Submission by the National Association of Pension Funds to the House of Lords' Economic Affairs Sub-Committee on the 2009 Finance Bill

Executive Summary

The NAPF believes:

- These proposals break the long established principle of EET under UK tax law;
- The proposals are a break with the long term framework for tax simplification introduced in April 2006. The complexity and arbitrary nature of the proposals will add a further administrative burden on UK pension arrangements and plan sponsors;
- The inclusion of employer contributions as a taxable benefit will be a disincentive for high earners to save through registered pension arrangements;
- The changes could have a secondary effect as many high earners are key company decision makers regarding remuneration strategy (including pensions) If this group becomes disengaged from pension saving there is a risk that these proposals could destabilise pension saving for lower earners in the company;
- High earners will pay obtain relief at 20% marginal rate but will pay tax on pensionable income at 40%, or even 50%, in retirement which is double taxation;
- That high earners will disengage from pension saving and target more tax efficient savings options so HM Treasury(HMT) are unlikely to raise their anticipated revenue stream of £3.1 bn;
- That the process of 'deeming' (valuing) employer contributions to DB schemes is likely to be complex for individuals - who must account for this through self assessment - and their employers;
- The proposals are insufficiently flexible. In particular the definition of 'regular contributions' should be amended – both during the Anti-Forestalling regime and the post 2011 regime - to permit annual contributions, as this is the basis on which company directors and the self employed contribute to pension schemes.

Introduction

1. The National Association of Pension Funds (NAPF) welcomes the opportunity to submit written and oral evidence to the Economic Affairs Sub-Committee on the changes to pensions tax relief proposed in the 2009 Finance Bill ('the Bill').

2. In making our submission, we have focused our comments on the likely impact of these new proposals on future saving via registered pension arrangements in the UK.

3. In common with the Treasury Select Committee, the NAPF believes that a proper debate on these proposed changes is required to identify some valid alternative proposals.

About NAPF

4. The NAPF is the leading voice of workplace pension provision in the UK. We represent some 1200 pension schemes from all parts of the economy and 400 businesses providing essential services to the pensions industry. Ten million working people currently belong to NAPF member schemes, while around 5 million pensioners are receiving valuable retirement income from those schemes. NAPF member schemes hold assets of some £800 billion, and account for over one sixth of investment in the UK stock market. Our main objective is to ensure there is a secure and sustainable pensions system in the UK.

Background

5. In his Budget speech on 22 April 2009 The Chancellor of the Exchequer set out the Government's proposals for changes to pension tax relief. In attempting to explain the rationale for the changes HMT reported that tax relief granted to UK individuals earning £150,000 or more had increased significantly since 2003 and now constituted some £6.1bn with the result that around 230,000 individuals received c.25% of total tax relief on pension contributions in the UK. HMT believes this to be a disproportionate application of pension tax relief which is unfair to those on lower incomes. However, this argument ignores the fact that, in large measure, tax relief on pension contributions is in fact tax deferral – relief is given at 40% on the build up phase while tax will be paid at 40% when received as retirement income by the saver.

6. The NAPF believes that the UK pensions system should not be used to affect income redistribution. This is more properly the role of the direct taxation system. If the Government is concerned about incentivising saving by lower income groups it should use some of the projected £3.1bn pensions windfall that will be generated by this change to improve incentives for lower income savers and scheme sponsors.

7. The NAPF acknowledges the arguments for change regarding pensions tax relief set out by HMT but seeks greater clarity regarding these proposals which as presently outlined are open to challenge for a number of principled and practical reasons which are described in paragraphs 9 - 24 below.

8. The NAPF believes that these proposals, if implemented, are unlikely to achieve HMT's objective of raising £3.1bn in additional revenue by tax year end 2012/13 as many individuals within the target income group will choose to discontinue saving via a pension scheme and will probably also divert some of the pension saving foregone toward more tax efficient alternative solutions through advice from professional tax advisers and remuneration and benefit consultants.

The Potential Impact on UK Pension Saving

The Principle of EET

9. Within the UK pensions system saving for retirement has always been regarded as deferred expenditure, ie saving from occupational income while employed (often for around 40 years) to provide an income for retirement. Deferred taxation is a practice which has been both encouraged and sustained by the principle of EET – Exempt (pension contributions both employee and employer where applicable) Exempt (investment growth and income) and Taxable (pension or retirement annuity is taxed at the relevant marginal rate of income tax being based on an individuals circumstances when retirement benefits come into payment).

10. The proposals within the Bill would erode this principle in two ways:

- Tax relief for those earning £150,000 or more would no longer be given at their highest marginal rate but would be reduced on a tapered scale from 50% at £150,000 to 20% for those who earn £180,000 or more;
- Secondly for those individuals earning in excess of £150,000 employer pension contributions payable on all 'relevant income' (as defined by HMT) would lose their exempt status and be a taxable benefit in the hands of employees and become subject to a tax charge at the relevant marginal rate for that individuals' level of income. For Defined Benefit schemes, however, HMT have acknowledged that placing a 'value' on the employer contribution element of benefit accrual will not be straightforward and to this end they have suggested an industry working group to formulate options on this key aspect of the proposed changes. These two aspects of the Budget changes are the most damaging and a big disincentive for high earners continuing to save via a pension scheme when potentially a significant additional tax bill, through self assessment, may be the outcome.

  The NAPF has modelled a range of calculations which compare the existing treatment of pension tax relief for high earners with the treatment proposed under the new regime. This impact assessment table is appended to this evidence submission as Annex A.

Administrative Complexity

11. These proposals will impose another layer of administrative requirements onto pensions saving only three years on from the tax simplification ('A' Day) changes introduced on 6 April 2006 under Finance Act 2004. The NAPF calls on HMT to deliver a full cost benefit analysis (Regulatory Impact Assessment) of the introduction of these new proposals on pension scheme and payroll administration.

12. The 'A' Day changes were intended to remove the multiplicity of eight different tax regimes for pensions since 1970 and establish a single long term framework for the assessment of tax on UK pension saving built upon the interaction of the Lifetime Allowance (LTA) and the Annual Allowance (AA) and the principle of EET.

Anti – Forestalling Regulations

13. The changes proposed in the Budget are intended to be effective from 6 April 2011 but interim Anti–Forestalling Regulations have been introduced from 22 April 2009 (Budget day) to restrict what Government would regard as over excessive use of existing tax reliefs by payment of significant pension contributions during the two year period before the new regime is in place. In effect all the extensive planning, consultation and significant expense of the 'A' day changes will likely be lost within three years as tax simplification as envisaged under Finance Act 2004 has not even been maintained through its transitional period until 5 April 2011.

14. The Anti-Forestalling measures undo a cornerstone of the 2006 pension tax reforms by the introduction of a new restrictive special allowance which caps relief on pension contributions for each individual in tax years 2009/10 and 2010/11 to £20,000 per annum and thereby seriously dilutes the existing Annual Allowance (£245,000 for 2009/10 and £255,000 for 2010/11) permitted in each of those tax years. Whilst we acknowledge that most contributors do not pay pension contributions of £245,000, the average annual contribution from among the high earner group is c.£64,000 gross so the £20,000 per annum special allowance ceiling is a significant reduction in the amount that these individuals can save over the next 2 years.

Impact on Lower Earners

15. The fall out from the removal of the principle of EET (see paragraph 9 above) and yet more new regulation could well have the negative effect of disincentivising those key executives and senior managers who have responsibility for remuneration strategy within an organisation.

16. In sum if these decision makers are disengaged from company pension provision as a result of the Budget changes, pension provision for lower paid employees could start to be undermined. These decision makers may conclude that the proposals contained within the Bill are a starting point to significant further erosion of the tax advantages which underpin workplace pension provision.

17. Moreover, the impact of these new proposals – so soon after the 'A' day changes of April 2006 - may mean plan sponsors will decide that the constant 'revolving door' of regulation means good workplace pension saving is simply too expensive and complex to maintain in the medium to longer term.

18. Similarly the introduction, or modification, of salary sacrifice schemes with regard to pension contributions which allow plan sponsors and employees to derive a benefit on National Insurance Contributions (NICs) and thus help keep the scheme affordable may be deferred or even abandoned as high earners will now be ineligible under the proposed new rules.

19. Some large UK listed corporates and the consultants who advise them have suggested a potential change in the remuneration packages for senior executives (eg shares which attract capital gains tax at 18% in preference to higher salaries with reduced pension tax relief). Should such changes occur the expected revenue from the pension tax relief changes is unlikely to reach £3.1bn.

20. The introduction of the special allowance of £20,000 contained within the Anti-Forestalling Regulations 2009 appears arbitrary largely because HMT have not adequately explained the rationale for this new pension tax relief limit (ie equivalent to only 8% of the extant 2009/10 AA and 7% of the AA for 2010/11).

21. The special allowance will remain static at £20,000 in 2010/11. The failure to uplift both this allowance and the £150,000 trigger point for relevant income in line with average earnings is likely to bring more individuals into scope each year. The NAPF would support an uplift in line with average earnings. A precedent for just such an uplift is being written into the Personal Accounts Scheme rules as the initial annual contribution limit of £3,600 is being annually uprated in line with average earnings under the Pensions Act 2008.

22. The impact on ordinary pension savers who do not follow the minimum requirement of quarterly pension contributions could be counter productive for individuals across a range of different circumstances (e.g the self employed or company employees upon redundancy) who through making additional or 'one off' pension contributions seek to maximise tax efficiency and obtain the best outcome for themselves with regard to retirement income.

23. The NAPF believes that once interim measures designed to prevent overpayment by high earners also impact on other pension savers outside this target group this impact completely negates the notion of fairness which HMT have stated is one of the primary policy aims which underpin the proposals in the Bill.

Unintended Consequences

24. With specific reference to defined contribution schemes, if a high earner decides to pay higher employee pension contributions in order to receive a higher rate or matched contribution from their employer they may find that through being responsible and proactive with regard to pension saving their combined contribution inadvertently exceeds the new interim contribution limit of £20,000 per annum. As noted in paragraph 21 above the special allowance will remain static at £20,000 in 2010/11.

Alternative Proposals

25. For all the reasons stated above the NAPF believes that alternative proposals to the treatment of pension tax reliefs for higher earners should be sought. These proposals may want to consider:

- Maintaining the status quo
- Reduction in the level of the Lifetime Allowance
- Reduction in the level of the Annual Allowance
- An increase in the level of the special allowance of £20,000 per annum

The Treasury Select Committee reported on 6 May 2009 "We urge the Treasury to monitor the effect of this change on pension savings and to keep under review the possibility that a cap on annual contributions might be a more equitable way of reducing the percentage of tax relief that benefits the highest earners"

26. The NAPF proposes that HMT undertake a full costing analysis to examine a range of different 'what if' scenarios on the revised amount of the Annual Allowance and other options.

27. The results of such analysis should then allow a more informed judgement to be made regarding a range of future options such as a lower Annual Allowance which could potentially raise additional tax revenues from reduced pension tax relief but which still includes sufficent incentive for high earners to continue pension saving through registered pension arrangements.

Conclusion

28. The NAPF believes that the proposals within the Bill while predicated on a notion of fairness and with a practical aim of policy consolidation on the tax relief on pensions are at best arbitrary in nature – particularly with regard to the interim Anti-Forestalling arrangements and will deliver unintended consequences which will damage pension saving in the UK.

29. Of greater long term significance the removal of the principle of EET leaves all workplace saving potentially vulnerable to the new, less tax-incentivised approach to all savers regardless of level of earnings a situation only likely to further discourage ongoing support for pension provision at a time when occupational schemes are under considerable pressure to survive.

30. Pension Managers, Finance Directors and HR professionals consistently request a reduction in complexity with regard to pensions. The NAPF have been foremost in arguing the case for a regime which offers good practical incentives and protection for savers but which allows employers respite from unnecessary regulation.

31. It is our view that the pension tax relief proposals set out in the Bill are designed as a short term policy fix to maximise revenues and reduce the public sector finance gap but are flawed in terms of meeting that financial objective as most high earners will disengage from future pension saving. In the longer term the proposals may be detrimental to the behaviour of all those responsible individuals who want to make adequate provision for their retirement. Moreover, they are likely to have the negative effect of destabilising pension provision for lower paid employees.

32. The Government (HMT) has promised to consult on these proposals and consequently the NAPF believes that we should enter that consultation process with a view that these proposals are ill conceived, will fail to meet their primary objective and should be fundamentally rethought and revised accordingly.

NAPF
18 May 2009
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ANNEX A
IMPACT OF PENSION TAX RELIEF REFORM: EXAMPLES

Example	**Gross income**	**Pension contribution rates (%)**		**Gift Aid (£)**	**Trading losses (£)**	**Extra pensions tax (£)**
		Employee	*Employer*			
1	155000	8	10	0	0	**0**
2	170000	8	10	0	0	**476**
3	180000	12	8	500	0	**1080**
4	220000	10	8	1000	1500	**9680**
	E.gs. 5&6 show how an employee can reduce his tax liability by accepting reduced employer contributions and replacing them from his own pocket.					
5	220000	8	10	0	0	**10120**
6	220000	10	8	0	0	**9680**
7	175000	10	15	0	0	**1937.5**
8	175000	0	0	0	0	**0**
	E.gs. 7 & 8 are identical, but no. 8 makes no pension contributions. No.7 saves in a pension, but pays £1,937.50 in extra tax as a consequence.					
	E.gs. 9 & 10 compare the same person. He receives a £5k pay rise, which means an extra £1,350 pension contributions - but £1,882 extra pensions tax.					
9	175000	7	20	0	0	**4774**
10	180000	7	20	0	0	**6656**

In e.gs 7, 8, 9 and 10, the gross pay includes a £20k non-pensionable bonus

In every case, these individuals will also pay an extra £3237.50 Income Tax due to the loss of the personal allowance above £100,000.