THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

ICAEW TAX FACULTY REPRESENTATION

TAXREP 32/10

RESTRICTION OF PENSIONS TAX RELIEF

Comments submitted on 26 August 2010 by the Tax Faculty of the Institute of Chartered Accountants in England & Wales to HM Treasury in response to the consultation document issued on 27 July 2010 by HM Treasury and HM Revenue & Customs

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RESTRICTION OF PENSIONS TAX RELIEF

INTRODUCTION

1. In this document we present the response of the Tax Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW) to the above-named discussion document published by HM Treasury (HMT) and HM Revenue & Customs (HMRC) on 27 July 2010 at http://www.hm-treasury.gov.uk/consult_pensionsrelief.htm.

2. We are pleased to have the opportunity to respond to this consultation. We would be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

3. On 12 August we attended a meeting jointly with other professional bodies with HMT and HMRC, in which we were able to put forward some key comments and concerns and discuss aspects of the discussion document.

4. Information about the Tax Faculty and the ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals to change the tax system.

WHO WE ARE

5. 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 134,000 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 775,000 members worldwide.

6. 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 these skills are constantly developed, recognised and valued.

7. The Tax Faculty is the focus for tax within the Institute. It is responsible for technical tax submissions on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 11,000 members of the Institute who pay an additional subscription, and a free weekly newswire.

KEY POINT SUMMARY

8. We welcome the opportunity to contribute but it would have been better to have sufficient time meaningfully to consider such far-reaching proposals.

9. We note that the government's overriding objective is to reduce the fiscal deficit and that other key objectives of fairness, simplicity and long term sustainability will be taken into account within the constraints of the fiscal objective.

10. Pension saving is a long term process. Actions taken by investors commonly cannot easily be unwound in most cases. Changes to the law therefore need to be properly considered and last for the long term. Any change that adversely affects the amount of tax relief for current members of pension schemes is retrospective taxation, which not only discourages investment but is contrary to our Ten Tenets for a Better Tax System (Appendix 1).

11. Many of the general comments in our response TAXREP 13/10 (see http://www.icaew.com/index.cfm?route=170817) submitted in March 2010 to the consultation paper published in December 2009 on pensions tax relief continue to apply.

12. The compliance and necessary information obligations that the proposals in the discussion document (and those for the high income excess relief charge ('HIERC')) will involve are likely to make many more employers, at least in the private sector, consider closing their defined benefit ('DB') schemes to future contributions, even for current employees.

13. A lot more people will be affected than under HIERC and will therefore have the burden of considering whether they are affected. The annual allowance should not be reduced to such an extent that tax on excess contributions is commonly payable, because the inability to plan on the basis of expected tax relief will lead to a perception that saving into a pension scheme is too risky and many will not invest into pensions.

14. A flat non-age related factor based on non-indexed benefit figures would be preferable as a means of measuring defined benefit scheme contribution (in the absence of quantifying the contributions themselves) on the grounds of simplicity. However, this depends on the figures selected for the factor and for the reduced annual allowance ('AA'). If the chosen factor means that the charge affects too many basic rate taxpayers and those with income only just taxable at higher rates, a more complex formula might be needed. This would suggest that a more accurate calculation of DB contributions will be needed which may necessitate inflation linking pension benefits and using age-related factors.

15. If the annual allowance is reduced then we recommend a carry forward of unused AA for four years and a one year carry back for of excess contributions. This is because there will need to be relief for people like the self employed who are less able to afford to make contributions whilst they are building up their businesses and those with contributions 'spikes' whether employed and in a DB or DC scheme (eg on promotion) or self employed and in a defined contribution ('DC') scheme (who for example sell their businesses and can at that time afford to make pension provision).

16. In the first year 2011/12, we suggest that the AA be double the reduced figure; this will make up for the absence of a brought forward amount and as the calculation of contributions is likely to be a bit rough and ready, help to ease the transition.

17. We recommend that the lifetime allowance ('LTA') remain unchanged at £1.8 million, as already promised by the previous government and therefore as already taken into account by members of pension schemes when formulating their investment plans. Otherwise there will be a need for grandfathering.

18. The exemption from AA limitation which applies in the year that benefits come into payment from a pension fund should remain. Although unstated in the discussion document, we should also welcome confirmation that the exemption from AA in the year that the member dies will remain.

19. The enhanced protection relating to pension savings accrued up to 5 April 2006 should remain.

20. Prima facie, a charge to income tax on contributions in excess of the annual allowance will be simpler to understand and calculate than the HIERC rules.

21. The tax charge that is levied on contributions in excess of the AA needs to come within the definition of income tax for double tax treaty relief purposes.

22. Past service and deferred benefits should be ignored.

23. Death and serious ill heath should be exempt from the AA. We would support exemption for ill health and redundancy in certain circumstances. The special rules for disregarding pension sharing and transfers from one scheme to another should remain.

24. Pension schemes should be obliged to provide members with tax return information by 5 July after the tax year end. We acknowledge that this is likely to give rise to oppressive compliance burdens for DB pension schemes.

25. Pension input periods should be aligned to the tax year.

GENERAL COMMENTS

26. We welcome the opportunity to comment on the proposals in the discussion document. Given the long-term nature of pension planning and the need to regain the trust of savers (which has been lost owing to frequent changes in the rules and pension funds' poor returns and inflexibility), it would be better to provide sufficient time for considered thought to be given to how best to reconcile the need to rebalance the exchequer's books with the need to encourage saving for retirement by individuals and employers.

27. We welcome in principle the proposals to simplify the pensions tax relief introduced in Schedule 2 to Finance Act 2010. We have said in the past that these rules (and the anti-forestalling rules) are far too complicated and will give rise to excessive compliance costs and uncertainty and that a much simpler system is needed. We therefore favour refocussing the restriction by reference to an annual allowance limit.

28. We note the government's stipulation that any revised approach should not cost more than the FA 2010 regime. We do not have access to the economic details behind the costings so are not in a position to comment about the proposed level of the annual allowance (somewhere between £30,000 and £45,000) but we consider that, as regards the proposed annual allowance ('AA') limit being reasonable, middle earners in defined benefit ('DB') pension schemes are unlikely to agree when they realise that actuarial increases in benefits from such schemes are going to be factored into the equation which will take the gilt off the gingerbread of pay rises associated with promotion. We believe that if past service is taken into account and a flat rate factor is used then any limit on the AA should be set at the upper end of the scale proposed, ie £45-50k rather than £30k.

29. The exact amount will have to depend upon whether, for example, age, inflation, past service, etc, are to be taken into account alongside the number and size of exceptions, exemptions and reliefs. As it would be appropriate to use the same AA for all pension schemes, the question is probably first what would be a reasonable AA for DC schemes and then how can a preferably non-age related factor for converting DB benefits into contributions be combined with, preferably, non-indexed pension benefits to arrive at a deemed contributions figure.

30. We assume that the overarching policy objectives include managing public finances in the longer term, which we presume requires a policy that encourages middle Britain to save via pensions. This requires joined-up policy, and if reducing pensions relief to a lower end limit of £30k creates the likelihood and hence a perception amongst would-be savers that pensions saving whether via their employer's pension scheme or privately is likely to lead to unexpected and large tax charges then this will tend to drive middle earners away from pensions towards shorter-term but higher-risk savings alternatives, such as venture capital trusts.

31. We remain concerned that pension saving is a long-term investment and consider it essential that taxpayers have certainty and stability. Lifetime planning is difficult enough because often people have no idea of what their income is going to be. Forward planning for pension contributions covers not only the well-known problem of traders with March year ends but will be especially difficult for those in employers' schemes who do not know by how much benefits will rise (DB schemes). The changes made to the pensions tax rules post A-Day reduce the attractiveness of pension saving as the perception is that further changes and restrictions are likely to follow. It is important that whatever decision is made, it should be followed by a period of stability

32. We acknowledge the need for urgency and therefore the very short period of time for responses. Nevertheless, with the four-week consultation period including the holiday period, this leaves little time for us to consult more widely about the proposed changes. Our reply is therefore of necessity focussed on the key points and if we have any further points that arise we will let you know.

33. It would have been helpful if more examples had been given of the particular circumstances that might give rise to problems or opportunities for avoidance so that the possible policy solutions can be considered. The consultation document generally appears written in terms (including a surplus of acronyms) which may be familiar to pensions industry experts but will not be to the wider population of stakeholders. This consultation document is not easy reading and we believe that there is a much greater need to explain the issues and the consequences in terms that can be understood readily. People need easily accessible information on pension provision.

34. In the longer term we question whether the current approach to pension provision, the associated tax treatment and, indeed, pensions as a long-term investment are sustainable. With currently low investment returns and no dividend tax credit, further restrictions on pensions relief will aggravate a long-term problem.

35. The main incentives currently for people to save into a pension fund are the tax relief on contributions and the tax-free cash lump sum on retirement. Although this is alluded to in the consultation document published on 15 July: '*Removing the requirement to annuitise by age 75*', we should welcome confirmation that the tax free lump sum will survive unscathed.

DETAILED COMMENTS AND REPLIES TO SPECIFIC QUESTIONS

Chapter 2 Policy design

Redesigning the annual allowance

36. We agree that the proposition in para 2.5 for a 'tailored charge', ie taxing contributions (or in the case of DB schemes, deemed contributions) in excess of the AA as the top slice of someone's income would be easier than using the formulae for tapering etc that apply to the high income excess relief ('HIER') regime, especially if it similar to the capital gains tax calculation, ie does not affect tapering of personal allowances which would give rise to harsh marginal rates.

37. Any such charge that is levied on excess contributions needs to come within the definition of income tax for double tax relief purposes rather than be a stand-alone charge, that is to say, it needs to be creditable in an overseas tax return. This will be particularly important for individuals who by overseas jurisdictions, such as the USA, are charged to income tax on world-wide income.

1 There are currently exemptions from the AA test which would undermine the ability of a reduced AA to restrict pensions tax relief effectively. In implementing a reduced AA, the Government would remove the exemptions from the AA test in the year benefits come into payment, and the exemption for individuals claiming enhanced protection under the Finance Act 2004 tax regime. The Government welcomes views on any other changes that might be necessary to ensure the AA operates effectively and to address the risk of avoidance that could lead to further significant and potentially adverse changes to the regulatory regime (Paragraph 2.7)

38. We disagree with the proposal to remove the exemption from the AA test in the year benefits come into payment (s.229(3) FA 2004) and para 49 Sch 36 FA 2004 enhanced protection. Pension provision is for the long term and people have been planning their pension around existing rules, which include the ability to make contributions in excess of the AA in the year that a pension plan is vested. Such additional contributions may arise because an entrepreneur has sold his business and can now afford to make meaningful pension provision rather than have to reinvest the case into his business. Suddenly and retrospectively to remove this particular option is fundamentally unfair as it will have a detrimental impact on many prudent and responsible people.

39. We consider that the original policy reasons behind the AA exemption and the enhanced protection stand and therefore feel that they should be retained, and that the lifetime allowance ('LTA'), which should be kept at its present value, albeit promised by the previous government, should be the limiting factor for pension scheme(s) from which benefits are being taken in the tax year, as at present. In the year of taking benefits therefore the reduced AA would then apply only to any other pension schemes of which the individual was a member.

Valuing defined benefit contributions

40. We agree that contributions to defined contribution ('DC') schemes are most easily valued by simply adding together employees' and any employers' contributions. Given that some DB schemes are pay-as-you go and many funded schemes are having to be topped up by way of additional employer contributions that cannot easily be attributed to individual employees, we accept in principle the need for DB schemes to have a basis different from that for DC schemes for attributing contributions to employees, and that the answer is to impute contributions from benefits.

Method for valuing defined benefit contributions

2 By only taking the newly accrued amount of annual pension in a DB pension into account, the use of a flat factor potentially creates opportunities for DB pensions to be used to grant additional pension value without this counting towards the AA test. The Government therefore welcomes views on this issue and practical options for limiting it, including the option of requiring a CETV [cash equivalent transfer values] calculation, or the use of age-related factors ['ARFs'], in specific circumstances to capture the value of certain pension enhancements (Paragraph 2.11)

41. It would have been more helpful if specific examples had been given of the types of problems that are likely to occur and how defined benefit might be manipulated to try and get round the proposed rules and how difficult this might be in practice. Outside the public sector many defined benefit schemes have been closed in favour of defined contribution schemes and this trend looks set to continue given the inherent uncertainty and valuation problems faced by the former. Private sector employers are simply not in a position to offer new DB schemes to any significant extent.

42. In the interests of simplicity and keeping burdens to a minimum, a flat-rate non-indexed approach to valuation would make sense.

43. Para 2.12 suggests that government is considering a flat rate factor of between 15-20. This is presumably on the basis of a deferred pension calculated on the basis of past service. We understand that at age 60 the appropriate factor might be in the region of 20, whereas for younger people the appropriate factor would be less. We consider that if the outcome points to a flat rate factor of over 15 or so then in order to prevent distortions across different ages then age-related factors will be necessary.

44. Another point to take into account in determining whether the factor will be age related or flat rate is the extent to which the annual allowance is reduced, so that if it is low then again a more accurate calculation will be necessary which would point to adopting age-related factors.

45. If past service is excluded (see answer to the next question and Appendix 2), then the quantum of the factor to raise the same revenue will be different.

Past service

and

Other issues around the valuation of defined benefit contributions

3 The Government would welcome views on the treatment of deferred members, revaluation and negative accruals, with a flat-factor approach to valuing DB accruals, and evidence on the administrative burdens of the different options (Paragraph 2.16 Tax Faculty note – the question in paragraph 2.13 is slightly different to that posed in the summary of questions)

46. As regards past service, we consider that this should be excluded from the equation. This will reduce the amount of information needed to undertake the calculations and make them easier and impose less of a compliance burden on pension fund administrators, which will help achieve the government's wish for simplification. We recognise the argument that schemes might improve past benefits in order to avoid the AA limit but this would then increase the liabilities and few DB schemes wish to do this at present.

47. We accept that, in broad terms, if past service is excluded, then on the basis of a given percentage rise in pensionable pay across the board a higher factor is likely to be appropriate to raise the same revenue – see Appendix 2. Our calculations in Appendix 2 also suggest that for a given monetary rise in pensionable pay, stripping out past service biases the charges towards higher earners, which is consistent with increasing the tax burden on the higher paid.

48. We also consider that deferred members should be excluded, partly to obviate the need for pension administrators to have to undertake calculations for such members, and mainly because in most pension schemes, the rights of deferred pensioners increase only on the basis of indexation for inflation. If thought necessary, perhaps a long-stop rule could provide that deferred members are excluded unless increases in their accrued benefits are not linked solely to inflation.

Applying the annual allowance in particular circumstances

4 With an AA operating at a significantly lower level it is important to consider whether exemptions from the limit should be granted in particular circumstances, while managing risks of avoidance, including the cases of death, serious ill health, redundancy, ill health, transfers and divorce. The Government would welcome views from interested parties on these issues and any other specific circumstances under which there may be an argument for applying the AA in a particular way (Paragraph 2.17)

49. We agree that there should be an exemption where individuals die or for serious ill health (as suggested in paragraph 2.16). Pension schemes often increase pensions at this time based on potential service to protect families and bringing this within a reduced AA could badly affect even lower paid employees.

50. A low AA also hits disproportionately the self-employed as members of DC schemes and those with fluctuating incomes. Under the pre-A Day retirement annuity and personal pension regimes, the amount of allowable pension contributions increased significantly with age. This was to reflect the fact that many self-employed people cannot afford to build up a pension while they are building up their business. The result is that many such people reach their fifties with little pension provision, so the increased allowance for older people enabled them make up for the lack of pension contributions in earlier years. There is also the problem of the self employed who have March year ends and employees whose bonuses are paid in March and so cannot ascertain their profits/earnings until it is too late to pay a pension contribution to set against that income.

51. People will not invest in pensions if there is no tax relief on contributions paid, so the problem of under-funded pension schemes for those who retire who would have invested but have not owing to tax relief not being available is likely to re-emerge with a reduced AA. There therefore needs to be some way in which those who cannot make regular contributions can obtain relief for their full contributions in years when they can make contributions, provided that taking one year with another the total contributions remain within the cap.

52. In the context of the proposals for a reduced AA, we recommend a carry forward of unused AA, for say four years (to tie in with new time limits), and a carry back to the previous year of excess

contributions. The time limit for claiming carry back and amending the previous year's self assessment could be when the current year's self assessment tax return is submitted, as for gift aid, and the previous year's self assessment could be adjusted by way of a box on the current year's return. In the first year 2011/12, we suggest that the AA be double the reduced figure; this will make up for the absence of a brought forward amount and as the calculation of contributions is likely to be a bit rough and ready, help to ease the transition.

5 Individuals may receive from their employer a significant increase in the value of their pension in cases of ill-health early retirement or redundancy. It is not clear that it would be appropriate to apply an exemption from the AA in these cases. Given the risks of avoidance, the Government is minded not to provide exemptions from the AA in these cases, but is willing to consider proposals from interest groups that would provide protection for individuals in particularly hard cases without opening up unacceptable scope for abuse (Paragraph 2.19)

53. See answer to question 4 above. We acknowledge that the need for simplicity needs to be balanced against fairness and that there are likely to be a number of 'hard' cases. Again, we suggest that a review is undertaken of potential problem areas of difficulty and whether some form of exemption would be appropriate, in the absence of which there will be a need for a facility to carry forward unused AA/carry back excess contributions as referred to in the answer to the preceding question to mitigate the spike, especially if the AA exemption in the year of taking benefits were to be abolished.

54. We would support exemption from the AA charge for those who retire through ill health (as opposed to terminal illness ill health). We would not envisage an increase in numbers because HMRC already has guidelines (Registered Pensions Schemes Manual) which set out who should qualify for this benefit without the scheme having to pay an unauthorised payment charge. The government needs to decide whether the probably increased outgoings of those who retire early through ill health, who are unlikely to be in a position to contribute in future to a pension scheme on which tax relief will be given, should be funded directly by the state or by employer and private pension schemes.

55. Regarding redundancy, members have encountered situations recently where relatively modestly-paid employees are disadvantaged if they seek to apply part of their redundancy package to a registered pension scheme in accordance with s.408 ITEPA 2003. This will also happen under the proposed rules and this will impact on these employees at a time where they are financially vulnerable. For this reason, we should like to see the restriction to the annual allowance suspended in cases of redundancy under s.139(1) Employment Rights Act 1996.

56. We note from paras 2.20 and 2.21 that the AA rules take account of pensions sharing orders and where individuals transfer pension benefits from one scheme to another. We welcome the fact that the discussion document says that the government feels that there is no need to change the AA rules here, but should welcome specific confirmation that they will not be disadvantaged under any new regime.

Redesigning the system of pensions tax relief

The lifetime allowance

6 The Government welcomes views on the appropriate level of the LTA, other issues associated with its operation in the context of a reduced AA, and on the trade-off between these and the level of the AA (Paragraph 2.25)

57. The current LTA figure of £1.8m was confirmed in the March 2010 Budget to apply at that level up to and including the tax year 2015-16. We consider that the LTA should remain unchanged. Given the long term nature of pension provision, we feel that any downward change to the LTA, for example to £1.5m as mooted in para 2.31, should be accompanied by grandfathering otherwise it would amount to retrospective taxation. Any such change would therefore involve members

having to enter into elections to preserve past benefits and HMRC to process them, as happened around A-Day, all of which takes time and costs money. Any proposal to reduce LTA, together with the proposal as a whole, needs proper analysis.

58. We have heard a suggestion that the LTA might be decreased to a figure between £600-675k. We consider that this would be far too low. A pension pot equal to the current LTA, £1.8m, could produce a pension at around 4% of the fund similar to that which one would expect from a DB scheme, ie an escalating annuity with dependent's pension on death, ie say £72,000. For those in DB schemes the LTA pensions multiplier is 20, so that a LTA of £1.8m compared with a two thirds of final salary pension from a DB scheme means that pensions of anyone who is earning over £135,000 is capped. If the LTA is reduced, then using the same assumptions as above, a pension pot of say £675k can produce a pension of £27,000. For those in DB schemes, a LTA of £675k compared with a two thirds of final salary pension means that pensions of anyone who is earning over £50,625 will potentially be capped. Whilst this is above average earnings, it is a lot of people and we should have thought that the government would want to be targeting those on higher earnings.

59. If the government policy is to reduce the AA considerably, that will become the key restriction on pension inputs. It will much harder for taxpayers building up pension funds to breach the LTA but any reduction is merely likely to penalise those who make pension provision over the longer term and once again discourage further the use of pensions. If the AA is under £50k, then a reduced LTA will act as a disincentive not only to invest but actively to manage a fund – it will potentially penalise those who take out a SIPP with good investments. We think that pensions investment should be encouraged. Before any decisions are made, it would be helpful to see some economic analysis of the effect of reducing the annual allowance.

Rate of relief for additional rate taxpayers

7 The Government would welcome views on the merits of capping relief at 40 per cent as an additional means of restricting pensions tax relief and the trade-off between this and the level of the AA (Paragraph 2.27)

60. We remain concerned that the 50% tax rate contributes to an overall lack of competitiveness and note that there have been studies by respected bodies that suggest that such a rate is counter productive. Although we note that it is projected to raise revenue, it does create a disincentive for high earners to work and invest in the UK, thereby discouraging business and reducing the UK's competitiveness. Furthermore, a restriction of pension tax relief to only 40% will add further complexity and will disincentivise pension saving by those who would otherwise be likely to invest the maximum permissible and thereby help to provide the critical mass necessary to enable the pensions industry to reduce costs for all investors.

61. We therefore feel that, with a much-reduced AA and excess contributions being charged at marginal rates, there is no merit in capping tax relief on permitted contributions for additional rate (50%) taxpayers at 40%.

Meeting the fiscal objective

62. Aside from our views expressed elsewhere in this memorandum, we are not commenting on the estimates in Annex A.

Chapter 3 Managing impacts on individuals

63. We note in para 3.1-3.6 that the government recognises that pension scheme members will try to 'aim off' the reduced AA and that those in DB schemes where the deemed contribution will be based on benefits will have less scope for controlling unexpected tax charges.

64. Para 4.22 says that 'the government is clear that a reduced AA would apply to all those receiving UK tax relief, with the exception of the cases set out in Chapter 2' which presumably refers to the cases cited in in para 2.18 namely death, serious ill health, etc, and pension sharing orders (para 2.20) and transfers between schemes (para 2.21). This indicates to us that the government does not intend to confine the AA charge to those on high incomes. We note in para 3.5 that it is recognised that spikes might push those on low and moderate incomes, whose annual accruals are commonly below the AA, over it in a single year. This suggests to us that, at the same time, the government is mindful that the charge could be unfair in some circumstances.

Options for managing impacts

8 The Government is keen to support employers to make adjustments to help individuals who may face large, but one-off, increases to their DB pension. The Government welcomes views on legislative action that could facilitate appropriate scheme redesign without undermining other aspects of the regulatory regime (Paragraph 3.10)

65. In a DB scheme, a spike might occur because a member's accrual rate is improved, say, from 1/80th accrual to 1/60th. This might arise as a result of benefits being adjusted because the scheme is overfunded – unlikely at present – or perhaps as a result of an automatic increase in accrual for members who have achieved say a set number of years pensionable service. An increase in DB benefits in a year is also likely when an employee is promoted and receives a pay rise, or as part of a redundancy package.

66. We have to say that the assumption in the discussion document at para 3.9 that the rules and trust deeds of employer pension schemes will be changed seemingly at the drop of a hat to mitigate the impact on employees is naïve. Whilst in some cases tailor-made changes might be effected for those in the board room, the average employee who receives an increase in DB benefits because of promotion or redundancy or some other reason will have to take as given the situation that (s)he is presented with, and, although delighted to have been, for example, promoted and for the pay increase and consequent additional pension benefits, will for the most part be unable to influence the extent to which the contribution exceeds the AA or prevail upon the employer to make expensive and time-consuming changes to the pension scheme deeds and rules just for him/her.

67. As noted above, we recommend that the simplest way of dealing with such spikes in the absence of specific rules for them is a carry forward of unused AA, for say four years (to tie in with new time limits), and a carry back to the previous year of excess contributions. The time limit for claiming carry back and amending the previous year's self assessment could be when the current year's self assessment tax return is submitted, as for gift aid.

Managing high charges

68. We note that the government will be consulting on this beyond September and look forward to being involved. At this stage we would note that the income of most people is likely to be committed so for example a tax charge of say £10k for someone on an income of £150k is a large sum which is unlikely to be readily available.

Chapter 4 Delivery and compliance

Current rules and delivery mechanism

69. We agree that SA provides the best way of reporting, paying and collecting AA charges. We trust that employees who wish to pay the tax out of earnings will be able to request a restriction in their code numbers.

Pension input period

9 The Government welcomes views and evidence on the benefits and burdens associated with aligning the pension input period to the tax year, for individuals, pension schemes and advisors (Paragraph 4.12)

70. In the interests of simplicity and certainty we consider that the pension input period ('PIP') should be aligned to the tax year.

71. However, the cost to employers and pension schemes could be considerable because such a change is likely to cause administrative burdens not only in the transition but also in the longer term for employers and their pension schemes who will have to meet information requirements on the timeously provision of particulars to employees, especially where employers pay rise year ends and their pension schemes year ends do not coincide. We welcome the fact that the discussion document does acknowledge that account needs to taken of the fact that alignment of PIPs with the tax year will create costs.

Information requirements

10 Given the need to support individuals, the Government welcomes views on the appropriate reporting requirements on pension schemes to provide statements of the total pension input amount over the pension input period (Paragraph 4.20)

72. For the purposes of this excess AA charge, members of pension schemes will need a statement showing what figure(s) to put in the appropriate box(es) on their tax return. It would be helpful if HMRC provide guidance on what people should do, for example, that they need to keep the document for the purposes of preparing their tax return and reminding them that if they are a member of more than one scheme, they need to add up the figures from all of them to determine whether they need to make an entry in the AA charge box on the return, and that if they are not in SA then they will need to report a new source of income/request a tax return if necessary.

73. To enable employees to carry out a reasonableness check, we consider that the calculations should be shown on the face of the statement. For DB schemes, it should be made clear what the pension figures mean, ie that it is a notional pension figure used for the purposes of computing the AA charge and is not an accurate pension forecast.

74. For employees who belong to only one scheme and whose contributions are well below the AA, the provision of a statement will be prima facie unnecessary. However, this needs to be reconciled with the needs of other employees whose contributions to their main employer scheme are below the AA but who are members of other schemes as well. We are inclined to the view that a statement showing contributions for the year will need to be provided to all members of pension schemes even where the AA is not exceeded, because the individuals may belong to more than one scheme and will need to collate information from several schemes to determine whether they have exceed the AA.

75. The provision of an annual statement will also help to bring home to people who might otherwise not be interested the importance of pension saving.

76. We are not proposing here that pension providers provide annual estimates of pension payable at retirement age as part of these statements because being based on assumptions they are, especially in the case of DC schemes, in the main speculative.

11 The Government welcomes views and evidence on the benefits and burdens associated with introducing reporting requirements on schemes to provide this information (Paragraph 4.20)

77. If PIPs are aligned with the tax year and the deadline for providing information to pension scheme members is 5 July (see answer to question 12), then the administrative effort and the impact of bunching for pension scheme providers and their advisers is likely to be considerable.

78. A requirement to provide information by a deadline means that pension schemes will have to update systems – indeed for a lot of DB schemes it will mean the introduction of new processes – which means that there is an immediate monetary cost to schemes/employers. The other concern is can the pension industry get these systems in place in time for April 2011? Once they are in place we suspect that it should not be too onerous to run an annual process to issue a statement with input amounts.

79. We would venture to suggest that this additional burden may well cause more private sector employers to consider closing their DB schemes even to existing employees.

12 The Government welcomes views on how quickly schemes could provide this information before the Self Assessment tax return is due, and whether employers could help pension schemes provide this information in a timely way (Paragraph 4.20)

80. We consider that employers/pension schemes should be obliged to provide contributions information to pension scheme members by the same deadline as for providing P11D particulars, namely 5 July after the end of the tax year, in order that individuals can complete their self assessment tax returns. Additionally, employers with DB schemes may need to be set a deadline by which they must provide relevant particulars, eg pensionable pay at relevant dates, to their pension scheme administrators.

How to treat overseas schemes and difficult cases for compliance

13 The Government welcomes views on any practical or administrative issues that may arise from applying the reduced AA, and associated information and compliance requirements, to individuals who are members of overseas pension schemes and benefiting from UK tax relief (Paragraph 4.22)

81. The lower limits are much more likely to cause practical and administrative difficulties for taxpayers who may be members of overseas pension schemes and may discourage overseas workers from accepting assignments in the UK. Overseas DB chemes are unlikely to be aware of the rules, and may well have non-31 March/5 April year ends/PIPs.

82. Clear guidance will be needed for all members of pension schemes, employers, pension scheme providers and especially those who are are members of or who sponsor or are involved with running overseas pension schemes. Members of such schemes may find it impossible to obtain the information necessary to make a return for an April to April period and maybe excess contributions to these schemes will have to be assessed to tax on a scheme year end basis, ie year ended in the fiscal year basis.

83. Again, we think that if the rules are to be changed, they should be kept simple and straightforward and that there should be no further changes to the rules as revised for the lifetime of this Parliament.

PCB
26.8.10

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APPENDIX 1

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/index.cfm?route=128518).

APPENDIX 2

EXAMPLE DEFINED BENEFIT SCHEME CALCULATIONS BEFORE APPLYING FACTOR

Note: the appropriate factor can be applied to the above increases to ascertain whether the annual allowance has been exceeded

I Assumptions: 1/60th scheme, 3% pay rise across the board, 19 years service

A Including past service		
Low earner	Medium earner	High earner
19/60 x £20k = 6,333	19/60 x £90k = 28,500	19/60 x £300k = 95,000
20/60 x 20.6k = 6,867	20/60 x £92.7k = 30,900	20/60 x £309k = 103,000
Difference £534	£2,400	£8,000
B Excluding past service		
Low earner	Medium earner	High earner
1/60 x £20k = 333	1/60 x £90k = 1,500	1/60 x £300k = 5,000
2/60 x £20.6k = 686	2/60 x £92.7k = 3,090	2/60 x £310k = 10,300
Difference £353	£1,590	£5,300

II Assumptions: 1/60th scheme, £10,000 pay rise, 19 years service

A Including past service		
Low earner	Medium earner	High earner
19/60 x £20k = 6,333	19/60 x £90k = 28,500	19/60 x £300k = 95,000
20/60 x £30k = 10,000	20/60 x £100k = 33,333	20/60 x £310k = 103,333
Difference £3,667	£4,833	£8,333
B Excluding past service		
Low earner	Medium earner	High earner
1/60 x £20k = 333	1/60 x £90k = 1,500	1/60 x £300k = 5,000
2/60 x £30k = 1,000	2/60 x £100k = 3,333	2/60 x £310k = 10,333
Difference £667	£1,833	£5,333

www.icaew.com/taxfac and www.ion.icaew.com/taxfaculty/blog/