



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS
IN ENGLAND AND WALES

Our ref: ICAEW Rep 14508

Your ref:

James Elder

By email: james.elder@dwpgsi.gov.uk

Dear Mr Elder

PENSIONS REFORM: PERSONAL ACCOUNTS: EMPLOYER OBLIGATIONS

The Institute of Chartered Accountants in England and Wales (the Institute) is pleased to submit comments outlining our views on employer obligations arising under the new personal accounts regime.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

Daniel Quint
Finance Director
ICAEW
T +44 (0)1908 248231
F +44 (0)1908 248064
E Daniel.quint@icaew.com



**THE INSTITUTE
OF CHARTERED
ACCOUNTANTS**
IN ENGLAND AND WALES

ICAEW Representation

ICAEW REP 145/08

**PENSIONS REFORM: PERSONAL ACCOUNTS: COMPULSORY EMPLOYEE
PENSIONS**

EMPLOYER OBLIGATIONS

**Memorandum submitted in December 2008 to the Personal
Accounts Delivery Authority by the Institute of Chartered
Accountants in England and Wales.**

Contents	Paragraph
Introduction	1 - 4
Key point summary	6 - 7
Who we are	8 - 9
Detailed comments	10 - 43
The ICAEW Tax Faculty's Ten Tenets for a Better Tax System	Annex

INTRODUCTION

1. The Pensions Act introduces from 2012 compulsory pension contributions for all employees and their employers where the employee is aged 22 or over and has sufficient 'qualifying earnings', broadly, specified earnings falling within a band similar to that used for NIC. The contributions may be paid to existing 'qualifying' occupational or contract-based schemes or if the employer so chooses or has no scheme, to a 'personal account' in a trust-based arrangement currently being set up by the Personal Accounts Delivery Authority ('PADA'). The new trust will be administering a Personal Account for each member. For the purposes of this paper, the new arrangements are referred to as the personal account ('PA') regime.
2. The new personal account regime is intended to encourage pension saving by those who are not currently members of adequate private pension schemes by offering them some of their employers' money plus an amount equivalent to basic rate tax relief in return for a payment into a pension account. The number of participants is uncertain, though there are predictions of four to seven million.
3. Whilst employees are to be auto-enrolled, an opt-out will be available – but it is clear that several millions of employees in the SME sector are the prime target sector. Most large employers (the top 10% of employers have over 80% of the workforce) will have pension schemes of various kinds already, so auto-enrolment should only affect them to the extent that they already have employees who have opted not to join an existing pension scheme, except for some special cases, such as cross-border employees. However, employers with pre-existing pension schemes will have to ensure that their pension schemes are as good as the personal account regime, which in some cases may involve increases in contributions.
4. This paper sets out our main concerns and issues as to the obligations that employers will face on which we would welcome clarification. ICAEW Tax Faculty benchmarks tax measures by using its Ten Tenets for a Better Tax System, which are summarised in the Annex. We consider that these tenets are equally applicable to the new PA regime.
5. This paper does not include points relating to quality equivalence between employers' own retirement benefit schemes and the personal accounts regime on which ICAEW in conjunction with other representative bodies have made submissions and met with Ministers to achieve a practical outcome.

KEY POINT SUMMARY

6. We are very concerned that the PA regime proposals will place a considerable initial and ongoing administrative burden on employers. This seems to conflict with the Government's stated desire to reduce regulatory compliance costs for businesses. The additional work for employers, and the associated costs of compliance, will be disproportionately high for certain employer groups, particularly those with a small workforce or with manual payroll systems or those in industries which have high workforce turnover or with staff earning around the band limits.
7. Our main concerns about the personal account regime are that:
 - Pension contributions will be based on new definitions of both earnings and bandings. The definitions of earnings and the bandings are different from taxable and NICable earnings and from pensionable earnings as generally

defined in scheme documents. This introduces further complexity to payroll procedures.

- The definition of a qualifying scheme is such that many existing employer pension schemes may not qualify without changes to the scheme rules, which would involve significant legal and other costs. Employers may therefore choose to close existing schemes to the detriment of their employees, who may see their pension provision reduce as a result. Where employers do not change the rules, they will need to monitor payments to existing schemes to ensure that the scheme remains qualifying. We have been working with government in conjunction with other representative bodies to devise a more flexible way of defining 'qualifying' schemes and with a view to minimising administration and payroll compliance costs.
- The principle of compulsory pension saving which underlies this legislation should not impose unreasonable processing burdens on business. However, the requirement and processes for auto-enrolment and auto re-enrolment with the option for the employee to opt out after contributions have been deducted and paid over, together with identifying underpayments and paying refunds, will result in considerable additional on-going work for employers.
- There are numerous practical issues which need addressing including employee identifiers, treatment of foreign employees and expatriates, various timing issues, management of employee queries, amending errors and employer and employee support.
- The detail is being left to regulations which will not have the same parliamentary scrutiny and public consideration as primary legislation, with consequent risk that the burdens on business of complying with the new regime may not be fully appreciated and therefore not be taken into account when the detailed rules setting out employers' obligations are decided upon.

WHO WE ARE

8. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world-leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.
9. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures that these skills are constantly developed, recognised and valued.

DETAILED COMMENTS

Definition of earnings

10. If employers are to deduct the right amounts without undue difficulty, then the definition of earnings for the personal account regime should be exactly the same as the NI definition. Pensionable income has not traditionally included any share option gains or termination payments, nor in many cases even certain cash earnings in the form of overtime and bonuses, but for simplicity of liability and collection it must be sensible for the NI definition to be used. Given that for personal account regime purposes the upper limit of the earnings band is a figure in the same order as the NI upper earnings limit, major share option gains are unlikely to be relevant, and small gains from SAYE options are in nearly all cases going to accrue to employees in existing pension schemes.
11. Many of the issues that arise for NIC, solutions for which have been legislated in the NIC legislation (eg the Social Security Contributions Regulations 2001), will need to be addressed for personal account pensions and legislated for if necessary. As the Pensions Act includes earnings bands of similar size to the NI earnings bands, we recommend that, in framing the PA contributions regulations, regard be had to inter alia the following:
- ☞ Earnings periods, and with that:
 - directors (who can manipulate payment schedules),
 - holiday pay,
 - employed deep sea fishermen with odd, long periods,
 - fluctuating earnings that might hover around the lower limit of the earnings band and occasionally even exceed the upper limit of the earnings band,
 - earnings paid all in one go, eg where agency workers submit timesheets all in one batch;
 - ☞ Multiple employments, and with that:
 - aggregation,
 - deferment,
 - refunds,
 - annual maximum;
 - ☞ Contributions in respect of SSP, SMP, SAP, SPP, occupational sick pay, PHI benefits;
 - ☞ Deemed earnings such as employment protection payments, share option gains, vouchers;
 - ☞ Exclusions from earnings because employers cannot handle them reasonably, such as tips and gratuities, payments in kind, expenses, childcare vouchers, contributions to unregistered pension schemes (such as overseas schemes, some of which are acceptable for NIC), redundancy and termination payments;
 - ☞ Exclusions from earnings for policy reasons, such as training costs, workplace car parking, bursaries, relocation expenses, qualifying motor expenses, overseas medical costs, benefits from approved employee share incentives, incidental overnight expenses, stolen card rewards from third parties, etc;
 - ☞ Catch-up payments where errors have occurred;
 - ☞ Self-employed earnings recategorised retrospectively as employment earnings (is the 'employer' to carry the liability for both employer and employee contributions arrears, as is the case with NI?);
 - ☞ Earnings created by retrospective anti-avoidance legislation; and
 - ☞ Earnings given up by way of salary sacrifice.

Earnings bands

12. The earnings bands are similar to but different from the NIC bands. This divergence will make it harder for employers with manual payroll systems – mainly smaller employers – to comply.
13. Presumably the annual lower limit for contributions is to prevent trivial amounts having to be collected, paid over to PADA and invested and trivial pensions being paid. The Act cites annual earnings bands but if NIC rules are followed for personal pensions, we have the immediate problem of NIC being non-cumulative for most employees. What is to happen in practice? Will the annual exemption be converted into a monthly exemption of, say, one twelfth of the annual contributions (or one thirteenth of annual contributions for those paid four weekly or on fifty-second of annual contributions for the weekly paid) with contributions being paid on the balance up to the upper limit or could the annual upper limit contribution for the year be paid in the first pay period of the year if the earnings are high enough? What happens if an employee on relatively low earnings leaves before earning the equivalent of the annual lower limit? Are his contributions refunded? What happens if an employee joins late in a year and his earnings do not reach the annual lower limit?
14. Is the upper limit an overall maximum for the employee over all his jobs or is it per job? If it is an overall maximum over all jobs then what happens with an employee who has two jobs and in each he earns, say, £25,000 a year? He does not opt out in either employment because he wants to maximise his pension benefit. If there is an annual overall maximum contribution payable as for NIC then at the end of the year then the employee and his employers will have overpaid contributions. It is easy to see what should be refunded to the employee but what about the employer? Who gets what back? Is there a pro rata calculation?
15. If the upper limit is an overall limit for the employee spread over all his employments, then presumably there will be some kind of deferment arrangement. For NIC purposes only the employee share of the standard contribution is deferred. That will not work for pension contributions. What happens if the employee loses the job in which he expected to pay the contributions, or his earnings are not as great as expected? What mechanism will be in place to collect contributions from some other employer on a retrospective basis?

Employee unique identifier

16. The logical unique identifier is the national insurance number ('NINO'), and if this is to be the employee identifier, then HMRC must dedicate resource well in advance of PA implementation to cleansing their database and afterwards to maintaining reliable data. PADA should be required to cross-check its NINO identifiers with HMRC's database annually and to correct errors before they become lost in old records.
17. However, we accept that the NI number system has its problems. Many people from abroad (see next section) never apply for a National Insurance number. The year end return is submitted with the NINO field blank and that return adds to the pile of non-matching items at Newcastle. That pile is now over 100 million items although it does go back to 1948. It is growing at over 1 million a year.

Employee unique identifier – foreign workers

18. Newly hired employees from EEA countries will have no NINO when they arrive, and a worker who has an EEA passport is entitled to start work without a NINO. The

current system of obtaining NINOs involves some delay. How is an employer to auto-enrol an employee without the unique identifier at the point he goes onto payroll and who may have moved on before it arrives?

19. NI numbers should only be issued where there is an NIC liability. Many individuals from abroad will not have such a liability and to issue numbers in such instances is likely to require a change in the law. The alternative suggestion is to use a number constructed from the date of birth. These numbers are no longer acceptable for NIC purposes and to bring them back into play would be a backward step.
20. The obvious answer is that employees from abroad should opt out. However, some may see the arrangements as a good deal and would not want to opt out. Employers who try to persuade employees not to participate run the risk of suffering hefty penalties.

Foreign workers in the UK and UK workers abroad

21. What is to happen where a worker has no NINO because he has no UK NI liability (eg seconded EEA workers with a long E101 under Article 17)? Are they to be exempted from contributions and PA membership? As this is a government-mandated scheme, how does it sit with the European Treaty and freedom of movement of labour, whether they are included or excluded by the basic rules? Will it be treated as a voluntary scheme? Which pensions directives will apply?
22. Employees from abroad who come from a non-agreement country are normally exempt from paying NI contributions for the first 52 weeks in the UK. This is intended to prevent trivial amounts of NI contributions being collected. Will the same apply to the new pension arrangements? Employers with employees in such circumstances know that NI numbers are not needed. If there is to be no exemption for PA regime contributions then there will be extra work for employers and DWP.
23. What happens to workers sent from the UK overseas? They might or not be in UK NI, depending on where they are and how long they are away: should that affect their PA membership? What if they are concurrently required to contribute to a host country social security pension that is potentially good enough to match the UK PA pension? How does the foreign element sit with personal account regime auto-enrolment?

EU social security law

24. Will these contributions be regarded as a social security contribution for EU purposes? Provision of full pension benefits is a feature of many EU social security systems so we suspect the answer is likely to be 'yes'. On that basis the UK would need to take account of exemptions via the E101 procedures.
25. If the UK view is that these contributions are not part of the social security system then a challenge to the European Court is more than likely. There was a similar situation a few years back when the French authorities tried to collect CSG and CRDS contributions from employees holding E101 certificates. They lost and were forced to return the contributions wrongly collected.
26. What do the various bilateral social security agreements say about such contributions? The UK could easily have to confront arguments similar to those likely to arise in the EU.

27. UK employees going to non-agreement countries are generally exempt from local pension arrangements. If the UK imposes liabilities in the UK then we can expect some retaliation.

Opting out – refunds

28. If there is to be a three-month window to opt out there will be a number of cases where an employee decides to opt out during the opt out period and where contributions have been deducted by the employer.
29. If the employer has to account to PADA for the contributions on an earnings period basis, what happens where there is a single employee and he opts out at the end of the three months? The employer will not have any contributions in hand to make the refund. Does the employer have to apply for funds from the appropriate government department as he does now for SMP or SSP? Will a formal refund have to be claimed from a central point?
30. In some cases the three month period may cross the tax year end. What will be the mechanism for refunds in such cases?
31. Similarly, how will employee refunds be dealt with where the employee has left?
32. We would welcome confirmation that employers will receive refunds of the employer contributions paid over to PADA when an employee opts out.
33. If instead of accounting to PADA for the contributions during the three month opt out period employers hold the contributions until the three month period is up, then this would cause a loss in investment return.

Opting out – the decision

34. Once the PA scheme beds down, everyone will know broadly what it is and what it means, assuming the government gets its publicity right. Everyone should then be in a position to make a very quick decision on whether or not to force their employer to pay them 3% more as a pension contribution in exchange for giving up 4% of band earnings as an employee contribution. We consider that it is not really a difficult decision, so 30 days ought to be plenty for the opt-out period, and most people will be likely to be able to decide when they sign their employment contract.

Opting in – and out: options for employers and employees

35. We consider that, for administrative simplicity, opting in dates should be restricted to when an employee reaches age 22, when someone starts a new employment and every three years starting from the start date of the personal accounts regime, ie 6 April 2012.

Contributions near retirement age / payment of benefits

36. How will the new personal account regime cope with the timing of benefit entitlement? What happens for basic retirement pension and state second pension ('S2P') is that any NI contributions paid between 6 April and the contributor's 65th birthday (ie when he is entitled to receive a pension) are ignored for contributory benefits purposes, for the simple practical reason that the DWP knows nothing about them until well after the person has reached state pension age and his pension has come into payment. There will need to be some similar mechanism for the new

mass money-purchase PA regime, because if employers' contributions and returns of contributions are not with the PADA by retirement age, how will PADA know how much pension to pay? (In employers' salary-related schemes this is not an issue).

Special cases

Mariners

37. We note that mariners are specifically included as workers. The typical mariner arrangement is that the employer or payer of wages is offshore and if there is an NIC liability it falls to the employee only and he pays this direct to HMRC. How will the new pension arrangements operate in such circumstances? This question goes much wider than mariners. There will be many instances where only an employee NIC liability arises – the employer is outside the UK and the employment arrangements are such that the host employer rules does not come into play.

Deemed employees

38. Has any thought been given to individuals who are usually self employed but are treated as employees for NIC purposes? The bigger groups in this category are entertainers and teachers and lecturers.

Personal company employees

39. Are measures going to be taken to include individuals who have their own service companies and whose earnings fall between the NIC lower earnings limit (LEL) and the earnings threshold with the rest of the income taken in dividends?

Tax relief for employees

40. Will contributions be eligible for tax relief at (i) basic rate and (ii) higher rate? We understand that the quantum of the 1% government contribution is intended to replicate basic rate tax relief, but are the employee's contributions actually deductible for tax purposes in the payroll or is the treatment the same as for NI, where employee pension contributions are not deductible? If they are deductible for tax, how will the information be provided to HMRC so that higher rate relief can be given? Also, if contributions are tax deductible, then refunds will need to be charged to tax. Will refunds be sent to employers to pass on via payroll or direct to employees, and what happens if the employee has left? How will the tax charge (if applicable) on the refunded contribution be collected?

Employer end-of-year information requirements

41. Employer end-of-year information obligations to employees and government departments should fit in with existing procedures. Thus, such information should be included on end-of-year forms P14/P60. Forms P60 are given to employees and forms P14 are sent with end-of-year declarations P35 to HMRC who we suggest, should pass the information (or a copy of the form P14 if filed on paper) to PADA, who can check that they have received from employers all the sums shown on the P14s as having been deducted from payrolls.

Communicating the PA regime to employees

42. If information available to employees can only be obtained by downloading from a website then this will result in many being excluded from access to it. There are

millions of computer illiterates in the workforce. Employees should be able to obtain information from paper leaflets that do not have to be downloaded from a website and be able to telephone a freephone helpline for advice and to ask for leaflets to be posted to them. Similarly comments apply to the provision of information to employers.

43. Rather than employers having to provide employees with 'starter packs' or similar, employers should simply have to notify an employee's personal details to PADA and leave the rest of the communication to PADA who should then send the appropriate information direct to the employee. If an employee currently wants details of his state pension entitlements, he asks HMRC or DWP, not his employer. There is no obvious reason why the personal account regime should be different.

PCB
12.12.08

THE ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99; see <http://www.icaew.co.uk/index.cfm?route=128518>.

Email: peter.bickley@icaew.com

© The Institute of Chartered Accountants in England and Wales 2008

All rights reserved.

This document may be reproduced without specific permission, in whole or part, free of charge and in any format or medium, subject to the conditions that:

- it is reproduced accurately and not used in a misleading context;
- the source of the extract or document, and the copyright of The Institute of Chartered Accountants in England and Wales, is acknowledged; and
- the title of the document and the reference number (ICAEWRep145/08) are quoted.

Where third-party copyright material has been identified application for permission must be made to the copyright holder.

www.icaew.com