TAXREP 32/11

ICAEW TAX REPRESENTATION

FINANCE BILL 2011

CLAUSE 65 AND SCHEDULE 16: BENEFITS UNDER PENSION SCHEMES

Parliamentary briefing submitted at Public Bill Committee stage in May 2011 by ICAEW Tax Faculty setting out concerns with these provisions

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CLAUSE 65 AND SCHEDULE 16: BENEFITS UNDER PENSION SCHEMES

Pensions annuitisation: unsecured and alternatively secured pension to be replaced by drawdown pension

Introduction

1. We have two concerns with these provisions on which we elaborate below.

2. The first is that certain annuities which are payable for life, such as non-surrenderable partnership annuities, will not rank towards the minimum income requirement.

3. The second is that transfers to another pension provider by someone who is in drawdown and would otherwise not have a review until 5 years has passed will result in the earlier ending of the review period and hence an earlier reduction in the maximum amount of income drawdown from 120% to 100% of GAD rates.

Minimum income requirement: partnership retirement annuities and other non-surrenderable annuities

Schedule 16, Part 1: Changes to benefits available under pension schemes etc

Paragraph 10: Flexible drawdown: minimum income requirement etc

4. Paragraph 10 inserts a new paragraph 14A into Schedule 28 FA 2004 defining the minimum income requirement.

5. We are concerned that partnership annuities such as those covered in paragraph 8 of Statement of Practice D12 are not covered within the categories cited in new para 14A(3) of Sch 28 FA 2004, even where the annuity is payable for life.

6. We recognise Government's wish to ensure that those who draw down their pension pots do not subsequently become a burden on the state, but we think that:
   - o those who have partnership retirement annuities of amounts that would, if they were relevant income as defined, enable them to meet the minimum income requirements are unlikely to have any need to fall back on state assistance, and
   - o where the payments represent payments in reasonable recognition of the past contribution of work and effort by the former partner, that former partner is unlikely of his or her own volition to forego these.

7. Similarly, where a life annuity is purchased in a non-surrenderable policy then the contractual terms mean that the duration and amount of payment cannot be changed. This means that it will be a guaranteed, life-long, income.

8. It may be that purchased life annuities are not treated as qualifying for the minimum income requirement because they operate under a tax regime different from that governing annuities purchased using pension fund monies. However, given that purchased life annuities in a non-surrenderable policy are payable for life and cannot be changed, we see no reason for excluding them.

Recommendation

9. We consider that an additional category should be inserted into new para 14A(3) to cover:

- annuities paid in reasonable recognition of the past contribution of work and effort by a former partner; and

- non-surrenderable purchased life annuities.

Drawdown pension year and basis amount for drawdown pension year: loss of transitional relief on a transfer between pension providers

Schedule 16, Part 3: Commencement and transitional provision

Paragraph 90: Previous limit on amount of pension payable in year to apply for limited period

10. Paragraph 90 provides that for a transitional period the previous Government Actuaries' Department (GAD) rate of 120% applies in place of the new rate of 100%.

11. We are concerned that the provisions of paragraph 90(3)(b) will prejudice a member of a pension scheme in drawdown who was before 6 April 2011 receiving income of between 100% and 120% of the GAD limit and effects a transfer to another pension provider after 5 April 2011. This will trigger a new reference period which means that the drawdown income from the new provider will be limited to 100% of GAD, whereas if that person had remained with the original pension provider the current reference period would continue for the original five year term.

12. This effectively amounts to a penalty for transferring to a new pension provider from an existing provider. This is unfair, particularly as prior to 6 April 2011 a transfer to a new provider did not trigger any requirement for a new reference period. We should welcome clarification as to why the draft legislation should impose this change which penalizes individuals who move their pension pot from one provider to another.

13. In addition to the unfairness, it introduces uncertainty which will create an administrative burden. This is because it can be very difficult to determine in practice the precise date of the transfer of a pension arrangement from one provider to another. Some providers regard the effective date as the date they receive confirmation of the current level of benefits. Others do not regard the transfer as complete until all the investments of the fund have been transferred into their name, which, particularly if there are any foreign investments, can take months.

14. The exact date of the completion of the transfer of a client's pension arrangement has never been critical before; but under the Finance Bill legislation it now is. It will have been very difficult, if not impossible, for pension administrators prior to 6 April 2011 to cope with transfers that were in progress, as it would not be possible for anyone to know whether they would be completed before 6 April. If they were not, and the level of pension is critical to the client, then the process will somehow have to be unravelled, which may not be possible if some of the pension fund assets had already been reregistered in the name of the new scheme provider.

Recommendation

15. We therefore recommend that paragraph 4(b) should:

- be framed by reference to when the transfer process is started (which in practical terms will simply be when the client first instructs the pension provider to transfer his pension scheme); and
- include an exception for those already in drawdown who transfer to another pension provider where the transfer process had been started on the date that the legislation came into force, i.e. 6 April 2011, to enable drawdown to continue for the remaining

part of the five years at the same rate with the new pensions provider as under the previous provider.

Further contact

16. For any further enquiries please contact:

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APPENDIX 1

ICAEW AND THE TAX FACULTY: WHO WE ARE

1. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

2. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

3. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including *TAXline*, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

4. We have set out in Appendix 2 the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

APPENDIX 2

THE 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.com/~/media/Files/Technical/Tax/Tax%20news/TaxGuides/taxguide-4-99-towards-a-better-tax-system.ashx).