

APPENDIX B

**Pension Tax Relief
Room 2/E2
HM Treasury
1 Horse Guards Road
LONDON
SW1A 2HQ**

Your Ref:
Our Ref: KQ/SMW
Doc Ref: 87
Ask for: Susan Williams
Date: 26th August 2010

Dear Sir

Restriction of Pensions Tax Relief – HM Treasury's discussion document

I set out below my personal comments in response to the consultation document.

The Government's policy is to encourage saving for retirement. It is vital that the current decisions and consultations regarding various aspects of pension provision are considered in the round and the likely impact such changes will have on the long term scale of pension provision. Is there likely to be less saving and if so what will be the long term knock on consequences, both financial and for society generally? My concern is that the various measures being considered will undermine confidence in pension saving to the long term detriment of all.

Moving on more specifically to the discussion document, as we all know, tax relief is given to encourage people to lock savings away throughout their working lives, with these savings to produce pensions that help them maintain their standard of living in retirement. In addition, pensions reduce the need for means tested benefits. Pensions are taxable and thus to a great extent tax is not avoided whilst working but rather deferred, with the lump sum providing the tax free sweetener at retirement.

The terms of reference for the Hutton Commission on public sector pensions include a reference to protecting accrued rights. This is only right – it would be invidious to collect contributions from someone for decades on one basis, only to change that basis at a later date to the person's disadvantage. One also sees this no-change principle applying elsewhere. Tax-free bonds sold by National Savings, for example, are not converted to taxable bonds part way through the period of investment. In the same way, pension benefits accrued under one HMRC regime must not be disadvantaged if that regime is replaced. Rather, the new regime should only apply to benefits accrued after the commencement of the new regime.

The discussion document however proposes the opposite; the impact will be that people are taxed where hitherto they would have been well within current allowances. In addition those within defined benefit schemes will be more adversely affected than those in defined contribution schemes, and those in final salary schemes will be the most adversely affected.

To illustrate this point I use the following example. The document suggests a valuation factor of 15 – 20, with me having used a factor of 18 for illustrative purposes. For the sake of simplicity, I am assuming a final salary scheme with a rate of accrual of 1/60th.

In March 2012 Mr Smith has 29 years membership. His pay is £40,000 pa. His benefits are therefore valued at:

$$29 \times 40,000 \div 60 \times 18 = \text{£}348,000.$$

In April 2012 Mr Smith is promoted and his pay increases to £45,000 pa. In March 2013 his benefits are therefore valued at:

$$30 \times 45,000 \div 60 \times 18 = \text{£}405,000$$

Deducting £348,000 from £405,000 gives £57,000 and thus we can see that Mr Smith, following a fairly unexceptional promotion, will exceed the suggested annual allowance (the AA) of £30,000 to £45,000.

The document also suggests that people who exceed the AA should be taxed at their marginal rate. If the AA is set at £45,000 Mr Smith would have a tax bill of £4,800 (£57,000 - £45,000 x 40%). If it is set at £30,000 he would have a tax bill of £10,800 (£57,000 - £30,000 x 40%).

However, out of a £5,000 pa pay rise Mr Smith will only see £3,000 net (ignoring other stoppages) and thus, if the AA is set at £30,000, Mr Smith would have to work for over three years in his new job before he showed any net gain.

Consequently what would effectively be double, and retrospective taxation, is bound to have an effect on the number of people prepared to apply for promotion, and to discourage pension saving. Such examples are also likely to have an adverse effect on scheme membership. It's also worth noting that the factors that determine the scale of gain are the pay increase and the duration of service. The longer serving employee that has saved for their retirement is far more likely to be caught by these provisions than someone with little pensionable service. To me this seems ludicrous, and discriminatory against older people who will be the ones with more membership. Solutions therefore need to be examined that reduce the impact of long service.

The document raises options for helping with the payment of a tax bill following the AA being breached, including phased payments. These will hardly be attractive. Another suggestion is that the pension scheme could "...pay the charge and reduce the individual's pension benefits correspondingly" and keep on doing this possibly (at substantial administrative cost) for employees that see further promotions, thereby further eroding accrued benefits.

You will also know that a good tax is one that is easy to calculate and easy to collect. What the document suggests will be neither, as all HMRC approved schemes will have to be taken into account. Consequently what will often be the case won't be what I describe with Mr Smith, but rather a Mr Smith that is an employee member of one scheme, who also pays AVCs, and has deferred benefits with one or more

previous employers. It will therefore be very hard for the HMRC to spot when someone exceeds the AA, and by how much.

Paragraph 1.6 of the document states that "Fairness between defined benefit (DB) and defined contribution (DC) schemes is an important contribution". I agree that this should be the case. With a DB scheme a member has accrued membership, and is accruing more in the current year. With a DC scheme a member has an accrued fund, and is adding to that in the current year. I note however that for the DC member, only contributions in the year are intended to be taken into account for the AA (para 2.8). But with a DB scheme, the membership accrued in the year is to be taken into account *plus all previous membership*. DB members will therefore be greatly disadvantaged, if what is suggested comes to pass.

In summary therefore I believe that the proposals and questions being raised in the document need a radical rethink. In particular the prospect of double and retrospective taxation is fundamentally wrong.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Kieran Quinn', written in a cursive style.

Councillor Kieran Quinn
Executive Leader of the Council