



SIMPLIFYING THE TAXATION OF PENSIONS: THE GOVERNMENT'S PROPOSALS

RESPONSE TO THE JOINT HM TREASURY AND INLAND REVENUE PROPOSALS

March 2004

Introduction and Overview

We are pleased to have the opportunity to comment formally on the second set of proposals from the Treasury and the Inland Revenue for the simplification of the taxation system applying to pensions.

Broad support

We responded to the first consultation paper nearly a year ago in our previous company name of Buck Consultants Limited. In our response, we applauded the concept of the proposals, and their very real attempt to introduce radical changes that would sweep away decades of historical complexities that have created the current stifling and overly-complex system. We are pleased to see that this second, more detailed set of proposals entrench that thinking. We are also pleased to note that a number of our comments appear to have been taken on board by the review team.

We were therefore dismayed at the announcement that accompanied the publication of these proposals, that whether or not they were to be introduced at all was to be made subject to the result of a review of the impact of one part – albeit an important part – of the proposals. From our knowledge of the pensions scene, it is clear that there is a significant amount of consensus in support of the principles behind the proposals. Not unnaturally there are differences of opinion over some of the details – it would be impossible to please everybody on every point.

However, the distinction between support for the principles and disagreement over details should not be confused. It is a deeply worrying development if public comment by parties with a legitimate interest in a Government proposal were to be punished by the withdrawal of a proposal that has broad support and which is in the country's best interest to implement.

We therefore sincerely hope that the promised announcement on March 17th will confirm that the simplification proposals are going ahead.

The future

In our response to the first consultation paper, we also highlighted the need to maintain the simplicity of the basic regime, once it has been introduced. Given the long-term

nature of pension funding, and the need to encourage voluntary participation, it is essential that there is certainty and stability in the governing regime. The experience of the past few decades, where substantial reviews are undertaken on a regular basis, must not be repeated. Similarly, the process of “regulation creep”, where regulations are added to over time, building up a complicated system that because of its piecemeal development is fragmented and inconsistent, must be avoided.

If, in ten years time we find that all that occurred here was that we simply started again with a new system, but continued the old process of adding and tinkering thereafter, history will record the present exercise as a failure. More importantly, the underlying aims of encouraging greater non-State retirement provision will not have been achieved – and the negative consequences of that will affect the whole country. In short, it is not a matter that we can afford to get wrong.

One important consequence of this is that if the new system is to stand the test of time, it must be as robust as reasonably possible from the outset. This implies that timescales may have to be extended to ensure that all possible details are thoroughly worked out, and their likely effects accurately anticipated. But the implementation of a successful new system does not stop with the publication of new regulations. The system then has to be complied with by individual schemes across the country.

This involves a considerable amount of work, and by definition, expense. Schemes will naturally be reluctant to spend time, effort and money on making major changes to their systems until they are sure that they know exactly what those changes will be. Also, given the unhelpful precedent set by the announcement last December that the whole proposal was subject to review, confidence in the Government’s commitment to introduce all or any proposed changes has been undermined.

Given the likely timetable for finalising the proposals, there will be very little time for schemes to adapt to the new system. In addition, all schemes will require attention at around the same time, placing a huge strain upon advisers and other professionals.

We want to see the changes introduced as soon as possible, but this has to be balanced with the longer-term need to get it right from the start. We therefore feel that, unless the full details of the new regime can be clearly and irrevocably published by early summer 2004, the implementation date should be put back to April 2006.

Key strategic issue - the lifetime allowance

This issue is probably the single most debated item of the proposals. The debate revolves around two issues - the starting amount, and the basis for its increase in future. Before we consider those issues, however, we would like to record our support for the reduction in the proposed level of the basic recovery charge, from 33% to 25%. We consider that this is a much more equitable figure.

We believe that the starting point for this debate should be the need to create a system that will encourage pension provision. There is a need to start with a clean sheet. In many other respects, the proposals do just that. However, this particular issue seems to have been based heavily upon the present earnings cap, its current value, and the basis upon which it is increased. Taken against that, the proposed starting level of the lifetime allowance is not unreasonable. We also note that the proposed 20:1 conversion factor to value a defined benefit pension helps to mitigate the worst effects of this for individuals with such a benefit, particularly at younger ages. However, for younger members with DC benefits, they may only be able to secure an annuity of around £45,000 a year before being subject to the recovery charge. DC membership is, of course, becoming the reality for a rapidly growing number of people.

However, simply because the present system has been around for 15 years, it does not mean that it is still an appropriate basis – if it ever was. There is a desperate need to encourage retirement provision, and the imposition of a relatively low cap for tax-assisted benefits does nothing to help. We therefore continue to believe that the lifetime allowance should be set at a higher initial level, one at which it will not impact upon most middle managers who are so important to the economic well-being of the nation. We do not consider that the size of the increase that this would imply should impact adversely upon the “tax loss” consequences flowing from the proposed simplified regulatory system.


The other issue – the basis of increase in the allowance, is clearly of fundamental importance to the future success of the new regime. Given the points made above, we simply cannot see the justification for not linking these increases to average earnings increases. Certainly the fact that this is the way it is done at the moment is not sufficient justification simply to continue with the same basis. The effect over time will clearly be to increase the proportion of the working population whose benefits are arbitrarily reduced by the imposition of the lifetime allowance. We simply do not understand how the Government can square that proposal with its professed desire to switch ever-greater responsibility for retirement provision away from the State.

Our specific comments on some of the details in the consultation document are included in the attached Appendix.

We hope that our response will help the Government maximise the opportunities that simplification can deliver and also encourage successful provision for decades to come.



Kevin LeGrand
Head of Technical Services
Mellon HR&IS
The International Financial Centre
Old Broad Street
London EC2N 1HQ



Ian Walker
Technical Services Manager
Mellon HR&IS
The International Financial Centre
Old Broad Street
London EC2N 1HQ

Tel: 020 7448 7000

Appendix

We set out below our specific comments on some of the details in the consultation document. The left hand column of the table represents the paragraph numbers in your document.

2.8	<p>The proposal to allow continuation of existing contractual rights to retirement before 55 is fraught with potential anomalies between members of occupational schemes and those with personal pension or section 32 contracts and between those in employment and the self or unemployed. At the very least, clarification of who and what will be protected is required.</p>
A4	<p>If an individual contributes a net amount under RAS equivalent to a gross contribution of 100% of their total earnings for the year, they will normally receive a tax credit greater than the actual amount of tax they will pay because of the impact of personal allowances and the lower rate of tax. We presume that the intention is that an individual who pays 100% of earnings under a net pay arrangement will be able to make an individual claim for the excess tax “relief” that they would otherwise lose by comparison.</p>
A12	<p>There will need to be clarification as to how annual accrual will be determined in cases where a money purchase benefit is underpinned by a defined benefit promise or vice versa.</p>
A34	<p>We presume that as a default, legislation will empower providers to reduce a member’s benefit by sufficient amount to pay the withholding tax.</p> <p>As a further option, we can see no reason why a member should not be able to choose to reimburse the trustees for the tax they have to pay and thus maintain the original level of benefit.</p>
A38	<p>It is proposed that when benefits under an arrangement are about to vest, the provider must obtain a declaration from the member as to whether the new benefits will be within their lifetime allowance. If they do not receive the declaration, they must assume that all the benefits are in excess of the member’s lifetime allowance and withhold the recovery charge accordingly. If a recovery charge was not due, then the member will be able to obtain a refund from the Inland Revenue.</p> <p>This procedure seems unduly cumbersome bearing in mind the very small number of cases where the recovery charge will actually be due. We would suggest that an administrative easement based on either or both of the value of benefits vesting and/or the member’s earnings in the previous tax year would significantly reduce administration for both providers and the Inland Revenue. It should also reduce the possibility of confusion and concern amongst those with small levels of benefit.</p>

A61	<p>Our initial thought was that it seemed inappropriate for the LPR to be responsible for paying any recovery charge due on a lump sum distribution of death benefits, when they would probably not have access to the funds on which the liability was based. However, we now realise that there are other circumstances where a similar situation could apply, for instance inheritance tax on lifetime gifts, although in that situation we understand that primary liability would rest with the recipient of the gift. The question of dealing with the liability for tax on the estate of the deceased is not one on which we would profess to be able to offer an expert opinion and is best addressed to people who deal with such matters.</p> <p>However, from the pension provider’s perspective, we would be keen to not introduce any unnecessary delay in payment or add administrative complications. The principle of the intended basis is therefore acceptable although we would ask for an administrative easement to avoid having to contact and report to the LPR on every occasion. We would also be anxious that the liability for tax position is clear, so that if necessary, appropriate caveats can be given when distributing such benefits.</p>
A73	<p>The change in age for eligibility for a child’s dependant pension is surprising, particularly because, as at present, a child could easily be in a worse position than any other person who was in any way dependent on the member. The child’s pension must cease when they reach a given age whatever their financial position at the time, whereas any other dependant’s pension can continue for life, even if their financial position improves significantly. We do not wish to introduce any onus on providers to monitor such situations, but it does seem harsh to lower the upper age for children, even when they are still in full-time education.</p>
A79	<p>Whilst we can see some logic in what is proposed, triviality has traditionally been available to allow providers to avoid the administrative work involved in paying small amounts of pension. The proposals indicate that in future it would normally be the member’s decision whether to commute, with the consequence that schemes could still be left with the expense of paying small pensions. We would ask that this proposal is reviewed.</p>
A150	<p>We would ask for clarification as to what is meant by there will be no NIC on benefits “provided they are within the limits of benefits that could be paid out of a registered scheme”.</p>
C22	<p>We presume that clear guidelines will be published concerning the valuation of DC rights at A-day that are dependent on the value of assets that do not have a readily ascertainable open market value. Such guidelines will need to be available well in advance of A-day, as contemporaneous valuation is likely to be needed to minimise uncertainty.</p>

C32	The consequence of members not registering tax-free cash sums in excess of 25% unless they are also registering the overall value of their benefits is that providers will be required to maintain historical records for such people for many years to come. This seems an unnecessary complexity that could be overcome by the registration of such rights in the period after A-day.
C38	We would ask for clarification as to the level of death-in-service benefits that can continue to be provided under both DB and DC schemes (or indeed a separate life assurance only scheme).
C49	The requirement for providers to deduct marginal rate tax from part of a member's cash sum seems an unnecessary administrative complication for all parties, including the Inland Revenue. We would suggest that providers be allowed to pay certified amounts tax-free, with appropriate post-event reporting to the Revenue.