

# PENSIONS TAX RELIEF ADMINISTRATION: CALL FOR EVIDENCE

PLSA RESPONSE

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## THE PLSA

We're the Pensions and Lifetime Savings Association; the national association with a ninety year history of helping pension professionals run better pension schemes. With the support of over 1,300 pension schemes and over 400 supporting businesses, we are the voice for pensions and lifetime savings in Westminster, Whitehall and Brussels.

Our purpose is simple: to help everyone to achieve a better income in retirement. We work to get more money into retirement savings, to get more value out of those savings and to build the confidence and understanding of savers.

## INTRODUCTION

1. The PLSA supports maintaining the main elements of the current approach to pensions tax relief and the level of fiscal support given to pension saving. However, we believe that there are some technical changes that could be made to the operation of pensions tax relief to maximise the benefits savers derive from it.
2. As such, the PLSA welcomes the Government's commitment to finding a solution to the Net Pay/RAS anomaly, which results in a significant number of people – especially lower earners – missing out on a government contribution to their pension savings. We believe that all savers should receive a government contribution, regardless of the pension tax relief arrangements offered by their scheme.
3. To resolve the present anomaly, we believe that a comprehensive, efficient, and cost-effective solution is required that will, at the very least, fulfil the policy intent of automatic enrolment by ensuring that all savers receive tax relief alongside their employer's and their own contributions.
4. As we have long argued, we continue to believe that a central solution (the P800 process), operated by HM Revenue & Customs (HMRC), would deliver the sort of comprehensive, efficient, cost-effective solution we believe necessary and require no further engagement from savers. We do not believe the *Call for Evidence* accurately reflects the challenges involved in implementing this approach and have set out appropriate clarifications below. The other options presented in the document do not represent fair and proportionate solutions to this issue.
5. In the absence of a solution, the Government would be perpetuating an anomaly that has created social injustices at the heart of the pensions system. For example, women in Net Pay schemes amount to three-quarters of those affected by this anomaly, and other groups who are disproportionately low paid, such as ethnic minorities, are also likely to be significantly affected. We believe that this situation is indefensible and must be rectified.
6. If the Government does not introduce a solution, the gap between those in net pay arrangements and relief at source schemes will only grow as Automatic Enrolment is extended via the reforms recommended in the Automatic Enrolment Review 2017, namely the lowering the age threshold for automatic enrolment from 22 to 18 and the removal of the lower earnings limit. Failure to take action could also damage trust and confidence in pensions and, in particular, tarnish the success of Automatic Enrolment.
7. This would clearly be undesirable, as we know that people are currently not saving enough to have an adequate income in retirement and removing tax relief will make this position worse. In 2016, the PLSA undertook a major research project that examined the likelihood that current workers would have a pension equivalent to the Pensions Commission's target replacement rate (TRR).<sup>1</sup> The findings showed that, of

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<sup>1</sup> The TRR for someone with pre-retirement gross earnings of less than £9,500 is 80%, between £9,500 to £17,499 is 70%, between £17,500 to £24,999 is 67%, between £25,000 to £34,999 is 60% and is 50% for those earning £35,000 or more.

the 25.5 million people presently in employment, just over 50%, or 13.6 million people, are at high risk of failing to meet their TRR.<sup>2</sup> Saving levels are lowest for the middle aged (Generation X) and the young (Millennials) so reducing and disrupting the level of financial support for pension saving will only store up problems for the future.

8. Consequently, it is essential that the Government ensures that the pensions tax relief system supports more effective long-term saving, particularly for those at the lower end of the earnings distribution. We look forward to further discussions with the Government on this important policy area.

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<sup>2</sup> PLSA, Retirement Income Adequacy: Generation By Generation (2016)

## QUESTION RESPONSES

### ***What are the factors that influence a pension scheme in its choice between using Net Pay or RAS for their members?***

9. A variety of factors affect the type of pensions tax relief arrangements a scheme operates. These factors include:
  - a. **Efficiency:** Schemes consider the ease with which they are able to use a particular administrative approach and, in the case of single-occupational schemes, how it fits with existing payroll management systems. All DB schemes and the vast majority of occupational DC schemes use Net Pay arrangements, because it is easier and less burdensome, administratively, to implement and operate.
  - b. **Cost:** Schemes consider the cost involved in implementing particular arrangements. Given the administrative complexity of operating RAS arrangements – compared to Net Pay arrangements – additional resource is required to operate them.
  - c. **Savings Population:** Schemes consider the characteristics of the savings population they serve, particularly whether they have a significant proportion of earners grouped around different tax thresholds, or whether they have a significant proportion of savers who are unlikely to pay Income Tax.

### ***How do pensions providers currently engage with employers around the differences between net pay and RAS for their employees? Is the method of tax relief a scheme operates a relevant factor in the employer's decision (either directly, e.g. when considering employees' financial positions, or indirectly, e.g. through an impact on provider fees)?***

10. In the main, RAS arrangements are used by non-occupational pension schemes, such as personal pensions, stakeholder pensions, and group personal pensions – though there are some exceptions (e.g. NEST). As a result, the decision to choose a RAS or a Net Pay scheme is one of a number of factors employers consider, based on the type of pension arrangements they want to offer employees.

### ***Are there ways that this approach [paying a bonus using RTI data] could be delivered that would not engage the issues identified above, namely the challenges in ensuring consistency across all taxpayers for all aspects of the tax system in a timely fashion, and additional burdens for scheme members and scheme administrators?***

11. The *Call for Evidence* document sets out a number of barriers to the use of RTI data as a means of solving the Net Pay/RAS anomaly. We do not accept the barriers set out by the Government and address these issues below.

- a. **Membership Reporting:** The document states that net pay scheme administrators would have to report their membership to HMRC so that potential bonus recipients can be identified. However, we do not believe this to be the case. This is certainly the case for RAS schemes, but Net Pay arrangements differ in as much as they are directly linked to employment relationships. Employers already provide HMRC with details of Net Pay pension contributions via PAYE real-time information (RTI). Thus, HMRC would not need to collect this data from schemes. This means that it is highly unlikely that there would be an additional member reporting burden on schemes or third-party administrators.
  - b. **Individual Claims:** The *Call for Evidence* document states that it would be necessary for savers to claim the RTI bonus. However, the P800 system for reconciling individuals' tax affairs does not currently require an individual claim. Where a refund is due to an individual, HMRC sends the individual a calculation of the amount. The individual may then go online to ask for that repayment to be made direct to their bank. However, if they do nothing, HMRC send them a cheque after 45 days.
  - c. **Time Lag:** The *Call for Evidence* states there will be a time lag between employer/employee contributions and the payment of an RTI bonus. Unless RAS schemes pre-fund the pensions tax relief savers receive, this is already an in-built feature of this form of pensions tax relief administration. Moreover, where tax rebates are made to individuals for other reasons, a time lag also exists.
12. In light of the above, we continue to believe that the use of a modified P800 process provides the most practicable solution to the Net Pay/RAS anomaly, and that it would result in no additional burdens on savers, schemes, and employers.
  13. We accept that more work is required to understand how the use of RTI payments for the purpose of providing an equivalent government contribution to non-taxpayers in Net Pay schemes would impact on individuals' welfare benefit entitlements. We also accept that HMRC would incur some costs related to systems development to adapt the P800 process for this purpose.
  14. Nevertheless, of the options available to the Government, the P800 process offers the most effective solution to the Net Pay/RAS anomaly. A modified P800 process could also be used to address other emerging issues with the tax system. For example, it could enable the Government to provide accurate pensions tax relief payments to savers in Scotland, who are now subject to different Income Tax rates to workers in the rest of the United Kingdom (UK). This would help to ensure consistent treatment of savers across the UK in whatever form of pension arrangement they find themselves. The wide applicability of this solution makes it particularly attractive as an investment.

***We would welcome views on whether equalising outcomes by removing the top-up for non-taxpayers would represent a fair solution to this issue? If possible, it would be useful to understand the impacts on schemes and providers from any such change.***

15. The PLSA cannot support this solution, as it would have significant consequences for savers and schemes. In particular, we are concerned about the impact it would have on:
- a. **Pension Adequacy:** It would lead to 1.3 million lower earners in RAS schemes losing pensions tax relief (alongside the 1.5 million lower earners in Net Pay schemes who do not currently receive it). This would make the cost of saving for retirement more expensive for these savers (at a time when many will be negatively affected by the Covid-19 pandemic) and could undermine automatic enrolment if it were to lead to an increase in opt-out rates. PLSA research (2016) on pensions adequacy found that just over 50%, or 13.6 million people, are at high risk of not meeting their target replacement rate.<sup>3</sup> Anything that further undermined likely pension adequacy would clearly be undesirable.
  - b. **Scheme Burdens:** It would place additional burdens on employers, schemes, and third-party administrators. This is particularly unwelcome at a time when employers are suffering from the impact of Covid-19 and schemes are already in the process of implementing changes resulting from several current regulatory initiatives.
  - c. **Generational Disparity:** Given that all DB schemes operate according to Net Pay arrangements, and that (at least in the private sector) cohorts with DC entitlement tend to be younger, the removal of RAS relief would penalise younger savers in DC schemes.

***We would welcome views on whether this approach [employers operating multiple schemes] would: reliably mitigate the potential difference in outcome for low earners on a consistent basis; be a deliverable, affordable and proportionate solution for small employers with a high proportion of low-earning employees; and be appropriate for low earners who are members of defined benefit pension schemes.***

16. Despite the apparent benefit of this proposal (i.e. enabling all employees to receive pension tax relief) and its initial attractiveness, the PLSA does not support this option.
17. A recent survey of our members, confirmed by the expertise of members of our Policy Committees, highlighted a range of challenges schemes would face in implementing this proposal. These challenges include:
- a. **Payroll Issues:** It would be difficult for payroll to divide people between schemes and it would be even more difficult to administer people changing from one to the other as their earnings change. This would involve significant cost for employers to upgrade their payroll systems.
  - b. **Communication:** Schemes would have to change their communications to help savers understand the different options. This would entail additional administrative costs for schemes. Equally, given that evidence suggests that

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<sup>3</sup> <https://www.plsa.co.uk/portals/0/Documents/0605-Retirement-income-adequacy-Generation-by-Generation.pdf>



savers do not currently have a good understanding of how pensions tax relief operates, introducing a new level of complexity could reinforce saver confusion.

- c. **Liability Risk:** Employers could run the risk of being pursued by savers who feel they were misallocated to a Net Pay/RAS scheme. This could result in additional cost to employers, as well as a diminution of trust in the pension system.
- d. **Variable Earnings:** This approach could prove to be particularly challenging for employers that have a substantial number of employees with variable incomes (e.g. a significant number of workers on flexible or part-time contracts, or industries in which overtime is common, such as the retail sector). This could result in members being moved between scheme arrangements on a regular basis.
- e. **Multiple Jobs:** To allocate employees to the appropriate scheme, employers would have to understand where they had additional income that might affect their overall tax status. It is unreasonable to expect employers to have this level of understanding of an employee's circumstances.
- f. **Member Charges:** The additional cost and resource required to administer two schemes could result in savers facing higher charges than they do today. This is a highly undesirable outcome, as over the long-term this would have an impact on the adequacy of a member's savings.

18. PLSA members also expressed concerns that this approach could disproportionately and negatively impact smaller employers running in-house schemes for their employees.

***What would be the impacts on schemes and providers of requiring all DC schemes to use RAS? Would this represent a proportionate decision, given potential benefits to some employees and employers?***

19. The PLSA does not believe that this solution represents a proportionate approach and we have concerns about its effectiveness as a comprehensive solution to the Net Pay/RAS anomaly.

***Practical Challenges***

20. There are several practical challenges that this proposal presents, including:

- a. **Communication Issues:** Employers would have to communicate the change to employees, given that there would be payslip changes, and schemes would have to invest in changes to member documentation.
- b. **Pre-Funding Costs:** Schemes/employers that operate RAS arrangements tend to pre-fund the pensions tax relief, so that it is invested at the same time as the contributions are paid. They can reclaim the pre-funded tax relief on a monthly or annual basis. This requires additional upfront expenditure from the scheme or sponsoring employer. The size of the scheme influences the scale of this cost and the work involved in doing the monthly claims. Schemes have the option to reclaim relief on an annual basis, but doing so has implications for funding (if the scheme pre-funds) or the member (as, where

schemes/employers do not pre-fund they wait longer for the relief to be invested).

- c. **Additional Costs:** A PLSA member survey highlighted significant costs associated with implementing this solution. A summary of the costs (by type) is set out below.<sup>4</sup>

<b>Category</b>	<b>Average Cost</b>
Employer Payroll changes	£890,000
IT Development changes	£433,750
Implementation of new procedures (e.g. reclaiming tax relief from HMRC)	£1,706,667
Other systems and processes changes	£3,027,000
Changes to member communications	£2,069,000
Changes to scheme documentation	£97,500
Employee resources (e.g. project management costs)	£740,000

21. Moreover, the vast majority of third-party administrators (TPAs) do not operate RAS. Though TPAs could gear up to offer RAS if required to, the cost of doing so is likely to be significant. Where this cost is not met by employers, it is likely to be passed on to scheme members in the form of higher charges.

### ***Legal Issues***

22. The Registered Pension Schemes (Relief at Source) Regulations 2005 set out highly detailed, very specific requirements that must be satisfied in every respect for RAS to be granted.<sup>5</sup> Failure to comply with these requirements in their entirety (no matter how technical a breach may be) could result in tax relief not being granted to a scheme or, if a breach is discovered after tax relief has already been claimed, repayment of the relief in question being required by HMRC.
23. The highly detailed nature of the Regulations is likely to be difficult for a mass market automatic enrolment scheme to meet. These vehicles do not tend to operate on the basis of explicit declarations as envisaged by the 2005 regulations. This approach would be particularly difficult for master trusts to comply with, given the number of people involved.

<sup>4</sup> These figures were gathered when the PLSA was considering its policy position regarding the possibility of schemes being required to move from Net Pay to RAS arrangements. The sample size was small, with only 9 schemes responding to the survey. As such, they are indicative estimates rather than robust forecasts.

<sup>5</sup> For example, individuals or employers (in cases where employees have been automatically enrolled) must provide HMRC with the relevant individual's full name and permanent residential address including, where the address is in the United Kingdom, the postcode; date of birth; and national Insurance number (or a statement that the individual does not have one).

## ***Unintended Consequences***

24. Although the move to RAS would result in all low earners receiving a government contribution to their pension savings, it is likely to have the unintended consequence of disadvantaging higher earners. They would not automatically receive tax relief at their marginal rate. They would have to reclaim relief above the Basic Rate tax band via the annual self-assessment process. In practice, this would likely to mean that many higher rate taxpayers would not reclaim the additional relief due on their savings.

***Would requiring all new providers of DC pensions to operate RAS represent a fair solution to this issue? The government would welcome views on the longer-term implications of such a requirement, for example whether this would result in existing schemes re-evaluating their arrangements.***

25. We do not believe this would represent a fair solution, for the reasons set out above. It would be highly challenging for schemes to implement and would create additional barriers for higher and additional rate taxpayers to claim the tax relief they are entitled to.

***Views on whether there would be any benefit in extending RAS to all DB schemes as well as DC schemes would be welcomed. Alternatively, the government is interested to collect evidence on challenges that prohibit such an approach.***

26. The PLSA does not see any benefit in extending RAS to all DB as well as DC schemes. In fact, PLSA members have indicated that such a move would be problematic for DB schemes, because no DB scheme operates on a RAS basis.
27. There would be significant upfront costs involved in preparing DB schemes' systems and processes to enable them to operate RAS arrangements, similar to those that would be experienced by DC schemes. However, the more problematic issue surrounds the likely impact this would have on the viability of DB schemes.
28. Were legislation to require DB schemes to move to RAS arrangements, this would have an impact on funding levels as there would be less money going into the scheme. This is because the higher earners would no longer receive the benefit of Higher/Additional Rate relief automatically. The additional relief can be reclaimed, but HMRC deals with this directly with the scheme member, either by adjusting their tax code or reimbursing them directly. In other words, the reclaimed relief does not go back into the scheme.

***What changes could be made to the current methods of pensions tax relief that would ensure consistency in outcomes for taxpayers across all aspects of the tax system? If possible, please provide evidence as to how these could be delivered in a proportionate manner by all relevant stakeholders.***

29. The PLSA believes that the most important adjustment to current methods of pensions tax relief would be to enable lower earners in Net Pay schemes to receive a government contribution to their pension savings (i.e. the issue under consideration in this *Call for Evidence*).

***Alternatively, is there a balance to be struck in ensuring consistency in outcomes as far as possible, but prioritising simplicity for individuals? Is there evidence that would support this approach as more likely to build trust and engagement with the pensions system?***

30. We believe that any reform of the pensions tax relief system, whether small scale (e.g. to fix technical issues) or on a bigger scale (e.g. a complete review of the system of pensions tax relief) should be based on the following 5 principles:

- **Promotes adequacy:** Provides financial support and incentivises saving for retirement.
- **Encourages the right behaviours:** Helps savers make the right decisions about retirement saving.
- **Fair:** Helps everyone – the employed, the self-employed, and non-workers - save for retirement.
- **Simple to adopt and administer:** Avoids unreasonable transition and on-going costs for employers and schemes.
- **Enduring & sustainable:** Designed to not require repeated change and so builds confidence in long-term saving.

***The Government would welcome any evidence on whether the RAS system of pensions tax relief administration creates significant additional burdens as compared to net pay, as well as setting out what those burdens are, suggestions for any changes that could be made to ease such issues. In particular, the government would welcome thoughts on the following themes: whether the current system of declarations causes difficulty in claiming tax relief; any suggestions for practical ways that the earnings limit could be confirmed that would benefit the individual pension scheme member; and potential operational changes needed to support a requirement for interim claims to provide relevant details of individual members.***

31. We have set out above evidence on the additional burdens RAS arrangements place on schemes. We also believe that requiring all schemes or all DC schemes to use RAS arrangements would create significant additional burdens for HMRC, as it would require officials to process a much larger number of tax relief reclaims from pension schemes than they do today.

***The government would welcome views on whether there are operational changes that could be made to improve the operation of the RAS system and improve member outcomes. Is there evidence that current processes can help to support some employers or pension schemes; or does the paper-based nature of the RAS system create any obstacles in the process for claiming tax relief?***

32. We welcome the Government reviewing processes to make them efficient for all stakeholder, but have no specific suggestions at present.

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