TAXREP 31/99

STAKEHOLDER PENSIONS

Memorandum submitted in November 1999 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales to the Inland Revenue in response to consultation brief No.6 issued in September 1999.

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STAKEHOLDER PENSIONS

1 We refer to the Consultation Brief 6 issued on 16 September 1999 and welcome the opportunity to comment.

A GENERAL COMMENT

2 Whilst conceptually we agree with the proposal to have a single set of rules for all direct contribution pension schemes, we are concerned about the proposed abolition of the current carry forward rules. Although we understand the reasons as to why the Government has suggested this, we do not think that the right to continue making contributions for five years after an employment/self employment ceases is an adequate trade off for the loss of this valuable relief.

B DETAILED COMMENTS

Paragraph 4.3

3 Although we agree that in principle it would be sensible to allow people to pay into a stakeholder pension as well as a defined occupational pension, we do not think that it is really practical. The rules for the two are very different, and we do not think it will be straightforward to set up a fair system to enable someone to contribute to both. In any event, we are not convinced that this is necessary. A member of a defined benefit scheme can already make Additional Voluntary Contributions (‘AVCs’) to a separate scheme. As AVCs are usually money purchase schemes, what is probably needed is to ensure that pension providers set up AVC schemes on the same low cost basis as the Government proposes for stakeholder pensions, thus achieving a similar objective but by way of a slightly different route.

Paragraph 5

4 The second bullet point states (at the top of page 6) that the new system will cater for the “recently divorced who may have a lump sum to put into a pension”. We would be surprised if a contribution limit of £3,600 would enable a lump sum to be used effectively to achieve a financially worthwhile pension. If the Government really wished to enable such a lump sum to be invested into a pension, then they should allow a carry forward of the £3,600 limit for, say, six years, so that a person who receives a lump sum can invest sufficient into a stakeholder pension to provide for a realistic pension entitlement.

5 The suggestion that the £3,600 limit should not be tied to earnings is conceptually an attractive idea. The document recognises that some people may have savings and savings income, but it is highly unlikely that carers, unemployed or recently divorced people will have £3,600 a year of savings income. It is more likely that they may be in the receipt of a lump sum, either on say a divorce, or a legacy or other exceptional payment, which they would be prepared to put into a pension if this could be done on a one-off basis. However, a limit of £3,600 in any one year is far too low for this to provide them with a sensible and realistic option.

Paragraph 13.2

6 Although the suggestion that trustees of an existing money purchase scheme could be given the choice to opt into the new regime appears attractive, we are not convinced that in practice this will be the case.

7 The proposal will put a burden on the trustees to make a decision affecting all of the employees in the scheme, in circumstances where the future effect of that decision cannot be readily foreseen. Rightly or wrongly, the trustees may be exposed to potential claims from members who may feel that their interests were prejudiced. A member of a money purchase occupational scheme already has the ability to opt out of the scheme and take a transfer payment into a personal pension scheme. It would be preferable to encourage transfers into a stakeholder pension on an individual basis.

8 If the trustees' option route is adopted, the only way we can see to deal with the funding question within the existing scheme is to work out for each employee what aggregate contributions could have been made to a personal pension fund (or for years before the introduction of such schemes to a retirement annuity) and what those funds would have built up to (using a standard yield figure), and requiring any excess of the fund attributable to that individual employee over such figure to be repaid to the employer. If the trustees wished to opt into the new regime, they would be in a very difficult position if this reduced the fund available to meet the pension for any individual employee.

Paragraph 14.2

9 We are not convinced that the proposed abolition of the carry back of contributions paid after the earnings cease is fair. Currently, a contribution paid in the two years following a cessation of the earnings can be set against the earnings for the last year in which such income arose. Whilst in theory it appears more attractive to allow a person whose earnings have ceased to continue to make contributions at the previous level for up to five years, it appears to be based upon the assumption that the person will have other taxable income against which the relief can be given.

10 In many cases, this is an incorrect assumption. We accept that the provision for deduction of basic rate tax at source means that, even if a person has no other income, basic rate relief will be obtained for the continuing payments, with the result that the real loss is only at the higher rate tax relief. However, that can make a significant difference, particularly where a person has to choose between using whatever money is available to him to maintain his standard of living or to make pension contributions.

Paragraph 15.3

11 Similarly, the carry forward rules were designed to cover two important situations. The first is where the income cannot be ascertained during the tax year in which it arises. In practice this does not apply to salaried employment, but is very important in relation to the self employed where the taxable income for a year cannot be ascertained until after the close of the taxpayer's financial year when the accounts are prepared. This may not matter unduly where a trader adopts a 30 April accounting date as he will have 11 months left in the tax year in which to ascertain such profits and make the appropriate contribution. However a person who acceded to the encouragement by the Inland Revenue to adopt a 31 March year-end will be in a very difficult position, particularly where profits fluctuate significantly.

12 The second is where a person is building up a business. In practical terms all available income often needs to be ploughed back into the business, so such people often defer starting contributions until the business can afford to suffer the adverse cash flow effect of the pension payments. With no ability to carry forward unpensioned income such persons will be unable to catch up on contributions for the early years in business.

Paragraph 16.2

13 It is financially important for a person to have life assurance cover where he has a defined contribution pension scheme and the fund has not yet been able to build up significantly. In this case, the life assurance cover provides a fund to pay the widow's pension benefit. However, it is questionable whether it is fair that tax relief should continue to be given for life assurance contributions paid through a pension scheme but not to payments made for life assurance cover paid outside a pension scheme. It may be that life assurance cover should be limited to the amount that is needed to replace the projected pension fund at retirement age in the event of the employee dying prematurely.

Paragraph 17

14 We do not agree with the proposal that new defined contribution schemes should not be able to be set up unless they adopt a standard set of rules produced by the Revenue. We are surprised that comments are specifically invited on whether this is a good idea, particularly if it is thought that the proposal will limit innovation in any way. It is self evident that this proposal must stifle innovation.

Paragraph 18.6

15 We agree that there does not appear to be a significant need to extend stakeholder pensions to people contributing to an occupational defined pension scheme.

Paragraph 19.1

16 We do not think it should be a function of the tax regime to assist providers in allowing transfers to other schemes without charge. This is something that providers should build into their management costs. The pension provider already receives tax relief income for bona fide business expenses, and we presume that transfer costs will be allowable as such an expense.

Paragraph 20.1

17 Whilst we agree that a contributor to a pension scheme should have to be either UK resident or in receipt of UK taxable earnings, we are concerned about the additional requirement that he should also be ordinarily resident in the UK. Ordinary residence is a very imprecise concept, which does not provide the high degree of certainty which will be necessary if stakeholder pensions are to be an attractive option. It is not an easy test to apply and we suspect that it will be virtually impossible for a pension provider to check whether a person is ordinarily resident in the UK.

Paragraph 20.2

18 We do not see why the UK taxpayer should give basic rate income tax relief to a person who is not resident in the UK and has no UK earnings. Such people are likely to be able to establish tax advantaged pension scheme outside the UK, and we do not think it is right that UK resident taxpayer should subsidise non-resident's UK pensions. A non-resident should be able to obtain tax relief for pension contributions only to the extent that he has UK taxable income.

19 If you have any questions on the above, please let me know. We would be happy to discuss any aspects in a meeting, if that would be helpful.

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