Summary of Responses to; *Simplifying the taxation of pensions: the Government's proposals*, published 10 December 2003

1 On 17 December 2002 the Government published a consultation paper, "*Simplifying the taxation of pensions: increasing choice and flexibility for all*" setting out the Government's proposals for simplifying the taxation of pensions.

2 On 10 December 2003 the Government published "*Simplifying the taxation of pensions: the Government's proposals*" a technical paper which contained the Government's amended proposals. The amendments to the proposals were informed by the 366 formal responses that the Government had received to the first paper. A further consultation period followed the second paper, 209 formal responses to the proposals were received before 5 March 2004 when the consultation closed.

3 Copies of each non-confidential response received during the second consultation period are held in the House of Commons Library and are available for viewing by members of the public.

4 Responses from the pensions industry and various representative bodies were pleased that the Government had taken their previous responses on board and made further points on a number of details. Responses from the public covered a wide range of issues, mainly reflecting recent media and personal interest in the main proposals.

5 There were 5 main categories of respondent:-

Table 1: Respondents to *Simplifying the taxation of pensions: the Government's proposals*

TYPE	NUMBER
Individuals	47
Representative bodies	35
Employers	25
Pension providers	40
Financial services providers	62
Total	209

6 The majority of responses from pensions industry and employer groups were favourable about the overall impact of pensions simplification. Comments from this group included:

- "We welcome the revised proposals and believe that these represent a major step toward simplification for investors and providers alike." – **HSBC**
- "We very much welcome the radical nature of the Government's

proposals and support any attempt at simplifying the complexity inherent within the current pension tax rules." –**Thomson's Group plc**

- "We recognise and welcome the enduring benefits of simplicity and flexibility that the Government's proposals will promote, especially for new or recent entrants to the workforce." –**Vodafone**

- "HBOS applauds and supports the Government's genuine objective of simplifying the pensions tax regimes and believes that the result will allow us ultimately to offer better value to consumers through less costly administration and simplified advice processes." –**HBOS**

Responses to the main proposals

Lifetime Allowance

7 Many respondents welcomed the proposals to replace current limits on tax-relieved savings with a single lifetime allowance for all pension savers. A large number of respondents took the view that the upper limits would only affect a small minority and that concerns expressed about the level of the lifetime allowance should not prevent the Government from going ahead with simplification.

8 There was continued concern from representatives across the pensions industry that the allowance would be set at too low a level and that as a result high earners would be disenfranchised from company pension schemes. Since publication of the document, the NAO review concluded that £1.4 million is broadly equivalent to the maximum pension allowable under the current occupational pensions regime, which includes the earnings cap. The Budget also announced that lifetime allowance would be £1.5 million in April 2006, rising to £1.8m by 2010.

9 There was some concern that the lifetime allowance would catch more people than the Government had estimated – potentially having adverse affects for business management and middle management employees. Many welcomed the independent review by the NAO of Government estimates of the number of savers who would be affected by the lifetime allowance. Since publication of the document, the NAO review concluded that the estimate of 5,000 people is at the lower end of a range of reasonable estimates. Sensitivity testing and other evidence is consistent with an estimate of around 10,000. Other estimates of the numbers affected – up to 600,000 have been quoted – include large numbers of people already capped by the existing earnings cap, and so are not directly comparable; and there is no evidence to discredit the estimate of around 1,000 people a year for the next ten years.

10 The certainty and consistency offered by universal valuation factors were well received by many respondents. However, some considered that they would treat Defined Benefit (DB) schemes more generously than Defined Contribution (DC) schemes The Government believes that using simple factors is preferable to more complicated, actuarial tables.

Annual Allowance

11 Respondents were generally satisfied with the level of the Annual Allowance, and welcomed the revised proposal to exempt contributions or accruals in the year of benefit crystallisation. However, many respondents questioned the need for the annual allowance. Some respondents asked for further clarification of how amounts to be tested against the annual allowance would be calculated. The Government continues to believe an Annual Allowance is essential for limiting potential abuses of tax relief.

Indexation

12 There was disappointment at the proposals in the technical paper to index the lifetime and annual allowances by changes in the retail prices index. It was believed that this would gradually erode the value of both allowances and increase the proportion of individuals caught by the lifetime allowance. The Government took these views into account, and Budget 2004 pre-announced the lifetime allowance for all years up to 2010 such that it increases in stages to £1.8 million in 2010 and both the lifetime allowance level and indexation will be reviewed every 5 years, with the first review in 2010.

A-Day

13 There was some enthusiasm, mainly from insurers and accountancy firms for introducing the simplified regime in April 2005. However a large number of occupational schemes, employers, IFAs and Financial Institutions argued that there were too many outstanding issues for a 2005 start date. These respondents felt that the pensions industry needed at least 12 months notice of the legislation to prepare its systems and its employees and therefore implementation should be postponed until April 2006. The Government wants to see the benefits of simplification as soon as possible, but recognised the implementation concerns of the industry. The Government therefore decided to legislate in Finance Bill 2004 and implement the simplified regime in April 2006, allowing employers and providers sufficient time to fully implement the benefits of simplification.

Transitional Protection

14 The proposals to offer enhanced protection of funds, which might grow in excess of an individual's Lifetime Allowance were widely welcomed.

15 Some respondents were concerned that the proposals on transitional protection were overcomplicated. It was suggested that this could lead to unnecessary cost, confusion and uncertainty and even that it could undermine the objective of simplification. It was suggested that a longer period should be allowed for a member to choose between the different types of protection. It was also suggested that rights to a lump sum in excess of 25% of total fund value should survive a transfer between schemes. The Government believes the transitional protection strikes the right balance between being fair while introducing as simple a regime as possible which will apply equally to all moving forward.

Minimum Pension Age

16 A small number of respondents expressed concern at the proposal to raise the minimum age for taking a pension from 50 to 55 by 2010. The majority of responses on this subject did not object to the change and were more concerned with how it would be introduced. The proposal to uphold existing contractual rights to take a pension from an occupational pension scheme before age 55 was welcomed, and some respondents asked for further detail on what would count as a contractual right for this purpose.

Low Normal Retirement Age

17 The Government's proposals to allow those with existing rights in schemes with agreed low normal retirement ages such as professional football players to take their pensions early, with a consequent reduction in the lifetime allowance for each year before 55 that they do so, was welcomed. Some respondents felt that this opportunity should be offered to future pension savers in the same position.

Trivial commutation

18 There was concern from industry representatives and practitioners that the revised proposals to allow pension pots whose total value was less than 1% of the lifetime to be commuted into tax-free lump sums could lead to higher levels of commutation, fragmentation of existing funds and possible abuse. In response to this concern, the facility for pension scheme members to commute trivial pensions has been changed so that it will only be available to those with total pensions with a capital value of less than 1% of the Lifetime Allowance. People in this position will be able to choose a year falling between their 60th and 75th birthdays in which all trivial pensions may be commuted.

Death benefits

19 The Government's proposals to continue to allow dependant's pensions to be paid from a pension fund where a member dies before age 75 were widely welcomed. However there was disappointment that the Government would continue not to allow any return of capital where a member died after age 75. Some respondents felt that this would discourage pension saving. The Government continues to believe that pension saving should be used to secure an income in retirement. There are a variety of other ways to save to return capital after age 75.

Alternatively secured income

20 The Government's proposals to introduce alternatively secured income as a means for scheme members to receive continuing benefits after age 75 without purchasing an annuity was welcomed and respondents believed that this could become a popular way to receive benefits after the age of 75. Some of these asked the Government to allow any residual funds on death to be transferred to another pension scheme or to an approved charity.

Retirement Annuity Contracts

21 In *Simplifying the taxation of pensions: the Government's proposals* the Government confirmed its commitment to applying PAYE to pensions paid from Retirement Annuity Contracts so that pensioners with RACs would not have to reclaim tax withheld on their income at basic rate. However some respondents, in particular groups representing the interests of elderly people, objected to the Government's proposals to delay any change to the basis of taxing pensions from Retirement Annuity Contracts until at least 2006. These respondents considered the continuing demands of bureaucracy and the shortfall in income to be unacceptable burdens on the elderly. However some RAC providers expressed relief that the change would be deferred, as they felt that a swift move to PAYE would add significantly to their transition costs.

s615 Schemes

22 A number of respondents urged the Government to retain s615 schemes. They observed that s615 schemes are ideally suited to providing pensions across national borders, and pointed out that the schemes cost the Exchequer very little in relief, but if s615 was removed the UK was likely to lose fund management business to competitors elsewhere in the EU.

Residential Property

23 There was also concern among industry practitioners about allowing registered pension schemes to invest in residential property. Some respondents welcomed this as a more secure and stable investment than the stock market. However, a greater number feared that an influx of pension scheme investment might overheat the housing market. The Government remains committed to the single investment regime. Individual property investment is not likely to be attractive in many cases. In particular, the requirement to put all rental income into the pension fund is likely to be unsuitable for many buy-to-let landlords, who may need to access the income returns before they commence drawing a pension. Most homes bought by the pension fund will have to be sold when the member reaches 75.

Industry Costs

24 The Government's estimates of 5% savings on administration following the introduction of the simplified regime were agreed to be reasonable by certain respondents. Some respondents also commented that most of the savings resulting from simplification would be made by consumers, who would no longer need to take as much financial advice before saving in a pension.

25 Few pension providers were able to offer precise estimates of transition costs for moving into the simplified regime. The Association of Consulting Actuaries estimated that total costs to industry for non-insured occupational schemes were likely to be

£150m-250m. Many respondents suggested that the administrative and financial burden could be excessive for small and medium sized pension providers. The Government believes that the long-term savings from operating one simple regime will outweigh any short-term costs.

26 Several pensions providers suggested that the Government could further reduce transitional costs to industry by introducing provisions to override existing references to old pensions tax regimes in scheme rules.

E-filing

27 The proposals to move to an electronic system for sending key compliance information to Inland Revenue were welcomed. Some respondents felt that E-filing might be unsuitable for smaller pensions providers and ought not to be made mandatory.

Conclusion

28 The Government has analysed and considered all responses, including alternative proposals, received to this round of consultation.

29 On 10 March 2004, following the conclusion of a National Audit Office review, the Chancellor of the Exchequer announced the Government's intention to proceed with its proposals to simplify the taxation of pensions. Legislation to implement the proposals will be introduced in the 2004 Finance Bill.

30 The Chancellor also announced a number of changes to the proposals, many of which were informed by responses to the second round of consultation. For further details draft legislation and explanatory notes can be found on HM Treasury's website (**www.hm-treasury.gov.uk**).