



Actuaries propose framework for taxation of residual pension resources...

GOVERNMENT TOLD ACCUMULATION OF CAPITAL IN PENSION SCHEMES SHOULD BE ENCOURAGED AS MOST PEOPLE ARE UNDER-PENSIONED

17 October 2005 - The Association of Consulting Actuaries (ACA) in its response to the HM Revenue & Customs discussion paper on *Inheritance Tax (IHT) and Pension Simplification* has expressed its frustration at 'the continual introduction of new regulation and guidance that is tarnishing the overriding principle of pension tax simplification'.

As a fundamental principle, the ACA says it is disappointed that Ministers feel the need to include pension savings as assessable for IHT. The argument that accumulation of capital within pension funds should be discouraged goes against the facts reported by the Pensions Commission that most of the population is under-pensioned.

The ACA has therefore recommended a tax framework for residual pension resources as follows:

- Death in service benefits up to the Lifetime Allowance on death before age 75 should be payable IHT free as now. The present system works well and HM Revenue & Customs have protection by virtue of the Lifetime Allowance Charge.
- The 75-age limit should be reviewed quinquennially in the light of increasing longevity trends.
- On death in retirement before age 75, if residual funds are used to provide dependants' pensions, there should be no IHT. The dependant's pension would obviously be liable to income tax.
- On death in retirement before age 75, if residual funds are paid out as a lump sum, there should be no IHT. There are already provisions for a 35% tax charge under *Finance Act 2004* and so there seems no justification for an additional 40% IHT charge.
- The 70% limit on maximum drawings after age 75 under ASP (Alternatively Secured Pension) should be removed and replaced with the 120% limit, or an even higher limit in order to permit funds to be accessed in cases of disability, etc. (subject to appropriate controls)

- On death in retirement after age 75, if residual funds are used to provide dependants' pensions, there should be no IHT. As on death before 75, any dependant's pension would be liable to income tax. This would treat small and large schemes consistently.
- On death in retirement after age 75, the legislation should be changed to allow residual funds to be paid out as a lump sum to beneficiaries - but subject to full IHT.
- Alternatively, such funds could be reallocated on death within the pension scheme to other pension scheme members without IHT and used to pension a new generation. The Lifetime Allowance check would curb any excesses. This would provide consistent treatment to the system that operates within group final salary schemes.

"We believe that the above system would be widely considered as fair, avoid abuse, avoid substantial administration costs, avoid subjective judgements and accommodate national objectives," said Mark Howard, Chairman of the ACA Committee, which developed the response.

"Most people are concerned as to whether they have adequate savings for a potentially long old age and retirement. They are worried that they may have high living costs, late in life, when they and/or their partners may incur disability costs, superimposed on the high cost of normal living". For these reasons, in an age of increasing longevity, the ACA says that the concept of a level pension is outmoded for many and a substantial number of people will wish to maintain resources to provide for these potential later life costs. Demographic changes imply that this will be an increasing trend.

Another important background factor to consider is that the next generation is likely to be even less pensioned than the present. Unless resources are retained within the pension sector, the State will be forced to provide additional benefits in future for many more cases of hardship.

The ACA also calls for some changes to be made to the new regime for drawing pensions after age 75 which will come into effect in April 2006. The proposed new regime actually encourages an unnecessary build up of pension funds for those who survive post 75 and opt not to buy an annuity. For some reason, the maximum pension that can be drawn by those opting for this new regime ("the 70% limit") is less than that that would be sustainable via an external annuity. This factor itself will automatically ensure that there are unused residual funds on the death of a pensioner in the new regime and at the same time inhibit pensioners who intend to use their pension resources late in life to take full advantage of what they have accumulated.

"We believe that this probably unintended result is against the national, Government and individual interests and we would ask that the Government reconsider the 70% limit on pension drawing after age 75 - as this will be the cause of an unnecessary problem. The ACA suggests it be increased to 120% to be consistent with the pre 75 position," said Mark Howard.

