
3. In 2015 IPSA consulted on and implemented changes to the MPs' pension scheme as part of its review of MPs' overall remuneration. A key objective in making the change from FS to CARE was to ensure that MPs' pension arrangements, which had grown increasingly expensive to provide in the preceding years, were put on a more sustainable basis. The House of Commons, in a 2011 motion, had declared its support for the introduction of a new pension scheme for MPs which was informed by the report of the Independent Public Service Pensions Commission chaired by Lord Hutton of Furness (known as the 'Hutton report')². The 2015 changes to the MPs' pension scheme included similar transitional arrangements for some groups of members, defined by age, as was implemented in other public service pension schemes.
4. Although the MPs' pension scheme was not directly impacted by the McCloud judgment, IPSA concluded that when the Equality Act tests were applied, there were some members who may have been treated unfairly relative to others during the 2015 transition to the CARE section. Following two public consultations, in March 2021 and February 2022³, IPSA decided that it would make changes to the MPs' pension scheme in order to eliminate any age-related unfairness arising from the 2015 transition.

¹ Read the [Government's response](#).

² PCPF debate in Parliament 17 October 2011: [Parliamentary Contributory Pension Fund – Hansard – UK Parliament](#)

³ IPSA's [previous consultations on its response to McCloud](#).

5. The changes fall into two main categories: closure of the FS section to future accrual from 31 March 2023; and providing impacted members with a choice about whether they wish to be treated as a member of the FS section or the CARE section during a specific period of time (8 May 2015 to 31 March 2023), known as the ‘relevant period’. IPSA’s response to McCloud is broadly similar to the Government’s approach for other public service schemes, although it does differ in some respects where we considered that appropriate, taking into account the size of the MPs’ scheme and characteristics of the MP role.
6. Following consultation, amended pension scheme rules setting out these changes were laid before the House of Commons on 30 March 2023.⁴

Progress on implementation

7. In order to ensure a fair, workable, and good value response to McCloud, IPSA has been engaging closely with the Parliamentary Contributory Pension Fund (PCPF) Trustees, who hold responsibility for administering the pension fund, and the Secretariat team who support them. We have agreed an approach to collaboration which recognises our respective roles and responsibilities, but also our shared objective of ensuring success in this work.
8. The PCPF has made significant progress over the past 18 months on implementation of the McCloud response. In drafting the scheme rules themselves, IPSA has provided discretion to the PCPF Trustees to help them address complex or unanticipated issues.
9. Most affected members have now received individualised figures illustrating the impact of the choices available to them on their pension, including possible changes to accrued benefits, contributions, dependant benefits and pensions in payment. With the PCPF, we have also put in place a range of financial education and guidance resources, including a dedicated webpage with FAQs, seminars, one-to-one meetings, a digital comparison tool and a panel of independent financial advisors with knowledge of the scheme (members who seek financial advice will need to pay for it themselves).
10. Affected members will be invited to communicate their choices over the coming months, and currently we expect those to be implemented during 2024-25.

Tax consequences

11. A particular challenge, and one outside of IPSA’s direct control, has been to understand and account for the tax treatment where members opt to change their benefits for the relevant period. IPSA has been clear that individual members are responsible for their own tax affairs and should pay additional tax corresponding to improvements in their pension benefits. However, any change in benefits arising from prior years’ accrual will not have retrospective effect for tax purposes and may result in some cases in adverse tax charges which would not ordinarily have been due.

⁴ The [March 2023 version of the MPs’ pension scheme rules](#).

12. The legal arrangements relating to the MPs' pension scheme mean that it does not fall within the scope of legislation governing the 'mainstream' public service pension schemes, including the Public Service Pensions Act 2013 which brought about the transitional protections that were the subject of the McCloud judgment. Because of these separate legal arrangements, the MPs' pension scheme also was not included in the Public Service Pensions and Judicial Offices Act 2022, which implemented the McCloud remedy across other schemes. Powers conferred to IPSA under the Constitutional Reform and Governance Act 2010 enabled it to make changes to the MPs' scheme in 2015 and in response to McCloud without the need for additional legislation.
13. Because the MPs' pension scheme is not covered by the remedy which the Government is putting in place for other schemes, it is also outside of measures which would 'smooth' adverse tax consequences for affected members of those other schemes as a result of McCloud. IPSA does not have the power to affect to the tax treatment of individuals through the drafting of the MPs' scheme rules.
14. IPSA and the PCPF Trustees advocated strongly but unsuccessfully for PCPF members to be treated in line with other affected public servants in this area. Other public service schemes are benefiting from primary legislation which provides for tax 'retrospection', meaning that individuals are put back retrospectively in the position they would have been if they had been in the correct scheme all along, and the tax treatment follows suit. This means that in the main they will not face things like adverse tax charges as a result of their choice.
15. However because the MPs' scheme is not included in the wider public sector remedy, PCPF members who opt to change their benefits may be disadvantaged in relation to tax impacts, for example:
 - An increase in accrued benefits occurring in one tax year, rather than occurring in each of the eight years of the relevant period, could result in a breach of the Annual Allowance which would not have otherwise happened.
 - Members who are required to pay additional contributions in relation to their choice but have left active service are no longer entitled to tax relief on pension contributions.
 - Where members are due a refund of overpaid contributions relating to their choice, this cannot ordinarily be paid out by the scheme without incurring 'unauthorised payment' charges.
16. In April 2023, the Chief Secretary to the Treasury wrote to the IPSA Chair to confirm that, despite the lack of tax 'retrospection' for members of the MPs' pension scheme, the Government would facilitate a solution to address the potential adverse tax consequences for those members, and its view was that the most practical approach

would be to compensate members who owe a tax charge as a result of the McCloud response.

17. In this consultation we have set out proposals for a system of ‘redress payments’ to compensate impacted PCPF members for adverse tax charges, including the circumstances in which redress would be paid and how the process would operate. We have been clear that although this was not IPSA’s preferred solution, we believe it is the only route to ensuring affected members can have a fair choice.
18. We are grateful to the officials at HM Treasury and HMRC who have devoted their time and energy to help us navigate and develop solutions in this complex area. We are keen to emphasise however, that without the technical changes to tax regulations the Government has committed to, which would make the redress payments themselves tax-neutral among other things, the proposed solution would not be viable.

Other issues

19. A small number of technical issues with the pension scheme rules have come to light over the course of implementing the McCloud changes. We have included our proposals for addressing them in this consultation.
20. As implementation progresses, other issues relating to members’ very specific circumstances may arise, and we wish to ensure that the scheme rules provide sufficient flexibility for the Trustees to respond to these as appropriate. Therefore we are also seeking views about whether there are additional areas of discretion, beyond the significant discretions already available, which should be reserved to the Trustees to ensure fairness in this process.

How to respond

21. Please use our [online survey to submit your response](#). You can also email consultation@theipsa.org.uk if you prefer. **Please do not send us responses by post** as this may delay the processing of your response.
22. We will summarise the responses we receive when we publish our decisions. In doing so, we may refer to individual respondents and the content of their responses. We may also publish a list of who responded. If you would like your response to be treated as confidential, please say so clearly in your response. We will not quote from confidential responses or attribute the views in them to any particular respondent. Whether your response is confidential or not, we will not publish your email address or any other contact details, in line with our compliance with data protection law and the General Data Protection Regulation (GDPR). For more information about what we do with personal data, please see our [privacy notice](#).
23. **Please send us your response by 17 November 2023.**

The proposal for a redress payments process

24. Affected PCPF members will be asked to make a choice relating to their pension benefits in respect of the relevant period. Where a member chooses to change their benefits, this will be implemented during the 2024-25 tax year. In many cases, changes to contributions, accrued benefits and pensions in payment can be carried out via the normal administrative processes of the scheme. However, due to particular aspects of the pension tax regime, combined with the lack of tax retrospection for the MPs' scheme, there are some things which cannot be done through normal processing and may create adverse consequences for the member which would not ordinarily have arisen.

Objectives and scope

25. The overarching objective of the redress payments process is to mitigate unintended and adverse tax consequences arising from a member choosing to change their benefits in respect of the relevant period. To the extent possible, the outcome for an individual member should be that they are placed in the same position they would have been in, had they been able to accrue benefits in the section of their choice at the time. This would ensure that members are given a genuine choice regarding their pension benefits and that, as far as possible, any remaining unfairness between members is removed.

26. For the avoidance of doubt, members are responsible for their own tax affairs, and where their choice produces an increase in pension benefits, the tax due may also increase. This is fair and expected and is in line with how other citizens are treated. The redress payments process would aim to address adverse tax consequences that would not arise, but for the way that the McCloud changes are being implemented in the MPs' pension scheme.

27. It is envisaged that redress payments would be made to correct the following broad categories:

- **Refund of amounts reflecting overpaid contributions:** Depending on a member's choice, they may have made more contributions in the past than necessary to accrue their preferred benefits during the relevant period. Under the scheme rules, these overpaid contributions are to be returned to the member. However, the lack of retrospection for the MPs' pension scheme means that under pensions tax rules, the scheme cannot pay such a refund without it attracting 'unauthorised payment' charges. To avoid these, refunds would instead be made through the redress payments process.
- **Excess Annual Allowance tax charges:** These could arise due to an increase in accrued benefits being implemented in one tax year rather than in each of the relevant eight years. Or conversely, a member may have paid Annual Allowance tax charges in the past, but these would not have been due if the member had been

accruing in their preferred section at the time. A redress payment would cover the excess tax charge.

- **Excess Lifetime Allowance charges:** This could arise where a member has paid a Lifetime Allowance charge at the point of retirement, but it would not have been due if the member had been accruing in their preferred section at the time. A redress payment would cover the excess charge.
- **Tax relief that is no longer available:** Members benefit from tax relief on their pension contributions while in active service. In some cases, someone who has now left active service (that is, they are no longer an MP) may make a choice which requires them to pay additional contributions to the scheme. However paying those amounts 'gross' (that is, without tax relief) could put them in a worse position than they would have been, had they been paying the additional contributions while still an MP. A similar situation could arise where an active member is over the age of 75 and therefore no longer benefits from tax relief on contributions, but they were under age 75 during the relevant period. Redress payments would cover the tax relief amount they would ordinarily have been entitled to.
- **Higher income tax:** Members who have already retired may choose to receive higher pension benefits, in exchange for paying additional contributions. If payment of additional pension arrears occurs in a single year, this could put a member into a higher income tax bracket than they should be. Where this happens, a redress payment would cover the excess tax charge resulting from this one-off increase.

28. There may be other adverse tax impacts depending on an individual's specific circumstances and their choice. The proposed process would allow a member to provide evidence of an adverse tax consequence for assessment. Further information about the proposed process is below.

29. It is not our intention that compensation should be provided for inconvenience or other hardship which members believe they have suffered. Other financial losses – for example where members believe they would have made a different decision in respect of their wider financial arrangements in the past – are also outside of the scope of this proposal. We recognise that some members will feel they are entitled to this wider compensation, in addition to the redress payments which are the subject of this proposal. However, no member will be obliged to make any changes to their pension, and any active choice made to do so should take into account the whole of a member's financial arrangements.

Question 1: Do you agree that a redress payments process should be established to mitigate adverse tax consequences arising from members' McCloud choice?

Question 2: Do you have any comments on the proposed objectives or scope of these payments?

Process and funding

30. The redress payments process would be established through an amendment to the MPs' pension scheme rules. Although separate from the normal administration of pensions in the scheme, we are proposing that the redress payments process would be managed and administered by the PCPF Trustees, in line with the scope and criteria for such payments set out by IPSA in the rules. We believe this is the most practical arrangement, considering both the legal issues around IPSA's statutory remit and administrative issues. For instance, the Trustees are already responsible for all member-facing interactions in relation to the pension scheme, have access to administrative resource through the scheme administrator, and also hold relevant member data.
31. Funding for redress payments is still under discussion with HM Treasury, but subject to considerations of process and procedure, our view is that it would be most straightforward for this to be provided directly to the PCPF for the Trustees to then make payments out to members. In any case, the intention is that such payments should not have any negative impact on the pension fund itself.
32. Our proposal is for the redress payments process to open from April 2025, following implementation of members' choices during the 2024-25 tax year. This would be the earliest point at which redress payments to reflect refunds of overpaid contributions could be made to relevant members. However, many members would need to wait until the issuing of pension saving statements (PSS) in October 2025 to understand whether there were adverse tax impacts relating to Annual Allowance charges; and some may need to wait until they submit their self-assessment tax return for the 2024-25 tax year, due by 31 January 2026.
33. The impact of changes made following a McCloud choice could extend into future tax years. For instance, where high accrual in one year means that a member has no (or less) Annual Allowance left over to carry forward, this could mean that they are liable for a tax charge in a future year which would not have been due if their Annual Allowance in 2024-25 had not been impacted in this way. Because Annual Allowance can be carried forward into the three subsequent tax years, we are proposing to keep the redress payments process open until tax impacts would be known in respect of the 2027-28 tax year.
34. The envisaged timeline is as follows:

Date	Event
2024-25 tax year	Implementation of member choices
31 January 2025	Final deadline for member choices to be made
6 April 2025	Redress payments process opens

From April 2025	Refunds of amounts reflecting overpaid contributions made to relevant members
October 2025	PSS issued for 2024-25 tax year*
31 January 2026	Self-assessment tax return due for 2024-25 tax year*
<i>2025-26 and 2026-27 tax years</i>	<i>PSS and self-assessment tax return processes take place</i>
October 2028	PSS issued for 2027-28 tax year
31 January 2029	Self-assessment tax return due for 2027-28 tax year
5 April 2029	Redress payments process closes

35. Refunds of amounts reflecting overpaid contributions would be paid through the redress payments process automatically to relevant members. For other redress payments, a member would be required to make an application to the PCPF Trustees, supported by evidence of an adverse tax charge or other consequence arising from their McCloud choice. For example, where they have paid an excess Annual Allowance charge, they would need to provide a comparison between the pension input amounts resulting from higher accrual in one year as a result of their McCloud choice, and the pension input amounts that would have occurred if pension accrual had happened in each of the years of the relevant period. A member may make a prospective application before the tax charge has actually been paid, with sufficient evidence that it will become due.
36. Depending on the issue, the information needed to support an application may be available from the PCPF and/or from HMRC. Applications would need to take account of any other pension arrangements a member has in place, in order to clearly demonstrate the excess tax charge arising specifically from implementation of their McCloud choice. Further guidance would be made available by the PCPF to support members in making their applications and understanding the types of evidence they would need to provide.
37. The Trustees (or their delegated representative) would make an assessment of the application and whether the supporting evidence is satisfactory in demonstrating that an adverse tax consequence on the member has arisen solely from the member's McCloud choice. Any application meeting the requirements set out in the scheme rules would be approved by the Trustees.

Question 3: Do you have any comments on the proposed process or timing?

Question 4: Do you have any other comments on the proposals for a redress payments process?

Other issues

38. Apart from the main proposal for a redress payments process, there are two other technical issues which have been highlighted as a result of the McCloud changes to close the FS section to future accrual and to move all active members to the CARE section from 1 April 2023.

Members approaching age 75

39. The MPs' pension scheme does not allow members to start taking their pension while still a sitting MP. However, it is not unusual for MPs to stay in office well past normal retirement age, and in some cases into their 70s or even 80s.

40. As required by pension tax law, individuals lose access to tax relief on pension contributions after they turn 75. Under the FS section, members were able to opt out of active membership right before their 75th birthday, in order to access some of their pension by taking their lump sum. They would then be treated effectively as if they were pensioner members, even while remaining in office as an MP, with their pension 'abated' (suspended) until they leave Parliament.

41. However, the CARE rules do not allow for anything similar in respect of CARE benefits. Members who reach age 75 while still in active membership can opt out of further contributions and accrual but would not be able to take their lump sum. This difference has become more apparent now that all active members, including older members who previously were 'protected' in the FS section, are accruing benefits under CARE.

42. The FS section rules predate IPSA, but we assume that the FS rules were designed in this way to take account of the fact that members would normally leave active service at specific points in time (that is, at elections) and would not have control over whether that fell on one side or other of their 75th birthday. If this is the case, then it is unclear why the CARE rules should not provide for something similar.

43. We are proposing a change to the CARE rules to mirror the provisions under the FS section, to enable active members to choose to take their lump sum right before their 75th birthday. Their (reduced) pension would then be abated until they retire. This reflects the fact that most MPs commit to serving for the whole of a parliamentary term and have less flexibility around when they retire than people in other types of roles.

Question 5: Do you agree that the CARE section rules should be amended to allow active members approaching age 75 to take their tax-free lump sum, with their remaining pension abated until they leave Parliament?

Revaluation of FS scheme limits

44. The scheme sets out limits on the maximum level of benefits that a member can receive from the FS section. Where relevant, the calculation of this limit takes account of a member's 'Retained Benefits', meaning a pension entitlement built up under a different pension arrangement (usually before a member joins the MPs' scheme).
45. The limit is calculated at the date the member leaves FS service and then uprated between that point and the date of retirement, at the greater of a) 3% per year; or b) the increase in Retail Price Index (RPI). Meanwhile, where a member has left active service, their accrued FS benefits are uprated by Consumer Prices Index (CPI); but where they remain in active service in the CARE section, their FS benefits increase based on changes to the MP salary. In the latter scenario, it is possible under some circumstances that salary will rise at a faster rate than the limit increases, meaning that the member will receive a smaller proportion of their FS benefits at retirement than was calculated at the date the member moved to the CARE section.
46. As with the issue described above, this discrepancy has come to the fore as a cohort of previously protected FS members have now moved to the CARE section. The rules on FS section limits were designed at a time when it was assumed that members leaving the FS section were likely leaving Parliament altogether, and therefore the limits and pension benefits would be revalued in line with inflation until retirement. This issue therefore appears to be an unintended consequence of the introduction of the CARE section and subsequently the change to require all active members to move from FS into CARE.
47. We are proposing to amend the rules relating to FS section limits to account for changes to salary, where a member continues in active service in the CARE section. This would ensure that the limits would keep pace with adjustments to pension benefits, so that these are not reduced disproportionately when a member comes to retire.

Question 6: Do you agree that the FS section rules should be amended to ensure that they remain in line with the original intention in relation to how the limits on benefits are calculated?

Trustee discretions

48. The items mentioned above highlight the possibility that the implementation of McCloud changes in the scheme may raise additional unintended or unforeseen issues, some of which could be relevant to one or a group of members' very specific circumstances.
49. The scheme already provides areas of discretion for the PCPF Trustees to exercise in fulfilling their management and administrative functions. For example, the Trustees set actuarial factors on the advice of the Government Actuary; may choose to accept transfers into the fund; and have discretion to pay certain benefits upon the death of a

member. With IPSA's consent, they can settle claims and disputes with members and extend any time limits set out in the scheme rules. In relation to the McCloud changes, the Trustees are provided with discretion over implementation – for example, the collection of additional contributions; terms for the purchase of enhanced pension; and the timing of implementation of certain members' choices.

50. We believe there is a case for expanding the scope of discretions provided to the Trustees in order to address unintended or unforeseen impacts on members. We are keen to hear from the Trustees in particular, as well as from other consultees, on where additional discretion could be helpful in ensuring fairness across members.

Question 7: Do you agree that the PCPF Trustees need and should have additional discretion to address specific cases that were not foreseen in the rules?

Equality impact assessment

51. IPSA's overall intention in its McCloud response is to remove any age-related unfairness which may have been brought about by the transitional arrangements established as part of the 2015 reforms to the scheme. We believe the system of redress payments described in this consultation are vital to achieving that, by ensuring that adverse tax impacts do not perpetuate the unequal treatment of impacted members.
52. The demographics of MPs as a whole also suggest that providing younger impacted members (that is, PPMs and UPMs) the choice to accrue benefits in the FS section for the relevant period may also result in a positive impact on equality in relation to sex and race.

Question 8: Do you have any views on these or any other possible equality impacts resulting from the proposals in this consultation?