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Pensions Tax Consultation
Room 2/E2
HM Treasury
1 Horse Guards Road
London
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Dear Sir

Response to consultation on implementing the restriction of pension tax relief

The Association of Consulting Actuaries (the 'ACA') welcomes the opportunity to comment on the Consultation Document *Implementing the restriction of pensions tax relief* published jointly by HM Treasury and HM Revenue & Customs on 9th December 2009, intended to roll out Government's policy to "restrict pension tax relief for individuals with gross income of £150,000 and above."

Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes. Members are all qualified actuaries and are subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of defined benefit pension schemes. The ACA is the representative body for consulting actuaries, whilst the Faculty and Institute of Actuaries are the professional bodies.

We have taken part in various consultation meetings since the issue of the Consultation Document exploring the proposals and provided various detailed comments and feedback there. **Most of our members consider the policy and the proposed means to achieve it to be seriously flawed. However we have been given to understand that the political intent is absolutely to proceed in this form. In this context, we see it as a matter of public interest to engage, in trying to make a flawed policy less bad.**

1. Overall comment

1.1. Overlying policy

The Consultation Document makes it clear that the political aim of the proposals is

- a tax take assessed as £3bn pa; and
- that this should be taken specifically from “high income” individuals.

We do not have the underlying data to test whether the proposals will deliver the tax take, but the information provided by Government suggests that this represents the higher tax relief effectively given for pensions savings for the group: so that it would be more than achieved if such individuals simply stopped saving for pension, and instead invested in taxed vehicles. **It is important to appreciate that, other than in relation to any tax-free lump sum available on retirement, the "tax relief" on pension contributions should more accurately be described as "tax deferral", as pensions are, of course, subject to income tax when in payment.** Any increase in tax take from individuals who continue to participate in registered pension schemes, as a result of the restriction, may therefore be regarded as double taxation. To the extent that they reduce their contributions and other individuals stop participating, any such increase in the current total tax take is likely to be offset because of the reduction in tax take on pensions in payment in future years.

We would reiterate the statements we made when the proposals were first announced in April 2009. Quality workplace pension schemes are expensive to maintain, particularly in current economic circumstances. And locking income away into long term savings – with no access, and with the risk of ever changing tax rules with retrospective elements – needs a tax incentive.

A taxation policy that by 2011 will generally result in the high earning leaders of business having little incentive and potentially a tax penalty by saving in the company’s pension scheme (only 20% tax relief on pension savings and probably 40% tax when the pension is paid) is wrong. It will inevitably end the valiant resistance of many of these senior executives to closing off quality pension arrangements, thereby affecting employees at all levels. As consultants we are seeing the proposals directly accelerating the closure of defined benefit pension schemes - the true impact will be seen from 2011 as the details of the way in which the policy is to be implemented become clearer.

The Impact Assessment attached to the Consultation Document tries to identify immediate implementation costs but it ignores this long term impact for UK pension savings.

1.2 Approach to Implementation

The policy does not just impact those who are clearly “high income” – it affects those who **might** be “high income” but whose position will depend on unpredictable detail: the complexities, the uncertainties and the cliff edges inherent in the structure means a much wider group of individuals - at much lower incomes than intended - will withdraw from pensions than just those actually affected.

Each attempt at “fairness” in this misguided policy increases the complexity: the changes introduced by the Pre-Budget Report (such that the measure of income includes employer-funded pension benefits so as to “reduce distortions and unfairness otherwise caused”) increases the number of individuals expected to be caught by about a third from 230,000 to 300,000, and magnifies the complexity and impact on schemes.

The design will also have the unintended consequences of causing some material artificial changes in behaviour and distortions to remuneration, to minimise the impact of the new tax.

As you can see from the above, we consider that we are responding in the context of a policy that we consider flawed, and whose implementation can only be flawed.

Government have, in several announcements, indicated the wish that the policy operation meets the following criteria:

- “fairness” between defined contribution (DC) and defined benefit (DB) arrangements, and between different DB ones;
- simple to operate so that it does not give rise to disproportionate cost or likelihood of error;
- sustainable; and
- enabling individuals to understand the tax impact in advance and plan pension savings meaningfully.

We give examples in this response showing these cannot all be achieved. **It will be a political matter to decide the balance and compromises between these targets.**

We have given answers to most of the questions specifically asked in the Appendices to this letter.

Our response aims mostly to:

- enable gross anomalies to be avoided (or at least acknowledged); and
- minimise impact for the industry – where possible.

Our greatest concerns are mentioned below, although this is by no means an exhaustive list.

2. Complexity of the proposals

The proposals are extremely complex because the qualification for being subject to the relief restriction, and also the recovery tax rate, both depend on key items – overall taxable income and (for DB) deemed contribution value that cannot be known when the pension contribution is being made. **Few members or indeed advisers will understand all this and errors will be made increasing the arbitrary nature of the outcome.** Our evidence for this is the roll out of the temporary anti-forestalling legislation currently in place simply to maintain a “holding position” - we have seen completely opposing conclusions on the tax position from different advisers.

Particularly in relation to placing a value on defined benefits, individuals are likely to incur additional costs for seeking benefit information and a reasonable level of tax planning advice. Resources will also be required by other parties, including pension scheme trustees, actuaries and employers to work out the mechanics of the calculations and their application to each individual circumstance.

3. Cost of implementation

The Impact Assessment indicates the cost of implementing the proposals impacts the Government exchequer “negligibly”. The complexities suggest that proper monitoring would in fact involve HMRC in substantial additional policing and audit costs.

By far the more substantial cost falls on schemes, employers (both in terms of delivery, distortion of work and retirement pattern and the havoc created for remuneration policy) and the individuals themselves (including the cost of advice and even the basic information they

need to proceed. The experience we have had in advising on the Finance Act 2004 provisions (also complex but less so than these proposals) clearly supports this.

We expand on this in Sub-Appendix 3, but particularly note that the Impact Assessment so far given has not sufficiently broken down to be meaningfully tested; but that costs are likely to fall disproportionately on private sector defined benefit schemes and to be significantly underestimated in the Cost Assessment so far. **Our members are already working with employers to plan and budget for the actions needed as a result of the proposals. Before making any decisions about the practical application of the proposals we believe it is essential that you seek information from a sample of employers on the potential costs so that the impact assessment can be evidence-based.**

Money purchase schemes in general will be simpler to deal with but this does not mean that they will be problem free.

4. Cliff-edge created by the income threshold of £130,000

The provisions contain some significant cliff-edges that will result in a distortion of retirement patterns and remuneration package; and which make it impossible for individuals to anticipate the tax that will arise in relation to their pension saving.

4.1. Once employer-funded pension contribution is considered an immediate benefit-in-kind for tax purposes, it is appropriate as part of the Government's implementation to include this in the measure of an individual's "high income". We also understand why the proposals bring in the £130,000 threshold – it substantially limits the administration that would otherwise arise for no purpose, so we would not want this simply removed.

However it does create an extraordinary cliff edge at income levels of close to £130,000. The marginal tax rates of an extra £1 of income (potentially just building society interest) taking (relevant) income from £129,999 to £130,000 are massive.

*Example 1: An employee whose only income is a salary of £120,000 and employer-funded pension value of £50,000 (possibly the value placed on accrual at 1/60ths) would have no recovery tax applying. Being granted a bonus of £10,000 would trigger recovery tax of £13,000: **the £10,000 income would thus attract total tax of £17,200** (income tax, NI, recovery charge).*

Example 2: An individual with income of £129,999 and employer-funded pension value of £50,000 would have no recovery charge. But an additional £1 of income (e.g. bank interest) would again trigger a recovery charge of £13,000.

This seems to be an intrinsic part of the implementation; any attempt at smoothing the effect would increase administration or widen the net of those impacted. We offer no solution. However it is clearly not "fair". It will distort pay packages and create real problems in remuneration policy.

And the risk that a combination of pension savings and unexpected/unpredictable income could create substantial extra tax will put off a wide group from making pension saving: we have seen employers proposing withdrawing pensions as an element of pay package for salaries as low as £80,000 because of the risk that granting some normal element of income (or indeed personal income) or a quirk of the way pension is valued could trigger the sort of super-tax impact shown above.

4.2. The proposals include a “look through” for salary sacrifice made since 22nd April 2009 towards pension. We cannot see how this can be meaningfully operated as a sustainable structure. How does one ensure fair/equal treatment in the following cases:

- an existing employee on a salary of £140,000 who after 21st April 2009 sacrifices salary for £20,000 employer-funded pension (who will suffer the recovery charge);
- an existing employee on a salary of £140,000 whose salary sacrifice of £20,000 was originally implemented before 22nd April 2009 (who *may* suffer the charge, depending on how the proposed legislation is interpreted, if the arrangement is “renewed” after 21st April 2009); and
- a new recruit joining on £120,000 plus employer-funded pension of £20,000 (who will not suffer the charge).

Similar issues relate to those who change contracts and the many schemes that operate “flex schemes (we have seen this arise as a significant issue and source of unreasonable differences in treatment between individuals, for the current anti-forestalling regime).

5. Retirement from defined benefit schemes

Fundamental to producing a regime that meets the Government’s objectives is identifying a simple and fair way of valuing defined benefits and matching this to an accrual year. We anticipate that the principle of fairness will be difficult to meet for defined benefit schemes because the nature of the tax does not fit the way defined benefits accrue over the career of an individual and we expand on this further within this letter.

It is clear that one area for tension is some trade off between anticipating certain events upfront as the pension is accruing or leaving them to be taxed as and when they happen in the year of retirement. Either charges in early years will be pitched at a level that could result in overcharging (in which case it will be essential to have an effective rebate system) or there will be large (and unpredictable) charges in the final year.

This issue is particularly key for individuals who will be drawing their benefits in 2011/12 or shortly thereafter for whom there is no scope to level out any year-on-year gains and losses

The proposals as written will lead to substantial tax arising in early retirement that do not arise currently – the example in Box D2 of Annex C of the Consultation Document shows a recovery charge of £116,340 arising on an early retirement on terms which are currently part of the scheme’s rules, and which would currently trigger no charge.

Unless a measure is taken to soften this effect (see Appendix 1 of this letter) – **and published quickly** - individuals who would normally retire after 5th April 2011 may be panicked into retirement ahead of that date. This could encourage key individuals from industry and the professions to leave the working population in a way that could have a detrimental effect on the UK economy.

6. Time frame

One of the implementation policy aims is that individuals will be able to understand the tax impact of participating in pension arrangements. We are now just 13 months away from the date after which any pension savings made may trigger the tax, with headline points yet to be confirmed particularly in relation to DB, let alone the full detail that will be needed to determine an individual's actual position and plan appropriately. As well as the point about retirements made above:

- **Individuals who want to continue in a pension scheme after 5th April 2011 – and in doing so may trigger substantial recovery tax – need to have sufficient tax information well before 5th April 2011 to make an informed decision. We cannot see how Government will be able to make this available (the legislation itself, the regulations, the roll out of regulatory decisions such as factors, let alone the guidance that is essential in understanding legislation and to clarify any areas of uncertainty).**
- **The proposed tax is complex and sits on top of some complex structures affecting several tax areas (pensions, income etc). The implementation details of the proposals and then the legislation itself is being rushed through. There is a high probability that technical details will not work that are extremely important in scheme information provision, and in individuals' decisions, and that there will be substantial costs in establishing the position for particular cases.**

This does strongly suggest that the policy trigger date should be put back another year, with the anti-forestalling regime continuing pro-tem.

7. Likelihood and impact of corrections

In general, pension benefits are definitively calculated just twice – at the point of leaving and then at the point of retirement. This is why although schemes can be required to provide illustrations to members each year, the illustrations make no pretence of being more than just that. It is highly relevant that a recent DWP review of disclosure legislation thought the current arrangements – essentially a voluntary one for schemes that can be satisfied by providing illustrations – appropriate for the proper purposes of schemes.

The current proposals involve benefits being precisely identified annually with a real outcome in terms of a tax charge. Pension calculations are complicated because they cover a wide range of designs, changes and amendments and a plethora of overriding legislation. And benefits build up reflecting a whole history of such elements. Real life means that benefits get reinterpreted retrospectively. This could be because of a new reading of existing legislation (e.g. sex equality “Barber” legislation and the knock-on to GMP legislation); re-reading of deed changes (e.g. recent PPF work overturning the validity of some scheme deeds of amendment); as well as genuine administration errors including systematic errors (e.g. the several public sector schemes discovered to be overpaying pensions recently for some years).

The proposals create a one-off tax based on the understanding at the time, linked in to the individuals “high earner” status at the time. We anticipate that each such change could lead to a chain of tax corrections and reallocations, at disproportionate cost.

8. Sanctions for time or factual errors

A large number of parties are involved in making the policy work, starting from the employer providing information to the pension scheme trustees about who has earned more than the £130,000 threshold. If errors happen or deadlines are missed – and clearly this will happen – the Consultation Document seems to imply that the sanction will be on the individual in terms of interest or penalty from late or incorrect tax returns; and it will be up to the individual to seek redress as s/he sees fit.

This approach needs to be tested at each stage – are the demands being put on each party realistic?

9. Sustainability

We note that the policy design, and the draft legislation so far released, fits around a specific tax banding of rates and thresholds. It is likely that as and when those bandings change, many elements of the policy implementation will need non-trivial adjustments (and all the technical resource involved checking them) to work as intended. (Presumably at some point the Government will consider the possibility of increasing the £130,000 and £150,000 thresholds as inflation increases their impact.)

10. Arbitrariness

There will be huge differences between individuals making similar pension savings after 2011 but with key differences in “high income” timing.

Box D.2 in the Consultation Document gives the example of an individual with a final salary of £220,000 who, because her scheme grants unreduced benefits for retirement from active service at age 55, has a deemed contribution of £387,800 in the year of retirement, leading to a tax charge of £116,340. But if she had opted to work part-time in the two years before her retirement with her income falling below the £130,000 threshold, she would no longer be classified as a “high earner” and so this tax charge would not have arisen, despite her benefits being broadly unchanged.

It seems to us that this clear example shows the tax will work in an arbitrary way – yet another demining aspect.

Yours faithfully

Karen Goldschmidt
Chairman
ACA Pension Taxation Committee

Enclosure: letter of 17th February 2010 concerning redundancy carve-out

Applying the restriction of relief (Chapter 3)

A.1 The Government welcomes views on the best balance to strike between the smoothness of the taper and simplicity for individuals.

Stepping has the occasional advantage that, if the individual's income is anywhere within the step, his tax calculation result might, in some scenarios, be the same (so, relevantly, any correction to relevant income will, if only within the step, not change the recovery tax). However, this occasional advantage is outweighed by stepping creating cliff edges and complexity of programming. Our strong preference is that the taper is smooth, so using a formula to determine the maximum rate of tax relief.

The Consultation Document indicates that there will be a programmed calculator as part of the on line self-assessment tax return system: HMRC should make available a stand-alone version of this on their website (outside of the system focussed on self-assessment delivery and timing) to assist individuals' meaningful planning.

A.2 Given that the restriction of pensions tax relief for high-income individuals will apply over the tax year, the Government welcomes views on whether the pension input period for the purposes of assessment against the annual allowance should be brought in line with the tax year.

The Annual Allowance is a separate mechanism with a very different underlying calculation formula (particularly for DB). We are **not** in favour of enforced alignment with the tax year, which would reduce flexibility particularly for businesses with year-ends different from the tax year end; and could potentially add to the pressured workload of scheme administrators at one time of the year. Schemes can opt to align if it suits their purpose. (There may be a technical block to this in Finance Act 2004, if so this should be removed).

A welcome simplification would be to remove the annual allowance test altogether given that it will operate on a different technical calculated basis (the assessment period is only one element of difference) – but as the proposals stand at the moment we can see that HM Treasury's objection would be that individuals whose [relevant] income stays below £130,000 could have unlimited employer-sponsored pensions savings with full relief.

A.3 The Government welcomes views on any practical or administrative issues that may arise from applying the restriction of pensions tax relief to individuals on gross incomes of £150,000 and over who are members of overseas pension schemes and benefiting from UK tax relief.

The difficulty of operating this should not be under-estimated. Obtaining data on benefit accrual, whether specifically to 5th Aprils or any other date, may not be easy - or indeed possible at all – particularly if the concept and basis of the request is alien to the managers of the overseas pension scheme. Even for the simplest case, there are practical issues concerning, for example, foreign exchange rates for both defined benefit and defined contribution arrangements. Overall, this leaves individuals in the invidious position of a responsibility to calculate and report a tax liability with no means to do so.

A.4 The Government welcomes views on the proposal to use the higher of gross income in the current or previous tax year for the purposes of assessing whether individuals are affected by the restriction of tax relief in the year that benefits are drawn.

The proposal creates a situation in which identical individuals with identical income this year might be taxed differently because one had more income than the other in a previous year (and had already fully paid the taxes due on that income in the previous year). We are also not convinced that the actual implementation of the proposal has been fully worked out: is the double income test being used to test just “high income or not”, or also the appropriate taper position, and tax banding? Where individuals phase drawing benefits (increasingly common), will it apply to each benefit drawing? Clearly this adds to complexity.

A.5 The Government welcomes views on ways in which the impact on individuals affected by the restriction due to a redundancy payment of over £30,000 could be further mitigated without opening up scope for abuse.

We are very concerned in relation to this matter: it seems clear to us that without such mitigation the policy will apply unfairly on individuals who cannot be considered “high income” in any fair sense. Our separate letter of 17th February refers (copy attached).

Other comments on delivery: A-day tax legislation

The Consultation Document is silent on modifications to the Lifetime Allowance charge and the Annual Allowance charge (except to imply that the factors 20x and 10x may be changed). The policy intent of fairness should clearly not allow these taxes and the new recovery charge to apply to one element of savings.

Proposal: if an individual pays the new recovery charge, there should be a mechanism to offset that from any Lifetime Allowance charge that then falls due.

Valuing DB

A.6 The Government welcomes views on how well the valuation methods meet the objectives of fairness and simplicity, and whether any other factors should be taken into consideration.

No method will be both fair and simple.

The overall policy links a “year of benefit accrual” with a “year of high income” when the two are not so linked. The proposals treat defined benefit accrual as though it can truly be identified against one year when in fact the nature of defined benefit is that it reflects of a whole career’s experience of accrual, scheme history and legislative impact.

- The tax is to be applied as if to a premium for an insured benefit – but the benefit’s true value will depend on a multitude of contingencies, some not ascertainable for decades.
- The implementation also deliberately ignores the impact of grosser contingencies (such as the benefit not being delivered at all on scheme wind-up or entry to PPF).

- The Consultation Document already indicates that the Government plans to ignore parameters relating to the individual (e.g. gender or marital status), so ignoring a substantial real value difference (as well as being inconsistent with DC, where an individual can, at retirement, focus the use of funds for spouse benefit best to reflect his/her position then).

DB is a long-term proposition. The Consultation Document acknowledges that in DC, individuals “have more scope to reduce contributions” i.e. can be managed more easily with tax in mind.

Conversely, a member of a DC scheme could counter that DB members effectively benefit from deficit payments which are ignored for tax purposes.

Whatever approach is taken, it is extremely important, in avoiding unthinkable escalation of costs that **deferred pensioners** are carved out of the new tax by definition, so long as no change is made to their entitlement after leaving pensionable service (noting that promised revaluation would count as roll-out of an existing entitlement). We would be happy to assist, along with the Association of Pension Lawyers, in developing appropriate legislative wording,

A.7 Do stakeholders agree that (a two-way scale of) ARFs is the best approach for valuing the deemed contribution? If not, the Government welcomes views on what alternative method is preferable.

- The CETV approach represents a closer approximation to “fairness” in that it potentially encapsulates the specific qualities of the individual’s own scheme-specific benefits. However, it is inappropriate that an individual’s tax charges should depend on aspects of the scheme reflected in cash equivalent bases, for example the trustees’ chosen investment strategy; reflect legislation outside the tax laws.

Some (larger) schemes may have automated CETV calculations for the hypothetical leaving of in-service members so the cost of running a CETV calculation for tax purposes would be (relatively) marginal. For most schemes however, on top of the detailed leaver calculations already having to be done under any of the methods proposed, CETV would involve a complex calculation, in some cases requiring manual technical work, that would have no reason to be done except for the recovery tax.

In either case these calculations would be further complicated by the Consultation proposal that there would be some adjustment to reflect “neutral market conditions”. This is a non-trivial variation on the normal cash equivalent process.

- Using a single factor for all individuals would materially simplify the calculation of deemed pension contribution, reduce the delivery costs of the tax for schemes providing information (fewer information requirements) and reduce the likelihood of tax calculation errors. It minimises spurious levels of accuracy in a process that cannot be accurate overall.

However it creates large differences in effective tax charge; we are given to understand that Government would set such a factor at a high level to balance this likelihood of selection opportunities: so that many cases (for example younger individuals) would face a harsher tax than intended.

ARFs therefore do represent a compromise between these extremes, noting that the compromises involved in making even ARFs workable/simple/delivering necessary scheme cost savings **will favour some individuals and disfavour others.**

Overall however we note that some of the issues raised in Annex C are more significant than the choice of the valuation mechanism discussed above.

A.8 The Government welcomes views on:

(a) whether a two-way ARFs scale is preferable to a one-way scale

The Consultation Document indicates that the Government is committed to reflecting “normal pension age” (“NPA”, being a benefit’s due payment date), and targeting any added value from moving away from this. From the examples given in the Consultation Document, whether one-way or two-way factors are used simply changes when and how the process recognises NPA.

The advantage of using one-way factors would seem to be some simplified administration in the years of benefit accrual; but with a “catch-up correction” in the year(s) of drawing benefits. The approach would seem to introduce an extra arbitrary element to the way the tax applies. We would expect a lower charge to arise in earlier years and a higher charge in later years. The two will not balance out: individuals retiring soon after 2011 will particularly suffer from this disparity.

We are aware that the Association of Pension Lawyers has pointed out in the consultation meetings that identifying the appropriate “NPA” for a tranche of benefit for a member of a particular scheme might not be straightforward because of, e.g., the need to deal appropriately with established discretionary practice, or unfettered rights to retire from service applying differently in different circumstances. Sub-Appendix 1 comments on this further as well as the issue of “negative values” arising when individuals choose to draw benefits later than their NPA.

(b) which other influencing variables an ARFs scale should include in an average sense, bearing in mind the objectives of fairness and simplicity;

Possible variables for which additional adjustment might be made included:

- the level of increase to pension once in payment: a fully-inflated pension could be worth 50% more than a fixed pension of the same starting level. In practice, pension accrual related to new service will typically, in the private sector, qualify for guaranteed increases at annual price inflation capped at 2½%; but pension accrual related to salary linkage of historical service may well have an element attracting no increases, or significant fixed increases of, say, 5% per annum;
- the level of provision for dependants’ benefit in scheme rules (the Consultation Document indicates that actual marital status is to be ignored); and
- the risk that benefits might not be paid in full due to employer insolvency: but the Consultation Document indicates (s 4.18 and 4.19) that there will be no adjustment to an individual’s tax position if a scheme should become insolvent and the benefits on which high-income excess relief charge had been paid failed to be honoured.

Whilst the ideal might seem to be a single overall adjusting factor taking account of all recognised additional variables on an objectively justifiable overall basis for each scheme, the three variables above depend very heavily on individual circumstances. If too many member/scheme/benefit-specific factors are incorporated, this would bring in the complexity of cash equivalent calculations and the associated administrative burdens.

Sub-Appendix 1 suggests one possible set of compromises.

(c) whether there is any reason why cases where individuals have more than one NPA could not be treated using a two-way ARFs scale

Many members will indeed accrue benefits elements of which have different “NPAs” because of the history of accrued benefits being rated up by salary linking. There is no technical reason why multiple NPA tranches cannot be handled, but the additional burden on administration each year multiplies. Appendix 1 suggests a possible compromise in this area.

(d) whether the individual or the scheme should carry out the ARFs calculation to compute the deemed contribution

This is a question to be answered by those who administer schemes.

However, we note that it may be that in some schemes it is possible from first principles to identify that the year’s deemed contribution is zero or negative without carrying out detailed calculations. It would be a helpful easement in such cases if the scheme could simply state this rather than have to provide the member with the start and end year figures, if (depending on what the member has saved elsewhere, and depending on how negative values are to be handled – see Sub-Appendix 1) this is sufficient information for tax purposes.

(e) whether GAD should have a role in advising HM Treasury on setting and reviewing the scale

If Ministers wish the proposals to have a starting point which is “fair” – before the political compromises that will be necessary for them to be practical - it would seem appropriate to seek professional actuarial advice and the natural source would be GAD. The instructions to GAD would be important in determining the advice received and should be established upfront, and should be published, along with the resulting advice. It would also be important to be transparent about the extent to which ministers decide and set the scale, with GAD’s input being one of many factors considered.

(f) how the scale should be reviewed, taking into account predictability and fairness

In the interest of simplicity and ability of members to plan, and to avoid artificial attempts at “accuracy”, we suggest regular reviews no more frequently than every 3 to 5 years with the new factors being published at least 1 year ahead of the start of the relevant tax year.

A.9 If respondents favour the CETV approach, the Government welcomes their views on:

- (a) why the CETV methodology is appropriate given the Government’s principles of fairness and simplicity;**
- (b) the best way to apply the CETV methodology to value the deemed contribution for the purposes of restricting tax relief; and**
- (c) whether market movements should be stripped out and, if so, how that should be done.**

See above.

A.10 The Government welcomes views on whether there are any instances in which contributions or enhancements made to an individual’s pension should not be subject to the restriction of pensions tax relief and why these exemptions are justified in the light of the Government’s stated objective of fairness; and how these exemptions might best be crafted to avoid opening up scope for avoidance.

- Death benefits clearly should be excluded, being outside of the Government’s policy intent.
- Benefit accrual arising specifically because of serious ill health (ie when there is life expectancy of less than a year) should be exempt.
- There is a strong argument for exempting benefit accrual arising specifically because of “non-serious” ill-health (a common benefit being the delivery of accrued pension starting early without reduction) – although it might be appropriate not to exempt a “future service credit” element. However Government may want to frame this exemption carefully to avoid a large tax differential between individuals for relatively small differences (the current definition of “incapacity” in FA04 is simply inability to do one’s current job). Whatever exemptions are granted for DB should have a parallel for DC.
- Changes to benefits accrued before 2011 because of retrospective legislation changes should be exempt. Similarly changes to benefits accrued before 2011 because of genuine errors or reinterpretation of scheme rules should be exempt. We note that it may be difficult to identify what element is “pre 2011”.
- Corrections of a minor level should be excluded so as to avoid very large costs for the sake of very small tax takes.
- Improvements to benefits forced on schemes by legislation or case law should be excluded See Sub-Appendix 1 regarding transitional exemptions for pre 2011 accrual.

A.11 The Government welcomes views on the most appropriate treatment for DB employee contributions in a year when the deemed contribution is less than the value of the employee contribution.

See Sub-Appendix 1 regarding Negative Values.

A.12 The Government welcomes views on any of the issues raised in Annexes C and D.

See Sub-Appendix 1.

Delivering the restriction of relief (Chapter 5)

A.13 The Government welcomes views on whether employers should automatically request that pension schemes provide pension benefit statements to any employee for whom they have previously asked for one.

No comment – we leave response to those with closer administrative functions.

A.14 Do stakeholders agree that the Budget Payment Plan offers sufficient flexibility for those affected by the restriction of relief who wish to smooth payment of the tax liability across the year, paying a portion earlier than is legally required, if they wish to do so?

Individuals with recovery charges of between £5,000 and £14,999 should be able to spread their tax payment over three years in the same way as proposed for those with charges over £15,000. We are not aware of tax charges of such substantial size commonly arising elsewhere where there is no immediate income from which to fund them, so this does not set a precedent.

A.15 The Government welcomes views on its proposed approach to Scheme Pays and, in particular, whether the approach could be modified to minimise burdens, while delivering the same flexibility for individuals.

We can see that Scheme Pays is a political necessity if the Government wishes to pursue its policy aim. However it is fraught with difficulties for defined benefit schemes, and the cost and complexity of managing reductions in benefits is considerable. We provide full comments in Sub-Appendix 2.

A.16 Is it appropriate to make Scheme Pays available only to those in defined benefit pension schemes, recognising that individuals in defined contribution schemes, whether occupational or personal, have more scope to reduce contributions if they do not wish to incur the associated recovery charges?

We assume this question means “should Scheme Pays also be an obligation on pure DC schemes?”

A recovery charge of £15,000 or more would arise only for contributions exceeding £50,000 and usually such levels of payment would be in the knowledge that recovery charge is likely. Unanticipated cases will arise – particularly for example if taxed redundancy payment is not appropriately carved out of the income test. We understand that there is no intention to offer a “refund” facility (as is drafted into the anti-forestalling provisions). The obligation would (in fairness) be necessary.

A.17 Is it reasonable to allow individuals to only elect for a single scheme to pay in any given year, and for that scheme to pay only the portion of the charge relating to contributions or deemed contributions made to that scheme?

We assume that the requirement to offer Scheme Pays will only ever be imposed on schemes in which there has been actual deemed contribution in the relevant tax year; and that this question means “if an individual has had deemed contribution in more than one scheme in a tax year and the total recovery charge is £15,000 or more, how should the schemes be required to offer Scheme Pays? Say A has pension saving of £40,000 in scheme 1 and £20,000 in scheme 2, and the combination results in a recovery charge of £18,000, so above the £15,000. Is it reasonable to impose £12,000 on

scheme 1 and £6,000 on scheme 2 (ie 4/6 and 2/6)? We note that one cannot say which scheme “caused” the charge since it is a function of both income and pension amount.

It could be common for an individual to have deemed contribution in more than one scheme: cases will arise wherever an individual changes jobs, or where an employer is rearranging pension provision. We understand that the policy aim is that an individual should not have to pay more than £15,000 from his net pay. However, Scheme Pays involves schemes in very substantial set-up and management costs. It is unthinkable that a scheme that might otherwise not have to do this should do so because it is allocated a (small) proportion of a total year’s pension saving. It is equally unacceptable that individuals shop around as this creates extra costs and delays.

Our view is that no scheme should be forced into offering Scheme Pays if an individual’s proportion of deemed pension saving in that scheme as per the example above is less than £15,000.

We comment in Sub-Appendix 2 on schemes being able to **offer** Scheme Pays voluntarily, and in the circumstances above Scheme 1 and 2 should have such an option, but the matter should not be one that can be imposed by the individual.

This does mean that an individual may have to meet a total recovery charge exceeding £15,000 from his/her own resources if a member of several schemes, but we assume that in these relatively rare cases the individual will be aware of the position and make appropriate plans.

A.18 For defined benefit schemes, given that the method and assumptions used to actuarially reduce the value of a pension could vary across schemes and could allow schemes to disadvantage members electing for the scheme to pay, is it appropriate to set parameters for calculating the actuarially fair offsetting reduction to a member’s pension across all defined benefit schemes when implementing Scheme Pays, or to leave it to individual schemes’ discretion?

See Sub-Appendix 2.

A.19 Do stakeholders agree that it would be necessary to include an opt-out for the small minority of schemes that would be disproportionately affected, for example, by reference to a minimum level of funding?

Yes, in particular because of the cost of administration. One available measure is the PPF’s own annual update on the scheme’s funding level as it appears in the annual PPF levy invoices albeit that this reflects a historic and estimated position.

A.20 Do stakeholders consider that those with recovery charges exceeding £15,000 whose scheme is not able to pay the recovery charge should be allowed to spread payments over three years, with interest charged on the deferred element?

We agree that spreading is necessary but not that interest be charged, given the nature of the legislation. Also see A14 above.

A.21 The Government welcomes views on the consultation Impact Assessment, attached as Annex E.

The complexity and therefore the cost on employers, pension schemes and individuals of administering the proposed taxes should not be under-estimated.

In the bigger picture, we have major concerns that the tax will reduce the provision of registered pension schemes by employers and worsen retirement provision for employees.

More comments on this appear in Sub-Appendix 3.

Sub-Appendix 1 – further thoughts on DB valuation – possible compromise package

Fundamental to producing a regime that meets the Government’s objectives in a simple/ fair way is the interaction between the key parameters (the determination and treatment of normal pension age, revaluation and treatment of negative values). The desired result cannot be achieved by considering each of these factors in isolation as the Consultation Document appears to do. These parameters are particularly important to the determination of treatment of benefits accrued prior to April 2011.

The following is a possible set of parameters. All the elements of the structure interact: a decision taken on one element could substantially change what works better or worse for another element. So the views expressed here could change as the Government makes decisions in certain areas.

For the avoidance of doubt, we are not suggesting that these parameters would create a regime that is both fair and simple – such a solution does not exist. However the following is offered as a constructive contribution to the consultation.

An outline possible summary for valuing DB accrual

Revaluation

Proposal: *To be broadly equivalent to National Average Earnings. This reflects previous expectations of linking, acknowledges that some pension benefits (e.g. GMPs) are required by law to be revalued in line with National Average Earnings and lessens the anomaly of pre 2011 enhancements. One might argue that this is advantageous compared to DC but reflects the different nature of the benefits. ARFs should be set recognising, at young ages, that there is a good probability of salary-linking of the benefit involved ceasing mid-career.*

Recognition of scheme-specific NPA

The Consultation Document identifies that due payment age (NPA) of a benefit is an important parameter in the value of a DB benefit (the examples in Annex C gives as an illustrative example 20% higher valuation (23/19 = +20%) if a benefit is due from retirement age 60 rather than 65).

The development of UK pensions means that many individuals effectively have tranches of benefits “due unreduced” from several ages – many will have two because of the “Barber judgement” in relation to sex equality, some will have three because of recent changes to accrual scales to reduce costs. Reflecting each of these in annual calculations could involve disproportionate cost compared to the size of the tax involved; and could substantially add to the burdens on administrators and increase the potential for errors, depending on the level of automation existing.

Proposal: *The following is one possible crude approach (if tied in with the suggestions described above):*

- *in the year in which benefits are not being drawn, use the NPA associated with the current service accrual rate, or associated with the last tranche of service-related accrual if that has ceased (this is just a crude approach for simplicity - in relation to the salary-linked element of accrual, the weighted effective NPA may well be best reflected by earlier accrual rather than recent); and*
- *in the year in which benefits are drawn, identify the start-year base accurately reflecting NPA.*

For enhancements in the year of drawing all defined benefit from a scheme

We describe in the main part of the letter the large recovery taxes that may be levied on early retirement after 2011 in situations where no tax would have arisen had the retirement been before April 2011; and the disruption for individuals coming up to retirement after long service.

(Indeed under the proposals it would appear that all retirements at ages before the scheme's underlying NPA will give rise to some "pension accrual value" unless the scheme's early retirement factors happen to align exactly with the basis underlying the ARFs adopted for the recovery charges.)

Proposal: *a phasing-in period after 2011 in relation to early retirement practices and factors that demonstrably existed before 2011 (especially if an employer is prepared, pre 2011, to commit to such practices and effectively make them an entitlement), and in relation to contingent entitlements existing before 2011 but where the contingency arises after.*

Pension Increases

A pension with full index-linking in retirement can be 60% more valuable than a flat pension of the same starting amount. However, attempting to recognise this difference would lead to considerable additional administrative complexity (such as potentially having to break a pension up into six or more components).

We would expect the greatest weighting of accruing pensions to have some guaranteed element of inflation linking, whether it is capped at 2.5% per annum or unlimited.

Proposal: *the ARFs scale to be independent of the actual increase entitlement under the scheme, with the factors themselves to be based on an increase rate in retirement of 2.5% per annum.*

Dependant's benefits

Many DB schemes will provide some sort of dependant's pension, at levels typically 1/3rd to 2/3rds of the member's benefits. The potential beneficiaries vary between schemes, with "spouse at date of retirement" at one extreme, and "financially dependent" at the other, potentially with children's pensions in addition. As for pension increases, these differences can lead to material differences in the value of DB benefits offered by different schemes. However, the Consultation Document states that marital status is to be ignored in valuing defined benefit as part of an individual's deemed pension savings. As for pension increases, we believe that there are enough approximations elsewhere in the process that the additional complexity involved in reflecting differences of scale in a particular scheme adds disproportionately to the process.

Proposal: *the ARFs scale to allow for some element of dependant's pension independent of the level provided by the scheme (with some average allowance for there being no beneficiary to be paid such a benefit.*

Negative Values

The Consultation Document suggests "negative values" (ie years in which the assessed value of pension actually falls) will be rare – and indeed suggests these would mostly arise because of employee contributions outweighing the deemed value of defined benefit accrual.

We think this is incorrect: negative values could arise from years of depressed salary increases; on retirement before NPA on terms worse than GAD's; or on retirement from employment later than NPA (particularly complex). If no credit is given for these, then material inconsistencies will arise between individuals.

For example suppose the indexation allowance is 3% pa. Consider A whose pensionable salary is exactly at 3% pa for three years, compared with B who has no rise for two years and then one promotional rise of 9% - quite possible in the current economic climate; and compared to C who has an initial promotional rise of 9% and then none for two years. For simplicity assume that these individuals' benefits are solely salary-linking, and there is no additional service accrual. All three would have accrued the same benefit increase by the end of the three years; but A will pay no recovery charge, B and C will each be charged on 6% of their benefit. Ideally there would be a system of credits, carry forward and back (so in the examples above, B would have a credit to bring forward to offset against the year 3 recovery charge otherwise due; and C would be able to claim tax refunds in years 2 and 3). It is difficult to see how this could be accommodated in processes acceptable to Government!

Proposal: *One approach might be to use 5th April 2011 as an index point: the accrual for a tax year would consist of deducting from the end value not*

“the start year leave pension, plus one year of indexation”

But instead,

the higher of “the start year leaver pension , plus one year of indexation”

and “the 5th April 2011 leaver pension, plus accumulated indexation”.

with appropriate offsets for personal contributions.

This would also apply in the year of drawing benefit.

However, we acknowledge that this adds to the complexity of the system, and could substantially increase the burden.

Adjustment for schemes guaranteed by statute

Insolvency is a risk only for certain schemes, notably those covered by the Pension Protection Fund. Other schemes, effectively guaranteed by statute, have no insolvency risk and are consequently exempt from the PPF. Such exempt schemes usually provide index-linked pensions, by law, while schemes subject to the PPF usually only provide pensions that increase with limited price indexation (or, for past service elements, no increases). There is an argument for an uplift multiplier that would apply to any defined benefit scheme exempt from the PPF under regulation 2(1)(a) to (d) of the Pension Protection Fund (Entry Rules) Regulations 2005, SI 2005 No 590. This would encapsulate – in a token but average way – the value of the difference in indexation and the lack of any solvency risk. This is a highly relevant issue: according to the Consultation statistics, some 55,000 of the 110,000 individuals affected by the new legislation and in defined benefit schemes are employees in public sector schemes.

Sub-Appendix 2 – detailed thoughts on Scheme Pays

We understand that Scheme Pays aims at avoiding a substantial cash flow issue on individuals. However overall it should be recognised that it creates substantial burdens on schemes - additional costs and huge complexity and potential for error. The following are comments in relation to questions A15 and A18:

A.15 The Government welcomes views on its proposed approach to scheme pays and, in particular, whether the approach could be modified to minimise burdens, while delivering the same flexibility for individuals.

A.18 For defined benefit schemes, given that the method and assumptions used to actuarially reduce the value of a pension could vary across schemes and could allow schemes to disadvantage members electing for the scheme to pay, is it appropriate to set parameters for calculating the actuarially fair offsetting reduction to a member's pension across all defined benefit schemes when implementing Scheme Pays, or to leave it to individual schemes' discretion?

Timescales

The timescales proposed are totally unrealistic – even to the first stage (5th July) that will apply for all (identification of certain cases by payroll, production of statements), let alone achieving the member's confirmation of wanting scheme pays by 31st October.

The proposed timelines set single deadlines for two parties' actions and make no allowance for the delays that will occur in practice, particularly in obtaining information about earnings and benefits-in-kind, for schemes to collect data and carry out complex calculations for individuals with unusual benefit structures. Where individuals seek advice from tax or financial advisers, there will be additional delays while they are provided with information and formulate their recommendations. Where computer systems have to be reprogrammed, there may be a significant lead time before the necessary changes can be scheduled-in. Scheme administrators who are already hard-pressed will be under further pressure to prioritise this work and to spend time 'chasing' responses to avoid deadlines being missed.

Proposal: Although this is breaking a precedent, with such complex law involving so many new processes, we strongly request that the processing of the new pensions tax is allowed to miss the 31st January normal process. This small extra burden on HMRC's processes would be a small share of the cost of the industry.

Form of 'debits'

Schemes are being asked to pay out sums and then recoup them by members surrendering benefit. Our view is that it would be wholly inappropriate to impose methods and bases on schemes for identifying the appropriate surrender – the question should be left to the scheme trustees taking actuarial advice, with the requirement that the surrender is considered actuarially equivalent.

Considerable care will be needed in designing (and communicating) the form of benefit reduction that will apply when the member exercises the Scheme Pays option. Schemes will need full flexibility to keep it as simple as possible for them to administer and to explain to the member, while being sufficiently robust to ensure – as far as is possible - that given the nature of the scheme and its benefits, it recoups the amount it has paid out, and that other members are not disadvantaged.

Trustees should be able to charge from one arrangement in the scheme even if the accrual was in another arrangement (e.g. could require that an AVC fund were used to pay a charge arising from DB) – bearing in mind that the member can choose not to exercise the option of Scheme Pays.

Charging

The continuing administrative burden of taking account of a debit (or series of debits) in all future actuarial valuations and individual calculations (and communications) should not be underestimated.

The additional administrative costs that will be imposed on schemes must be recognised and an appropriate mechanism needs to be available to enable these to be passed on to the member. This will no doubt be the source of some friction and there is likely to be pressure for the costs to be absorbed by schemes or employers. (This is of course effectively an additional “tax” on the individuals concerned.)

We note that the Consultation Document does not indicate how schemes will be able to guard against individuals who did not earn £130,000 with the current sponsoring employer speculatively asking for statements, without a real tax need.

Limit of schemes' responsibilities

Schemes will be unwilling participants in this process and need to be protected against being drawn into dispute between members and the HMRC or being unduly penalised for the occasional honest mistake or failure to meet an unreasonable deadline. It must be made clear to all concerned that the scheme's responsibility is limited to the payment of a specified sum (calculated by the member) due to HMRC and implementing the agreed benefit reduction, in accordance with the member's written instructions. The member must be responsible for obtaining any financial or tax advice that is required and any interest costs or other penalties that are incurred.

Any subsequent adjustment to the payment or dispute about the member's tax liability would need to be resolved between the member and HMRC, with no further involvement on the part of the scheme.

Practical issues

The proposals and examples in the Consultation Document are confined to the simplest cases and give no indication of how Scheme Pays might cope with the kind of events that are commonly encountered in pension schemes. What if the status of the member changes at some stage during the process e.g. a change of employer, divorce or even death? What if the nature of the pension arrangement changes e.g. through restructuring, bulk transfer or the scheme entering the PPF or going into wind-up? It needs to be clear from the outset how the scheme pays process would be affected.

Interaction with other legislation – other than tax legislation

Any approach of Scheme Pays would need to be explicitly agreed with the DWP and the Pensions Regulator since it could affect the liabilities of the Pension Protection Fund.

(We note that, unless a refund mechanism is operated, there will be cases where effectively it is the PPF – ie the industry levy – that has paid the recovery charge to the Exchequer, with no equivalent saving in benefit payment. More widely, unless legislation is modified appropriately (which would mean extra complexity), paying a Scheme Pays amount could increase a scheme's PPF levy (the assets would reduce with potentially no reduction in PPF liability).)

There will need to be **substantial** changes to many areas of legislation that interact with schemes' obligations (such as contracting out, preservation, PPF etc). It will be essential to have an overriding law change to permit this payment and surrender without requiring schemes to pay for the expense of individual rule changes (i.e. a law change comparable to the two sets of regulations put in place for A-day LTA charging).

Schemes will need legal and consulting advice as to how their own rules and such overriding legislation interact to best implement the requirements.

Interaction with other tax legislation

We also note the practical issues in relation to the year of drawing benefit: an individual could retire in say May 2012 and would not know his income for the 2012/13 tax year – and hence the tapered tax rate – until after 5th April 2013, potentially much later, as well as the subsequent interaction with the scheme on its Scheme Pays offering; and delays could also apply in respect of a reduction for the preceding tax year).

At consultation meetings, HM Treasury have implied that the reduction in benefit due to Scheme Pays counts as changing benefit for all other tax calculations – so potentially for the year on year recovery charge calculation, the calculation of LTA charge at retirement, and the calculation of an individual's scope for Pension Commencement Lump Sum at retirement. The example above shows that the delays in the process make this unworkable.

Proposal: *The Scheme Pays reduction is ignored in carrying out the A-day tax calculations noted above. (This should be relatively easy as many schemes will choose to keep separate records of this complex adjustment, as a stand-alone debit item, until the point it feeds into pension payroll.)*

Optional extended use of Scheme Pays

It is possible that some scheme trustees (with the employer's consent) will be willing to offer Scheme Pays where the legislation does not impose offering it. This may be because systems will in any case have to be set up for a large number of imposed cases, so the marginal cost of widening the group is acceptable; or it may be that it allows the whole of a money purchase account in one scheme to be cancelled by meeting an obligation arising from accrual in another and therefore saves the scheme administration. We would suggest that the law permits this.

We have recently discussed with HM Treasury some of the numbers in the impact report, particularly in relation to what sort of range underlies the “averages” quoted. We have asked for further information. In the meantime, we do not propose a wholesale review of the Impact Assessment, but we highlight a few key points.

Numbers affected

The Impact Assessment states that there “are 300,000 individuals with gross incomes of £150,000 or more contributing to pensions”.

- This number ignores those whose income is over £130,000 but who ultimately prove to have gross incomes below £150,000; and.
- there is a substantial additional group beyond this, with relevant income ultimately below £130,000 but needing information or illustrations in case some element of income might take them above.

While loadings have been included in some areas of the Impact Assessment for these two additional groups we think these are inadequate in particular for the latter.

Averages –the disproportionate impact on private sector schemes, in particular DB

The Consultation Document provides the following breakdown (we have asked for further detail).

DC	OPS (most SSASs)	135,000	Personal Pension	55,000*	190,000
DB	Private sector	50,000	Public sector	60,000	110,000
					300,000

*The Document indicates that there may in fact be 100,000 individuals affected who are in personal pensions, allowing for overlap. The Document indicates that 55,600 schemes are involved of which 10,000 medium to large are occupational pension schemes (we assume that the majority of these are DB).

Of the 55,600 schemes, 500 are the 500 personal pension providers covering 100,000 members between them. We are not clear how many represent public sector schemes.

The Impact Assessment provides various averages. This approach is very difficult to analyse but it is clear that it hides the fact that the costs of these proposals fall disproportionately on the private sector, and in particular on DB schemes.

The cost profiles for the four main types of schemes are in no way comparable:

- public sector pension arrangements cover very large numbers of members, often with very standardised scales, so can benefit from massive economies of scale (and for example Scheme Pays may be comparatively simple to manage);

- work in respect of personal pensions again benefit from economies of scale, but large systems need changing, and considerable compliance issues can arise;
- with regard to SSASs, the “minimum work” to comply may be relatively light touch, any additional work would probably be considered tax planning and therefore ignored in the Impact Assessment;
- private sector occupational pension arrangements – particularly defined benefit – are likely to give rise to the most complex cases and are unlikely to benefit from economies of scale.

Similarly the cost profiles for employers will vary. The public sector employers will typically not have the employer issue we highlight below.

Overall for employers with private sector DB schemes, each scheme is different and will need to address the new tax provisions in the light of its particular scales (which may include many historic quirks), and its particular trust deed and rules. And there will be substantial fixed costs on various elements that mean a disproportionately high cost where only a few individuals are affected. These considerations will involve advice for the employer, the trustees and the administrators, none of which advice will be at a junior level. It is easy to see that private sector DB schemes and individuals with these benefits will bear the brunt of the costs.

We think it would be extremely useful for HM Treasury to provide breakdowns on this. We have very recently been provided with some information on the very wide ranges underlying the averages shown but not how they have been used; and without further information we cannot analyse how reasonably DB costs have been reflected. We would be happy to engage on this further if required.

Impact on employers (paragraphs 39 – 44)

The Consultation Document assumes a one-off cost **per affected employer** of £500 for familiarisation, £250 to provide necessary information to employees; and then £100 per individual for requests for further information – with loadings of 20% for employees additional to the core 300,000. We believe that this is based on the assumption that employers consider the change a matter of personal taxation, and therefore solely engage in highlighting that the tax will arise (and payroll identifying £130,000+ earners). We think this is necessarily incorrect for several reasons:

Currently many employers offer pensions as a core part of remuneration, with no option for an alternative. The new proposals mean that pension saving becomes tax penal for some individuals; or at best will lead to immediate tax burdens not backed by direct cash-based remuneration, and the consequent cash flow demands. Many employers will therefore see it as unavoidable to offer alternatives.

At the very lowest end one might imagine an employer with one “high income” individual in a DC arrangement; and that such an individual is informed enough on the tax changes to proactively ask the employer to change his/her remuneration package from a pension contribution to cash supplement instead. This may involve contract changes (involving legal advice), and payroll changes.

In companies with more individuals involved, the persons involved in reviewing the position and making decisions could encompass Finance Director, Remuneration Committees (or whatever structure determines pay at senior levels) and HR managers. If alternatives to pension (such as cash) are to be offered either as an option or as a fundamental change, the considerations and the need for advice from professionals increases very substantially.

From another perspective, we also believe it would be unlikely for an employer to set bonus targets to encourage staff if it is known that these might, because of the quirks of the pensions tax regime,

lead to substantial marginal tax rates: at minimum employers will wish to publish meaningful warnings, most will want to analyse the position further (with no simple solutions).

There will be substantial work at any time that it is proposed that an individual draws pension, or has it modified in a way that triggers recovery charge. Depending on the circumstances, the employer may choose not to engage, but may have to arrange for technical data (hypothetical information on the pensions to be used to calculate deemed contribution) for various scenarios.

For all these reasons, the proposed structure of the new charge means employers cannot leave it as a matter of personal taxation. We do not consider this as tax planning activity, but unavoidable HR issues for businesses. As you can see from the above the figures involved could be substantial.

We repeat that our members are already working with employers to plan and budget for the actions needed as a result of the proposals. Before making any decisions about the practical application of the proposals we believe it is essential that you seek information from a sample of employers on the potential costs so that the impact assessment can be evidence-based.

Impact on individuals (paragraphs 33 – 38)

The nature of the tax means that it will be a very complex. If an individual is to make decisions on a tax-informed basis, s/he is likely to need advice – particularly in complex areas such as modelling the impact of different income, and tax arising from the form of drawing benefit; and similarly in deciding whether to choose whether to take up the Scheme Pays option. This cost of advice is ignored in the Assessment.

Impact on pension schemes (paragraphs 45 – 77)

The above discussion on averages shows why we cannot meaningfully analyse many of the figures in the Impact Assessment. We can however give an example of one area where the averages are clearly gross underestimated for private sector DB schemes, and so seem unlikely when combined with other types of scheme.

- Paragraph 47 addresses **queries** received by schemes on this matter outside the “standard process”. It assumes that each query can be dealt with in half an hour for an average cost of £20; and then multiplies this up to £10m ((£20 x 300,000 people affected x 150% (to allow for others to query)). Presumably this means a substantial number can be met at less than £20?

For a private DB scheme, to answer queries to a standard that would satisfy Trustees’ quality control and indeed the Pensions Regulator, £20 might meet the most simple question requiring only an oral response (and a record of the question on file and peer review). In practice questions will relate to technically difficult areas (either pension calculation or taxation), would be expected to be handled by an individual of appropriate level of knowledge (likely to be much more costly than £40 per hour) and, if requiring a written response, careful expert peer review. Some types of questions can be planned for and engender pre-planned responses managed with benefits of scale. We would expect most members of defined benefit schemes affected or potentially affected to ask a reasonably complex question – which might **reasonably** involve at least three hours per case, and in some cases substantially more.

If one used an assumed minimum of **only** £300 per query solely for private sector DB schemes, including those with relevant income above £130,000 but gross income below £150,000, and also including a further margin (say, doubling the numbers) for those who ultimately prove to have relevant income less than £130,000, this would suggest a **minimum** of £30m for private sector defined benefit schemes alone (300 x 50,000 x 200%) – rather

than the £10m estimate across all schemes. In practice many such enquiries will be more complex and will involve supplementary questions and follow-up.

Some areas which seem to have been ignored:

- We assume that the above deals with ad hoc queries based on personal circumstances and plans. No allowance appears to have been made for the fact that, in order to plan reasonably (one of the aims of the policy), members of defined benefit schemes may ask – ahead of a tax year – what their likely deemed pension contribution would be. Effectively this reasonable but complex enquiry at minimum doubles the “standard information” costs.
- There is no mention of legal input in the scheme costs. In practice, legal review will be necessary to ensure the “leaver” calculations comply with the new legislation. The Consultation Document implies that these will reflect calculations already done by schemes; but already there are technical details in Annex C that schemes will have to understand and apply in the light of their particular structure (for example, identifying the Normal Pension Age(s) that is relevant for their scheme for the purposes of the tax).

Some of these calculations may be very complex – one fairly common example being if the rules of the scheme include the complexities introduced by pre- A-day Inland Revenue limits or the protection rules of the A-day regime. For these it may be that leaver calculations have not had to be carried out before for the case (and but for the tax requirements would never have been needed, since ultimately the member would retire from service). Such scales may not have benefits specifically identifiable as a figure at leaving (typically the formula will be “pension at of X plus index 1 unless Y plus index 2 is less) so it may be essential to obtain guidance from HMRC on how to proceed. In many such cases the calculations may have to be referred to senior consultants, actuarial advisers or indeed legal advisers, and involve expert review.

- For Scheme Pays, there is no mention in the Impact Assessment of the ongoing impact on other processes: calculations for these individuals (benefit statements, retirement calculations, divorce assessments etc), will be more complex because of the Scheme Pays adjustment and likely to involved manual intervention and senior peer review.

HMRC Costs

The Impact Assessment notes that there will be £3m pa cost of set up and enforcement for HMRC, compared to the estimated total for other stakeholders of £700m over five years. Using A-day as a template, we expect this to be an underestimate (and we are not sure of the provision made for matters such as changing legislation impacted outside tax law, such as DWP and PPF legislation).

But overall, as for A-day tax changes, by far the largest part of the cost of implementation and effectively of self-policing will fall on employers, schemes, members and the pensions industry.

Long term impact

Turning to the Competition Assessment in Paragraph 78, this does not address the impact that this change will have on the provision of pensions versus other financial saving products. The restriction of tax relief and the complexities will make pensions less attractive for the same individuals who, almost by definition, will be the same people who decide whether companies provide pension benefits for their employees.