NAPF

Securing the future of pensions

NAPF response: Pensions Tax Relief – Individual Protection from the Lifetime Allowance Charge

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NAPF

The National Association of Pension Funds is the leading voice of workplace pension provision in the UK. We represent 1,300 pension schemes from all parts of the economy and 400 businesses providing essential services to the pensions industry. We represent both public and private sector schemes. Our members provide pensions for 16 million people and collectively hold assets of around £900 bn. Our main objective is to ensure there is a secure and sustainable pensions system in the UK.

Introduction

The steady reduction in the annual and lifetime allowances poses continuing problems for pension scheme administrators. When the Finance Act 2004 was enacted, it was intended that these thresholds would have little relevance for most scheme members. Indeed, the changes brought in by Finance Act 2004 were justified at the time on the basis that the new tax regime would yield dividends in the form of a simpler, more fair, approach that members could easily grasp. The promise of simplicity has been betrayed in recent years as the allowances have become relevant in unexpected circumstances for even low- and middle-income members.

Changes to the lifetime allowance ("**LTA**") and the consequent administration of additional individualised tax thresholds for an increasing cohort of scheme membership results in problems beyond a complicated record-keeping exercise. As members sort through their options and request additional calculations and pieces of information that must be fit together with information concerning pension benefits in other schemes, administrators are being called upon to explain an increasingly counter-intuitive tax situation. The line between information to the member and advice becomes blurred, multiplying not only burdens, but opportunities for error.

The most direct consequences are being felt by high earners, who must engage in a certain amount of gamesmanship regarding protections if they want the rules under which pension contributions and promises were made to continue to apply when the benefit is taken. However, there is a more subtle damage to a wider group where the message that pension saving is complicated, even mysterious, is reinforced. Members who will never come near to any of the tax thresholds may be further discouraged from pension savings by reports in the press, however garbled, that the rules have changed again, and by increasingly caveated "basic" pensions advice.

The Government's stated policy that pension savings are essential and should be encouraged is being undercut by the impression that the tax laws pertaining to pensions are in a constant state of flux. For this reason, any changes undertaken should be implemented as cleanly as possible, and any ancillary rules and calculations in respect of protection of assets already committed to pension savings should be kept to the minimum.

Questions

Question 1: Are there particular difficulties for scheme administrators in allowing individuals to hold both fixed protection (FP12 or FP14) and IP14?

There is an additional burden for scheme administrators, who must keep track of two additional pieces of information concerning the thresholds at which the lifetime allowance charge may be assessed for an additional cohort of members. However, the two types of protection serve different purposes, and we believe that most members will apply for both, so as to protect themselves in the event that fixed protection is for some reason lost.

Question 2: Do you agree that individuals with enhanced protection should be excluded from applying for [IP14]? If not, please give the reasons why you think there is a case for allowing individuals with enhanced protection to apply for IP14 and set out any difficulties or issues this might create.

We think that the second reference to "enhanced protection" should be to "IP14".

Individuals will want to apply for fixed protection as well as enhanced protection – if enhanced protection is somehow lost prior to 2014, this would give that individual a second opportunity to protect some benefits. Of course, it would also create a situation by which some individuals would have multiple lifetime allowance thresholds, and accordingly increases the burdens on administrators, who must keep track of the various applicable individual thresholds. Obviously, the increase in the number of different thresholds applicable to any individual also increases the likelihood of administrative error, as to both the value of the individual's threshold and as to whether eligibility has been maintained. However, we believe that more than one form of protection should be available because the changing thresholds are creating a confusing situation and members should not be subject to what increasingly feels like a lottery concerning which rules will apply to benefits already allocated to pension savings.

Question 3: Would monitoring an individual's personalised LTA for the purposes of the tax free lump sum limit, be likely to create difficulties for scheme administrators?

The personalised tax free lump sum limit, based on the personalised LTA, will make administration more complicated. This will be especially true for defined benefit schemes, which quote options on retirement to the member that include tax free cash calculations as part of their regular benefit statements. Because the tax free lump sum will no longer necessarily be a fixed amount by reference to pension entitlement under the scheme rules, but will also depend on the fluctuating personalised LTA, it would in many cases need to be calculated manually in order to be accurate. As an alternative,

schemes may simply caveat their tax free lump sum calculations, resulting in a less than clean message to scheme members.

Question 4: Are these valuation methods fair and appropriate?

We do not have any comment on this question.

Question 5: Are there any issues or additional burdens associated with these valuation methods?

There will be an increase in requests for information that is not included in current benefit statements. For example, members routinely receive a statement of the percentage of lifetime allowance they have used, but the amount at which the benefit was valued is not necessarily shown. Members will need to compute the amount, and then run it through the equation required by the regulations in order to approximate the percentage of the new standard lifetime allowance. Scheme administrators can expect to receive many questions about the calcualtion, including requests for the precise value at the time the benefit was measured against the LTA.

Question 6: Should [there] be some form of revaluation of the pension debit for IP14 to take into account the change in the value of the individual's pension rights since 5 April 2014 and if so, on what basis this should be done?

We do not believe that revaluation of the pension debit against the personalised LTA would serve any useful purpose. As we understand it, this would cause a personalised LTA to which a pension debit is applied to reduce over time in some as yet unspecified way, and exacerbate the problems referred to above.

The purpose of imposing the LTA is or should be to discourage individuals from acquiring tax-protected pension savings above a certain level, rather than to raise revenue. The member whose benefits have been transferred to the ex-spouse pursuant to a pension sharing order no longer has access to those benefits. To penalise him or her for a notional increase to those transferred benefits is disproportionate and is not consonant with the reasons for imposing an LTA. It is true that the ex-spouse may pay income taxes at a lower rate when they draw the benefit they have received than the member would have paid, but the pension credit benefit will be subject to tax in accordance with the rules applying to the ex-spouse, and this should be sufficient.

Moreover, a decreasing LTA is likely to further complicate questions from high-earners as to when to take benefits. The advantages of retiring later will need to be balanced against a decreasing personalised LTA. Depending on how HMRC construct the relationship between the pension credit and the personalised LTA, it could even fluctuate, changing goalposts for members and scheme administrators alike. We see no strong policy reason for creating this situation.

Question 7: Are there any particular reasons why a scheme pays adjustment should not be deducted from an individual's personalised LTA, and in particular are there any specific administrative burdens that this might lead to?

We believe that a scheme pays adjustment to the personalised LTA would further complicate the calculation of the personalised LTA. Many schemes will find that their systems do not easily include such adjustments, and they will need to be made manually, increasing the likelihood of error. In addition, scheme pays adjustments tend to be made long after the increase in benefits that have given rise to the adjustment occurs, which will only increase the complexity of calculation. Scheme pays calculations and personalised LTA calculations are both already sufficiently complex – requiring coordination of the two is a bridge too far.

Question 8: What would be the impact if a deduction was also applied to individuals with primary protection whose pension savings are subject to a scheme pays adjustment?

This would introduce a new cohort of members for whom calculations would become more complex and more prone to error. The burden on scheme administrators is not justified by the additional tax that is likely to be collected.

Question 9: Are there any other circumstances when an individual's personalised LTA under IP14 should be adjusted?

We would favour adjusting the individual's personalised LTA in as few circumstances as possible. There may sometimes be a logic to certain adjustments, but that logic does not outweigh the practical disadvantages to further complicating the process.

Question 10: Is a three year window for IP14 applications about the right timeframe, and are there any issues associated with this?

We agree with the time frame.

Question 11: Are there any difficulties and issues that may arise if individuals cannot apply for IP14 until summer 2014?

Individuals retiring after the reduction in LTA and before IP14 is available could be affected unless care is taken to protect them.

Question 12: If you have any comments on the draft legislation at Annex B, please include these as part of your response.

We have no comments.

Question 13: Does the Tax Information and Impact Note at Annex C capture correctly the impacts and burdens associated with the introduction of IP14?

While it is possible that only approximately 120,000 individuals currently have £1.25 million in pension savings now, many hope that their current pension savings will grow to at least that by the time they retire. Therefore, scheme administrators will be dealing with questions and disclosure to many members who are attempting to plan their current pension contributions in accordance with the new threshold, but who have not yet reached it.

In addition, as you are aware, press reports concerning problems of high earners often filter down as problems with pension savings generally. To the extent that the rules appear to change often and to create situations in which past understandings on which savings have been made are undermined, pension saving by individuals who will never come close to meeting the thresholds is discouraged. The temptation to embellish the approach to individual protection with unnecessary bells and whistles should be resisted.

Further information

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