

Pensions Tax
Assets, Savings & Wealth
HM Treasury,
1 Horse Guards Road,
London SW1A 2HQ.

26 August 2010

Dear Sirs,

Restriction of pensions tax relief: a discussion document on the alternative approach

On behalf of ILAG, I have pleasure in submitting the following comments to assist with the above Review.

ILAG is a trade body representing members from the Life Assurance and Wealth Management industries. ILAG members share and develop their practical experiences and expertise, applying this practitioner knowledge to the development of their businesses, both individually and collectively, for the benefit of members and their customers.

We believe that the proposed reduction of the annual allowance should be used by the Government as a way to build a more straightforward and stable pension regime for the future. During this process the big picture needs to be considered with for example the changes flowing from the consultation on the age 75 rule being considered in drawing up the new regime.

As part of the simpler pension regime, as we explain below, we believe that there will be scope in most instances to remove the need to check against the LTA. With a simpler and more stable regime we feel you will not only get greater engagement from consumers but save providers and HMRC time and money.

While we are happy for people better placed than us to comment on the way the reduced AA would work for DB schemes we strongly agree with the view that there must be a level playing field. It would not be right we believe if concessions made to solely benefit DB schemes members resulted in a lower AA that would then impact DC schemes members.

Responses to the questions in the discussion documents are noted below. We would be happy to discuss these in more detail if required.

Yours faithfully

Mark Searle
Administration Team

Questions

Policy design (Chapter 2)

Q1 - The Government welcomes views on any other changes that might be necessary to ensure the AA operates effectively and to address the risk of avoidance that could lead to further significant and potentially adverse changes to the regulatory regime (Page 5 - Paragraph 2.7);

We are satisfied that the lower AA will operate as an effective cap to restrict tax relief. Our main concern is about the reference in the paper (see 2.7) to the removal of the exemption from the AA for individual's claiming enhanced protection. While we can see how this could work for DB schemes we are confused by what, if anything is intended for DC schemes. For somebody to retain enhanced protection with very few exceptions (for example contributions to pay for pension term assurance) they cannot receive any further contributions in their pension funds. So under the current definition of a pension input amount for a DC scheme we do not see how an amount could be received in excess of the reduced AA. We would be very concerned if there was an intention to include investment growth in the definition of pension input amount for such cases. This would be very unfair with for example investment growth of £60,000 one year and losses of £70,000 the next.

However, we believe that the lack of flexibility resulting from a move to the reduced AA could disadvantage the self-employed. When the A-day regime was introduced carry forward/back of unused relief was no longer needed in view of the much higher limits for tax relievable contributions. It was also the case that in the last year before taking benefit there was no test against the AA.

With the introduction of the reduced AA we would propose that carry forward of one year of unused AA should be allowed. It would still be the case that the contribution must be within the member's relevant UK earnings for the tax year in which the contribution is paid. In such cases we see the member entering the details on their self assessment return and this being monitored by HMRC.

While we accept that Government will have to take action if in the future evidence comes to light that the regime is being abused any such action must we believe be proportionate (real evidence of abuse not just based on some press stories) and focused (consulted upon to avoid unintended consequences).

Q2 - The Government therefore welcomes views on this issue and practical options for limiting it, including the option of requiring a CETV calculation, or the use of age-related factors, in specific circumstances to capture the value of certain pension enhancements (Page 6 - Paragraph 2.11);

We see the benefit of having a simple methodology and this should work well for most DB pension members.

However, DB schemes are not our main area of expertise and we will leave it to other better qualified respondents to comment if there are cases where the use of a CETV and/or age-related factors would be appropriate.

Q3 - The Government would welcome views on the treatment of deferred members, revaluation and negative accruals, with a flat-factor approach to valuing DB accruals, and evidence on the administrative burdens of the different options (Page 7 - Paragraph 2.16);

DB schemes are not our main area of expertise and we will leave it to other better qualified respondents to comment.

Q4 - The Government would welcome views from interested parties on these issues and any other specific circumstances under which there may be an argument for applying the AA in a particular way (Page 7 - Paragraph 2.17);

We agree that that the AA should not apply in a year that the member dies or commutes their pension on grounds of serious ill-health.

Q5 – Given the risks of avoidance, the Government is minded not to provide exemptions from the AA in these cases, but is willing to consider proposals from interest groups that would provide protection for individuals in particularly hard cases without opening up unacceptable scope for abuse (Page 8 - Paragraph 2.19);

No comment.

Q6 - The Government welcomes views on the appropriate level of the LTA, other issues associated with its operation in the context of a reduced AA, and on the trade-off between these and the level of the AA (Page 8 - Paragraph 2.25);

What we propose

In our opinion the move to a reduced AA will cause it to be the main method of capping tax exempt savings going forward. For example with a reduced AA it would be hard for new members to build up the size of funds that would currently be caught by the LTA.

This being the case we believe that in most instances the LTA should in fact be abolished to really bring about a simplified pension regime. With the much tighter input control of the reduced AA we feel that the output control of the LTA will be redundant in most instances.

We appreciate that there are some individuals who have already built up pension funds in excess of the LTA and the Government's concerns about tax leakage if the LTA was just to be abolished. However, in a lot of instances these people will already be protected against the LTA by transitional protection (for example primary protection).

However, we feel that it is possible to put in place safeguards that will do away with the need in most instances to carry out checks against the LTA. This will make things simpler for

consumers and so make them more likely to invest in pensions. The large reduction in the number of checks against the LTA will also save time and money for providers and HMRC.

We see the safeguards operating where the benefits payable are not subject to tax (for example the pension commencement lump sum). For example if the maximum amount of a pension commencement lump sum was capped at the lower of 25% of the pension fund or £450,000 (25% of £1.8 million) then any remaining funds, taken as an income, would be subject to income tax via PAYE. Under the proposals in the age 75 consultation any remaining crystallised funds paid out as a lump death benefit would be subject to a flat rate tax charge of 55%. We would suggest that the same approach used for lump sum death benefits should be followed for commutation on grounds of serious ill-health.

Transfers to overseas pension schemes would move the pension fund largely outside HMRC's control. As a result we can see the logic of retaining the test against the LTA, and where appropriate tax charge, for transfers to QROPS.

Under our proposal there would still be transitional protection from before 6 April 2006 but these would be a minority of individuals who would already be identified. While retaining this protection does mean extra complexity (for example scheme specific early retirement age) we believe that it is what the relevant individual would legitimately expect.

We would be happy to discuss further with you how we see safeguards can be put in place to protect the Government's tax take if our proposal is adopted. As mentioned above the large reduction in tests against the LTA we propose would we believe produce savings for HMRC as well as for pension schemes.

Practical issues to be considered

If the LTA is to be reduced or removed as we propose the impact on other aspects of the pension tax regime needs to be considered.

The limit for commutation on the ground of triviality is 1% of the LTA. If the LTA is reduced we do not believe it would be fair or workable if for example the triviality limit was reduced to £15,000 (1% of £1.5 million) from £18,000 (1% of £1.8 million) from 6 April 2011. Clearly there would be problems with cases if the year in which the individual had to commute their pensions straddled the 2010/11 and 2011/12 tax years (for example which figure do you use).

We believe that at the very least the triviality limit should not be reduced to below £18,000. In the interests of getting greater customer involvement we would suggest that the triviality figure should in future increase annually at least in line with prices.

If the LTA is reduced, we also believe that where the amount protected under transitional protection has increased since A-day in line with the LTA (for example scheme specific tax free cash in excess of 25%) it must be frozen as at 5 April 2011 and not reduced.

Q7 - The Government would welcome views on the merits of capping relief at 40 per cent as an additional means of restricting pensions tax relief and the trade-off between this and the level of the AA (Paragraph 2.27);

We would not support this idea which goes against the EET principal that has to date been used under the pension tax regime. Beyond the impact on affected individuals it will fairly or unfairly give rise to the suspicion that there could be a further reduction in future, with only basic rate tax relief available.

As we mentioned before, we believe that one of the keys to customer engagement is a stable regime in which people have confidence for the long term and which will not be tweaked in each budget. We also consider that capping tax relief would reintroduce too much complexity, when one of the aims of the changes should be to simplify.

Managing the impact on individuals (Chapter 3)

Q8 – The Government welcomes views on legislative action that could facilitate appropriate scheme redesign without undermining other aspects of the regulatory regime (Paragraph 3.10);

DB schemes are not our main area of expertise and we will leave it to other better qualified respondents to comment.

Delivery and compliance (Chapter 4)

Q9 - The Government welcomes views and evidence on the benefits and burdens associated with aligning the pension input period to the tax year, for individuals, pension schemes and advisors (Paragraph 4.12);

For DC schemes as noted in the document (section 2.6) individuals, employers and pension providers will actively seek to limit pension contributions to at or below the AA limit. As a result we do not see any benefit in changing the rules around pension input periods for DC schemes. As the need for transitional rules has been noted (section 4.13) we would recommend retaining the flexibility of the current system for pension input periods for DC schemes.

For DB schemes the scheme always sets the period, unlike with DC schemes. This would reflect their scheme rules and IT requirements (for example to match the scheme year end).

We foresee problems for customers and providers of DB schemes if there was a move, at such short notice, to pension input periods being fixed by tax year. For example there would be time and cost of communicating the changes to members and little time to make the IT changes required.

Q10 - Given the need to support individuals, the Government welcomes views on the appropriate reporting requirements on pension schemes to provide statements of the total pension input amount over the pension input period (Paragraph 4.20);

Currently policing that contributions/benefit accrual remains within the AA rests with the client and HMRC. In a lot of instances individuals will pay contributions/accrue benefits in more than one pension scheme. So, while providers/trustees can see if the AA is exceeded within their scheme, they cannot know the full picture.

While we agree that some individuals will need support, the existing reporting requirements should in our view be adequate for most people. There could be an issue when the AA is reduced but we feel that the transitional provisions being proposed (see Q9) will deal with this in most instances.

Q11 - The Government welcomes views and evidence on the benefits and burdens associated with introducing reporting requirements on schemes to provide this information (Paragraph 4.20);

As mentioned above we do not see an issue with DC schemes as explained in Q9 above. It is open to an individual to exceed the AA by paying into more than one DC scheme. We do not see this happening as the only way that they can then receive higher rate tax relief is by documenting their pension contributions on their self assessment return. It is also the case that people can currently try to abuse the relief at source rules. For example make the required declarations but pay in more than their annual relevant UK earnings.

DB schemes are not our main area of expertise and we will leave it to other better qualified respondents to comment on their requirements.

Q12 - The Government welcomes views on how quickly schemes could provide this information before the Self Assessment tax return is due, and whether employers could help pension schemes provide this information in a timely way (Paragraph 4.20);

See our answers to Q9, Q10 and Q11.

Q13 - The Government welcomes views on any practical or administrative issues that may arise from applying the reduced AA, and associated information and compliance requirements, to individuals who are members of overseas pension schemes and benefiting from UK tax relief (Paragraph 4.22).

No comment.

End.