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The Hundred Group
of Finance Directors

Chairman
Ashley Almanza

25 June 2009

Private and Confidential
Rt Hon Alastair Darling MP
Chancellor of the Exchequer
HM Treasury
1 Horseguards Road
London
SW1A 2HQ

Dear Chancellor

Budget Changes to Tax Relief on Pensions

I am writing to you on behalf of the Pensions Committee of the Hundred Group to raise our serious concerns about the proposals contained in your recent Budget to change the basis of taxation on pensions for those on higher incomes. I attach a schedule which sets out our concerns in some detail.

The Hundred Group represents the views of the finance directors of the UK's largest companies drawn largely, but not entirely, from the constituents of the FTSE100 Index. Our members are the finance directors of companies whose market capitalisation collectively represents over 80% of that of companies listed on the London Stock Exchange. While this letter and the attached schedule express the views of The Hundred Group of Finance Directors as a whole, they are not necessarily those of our individual members or their respective employers

We would greatly appreciate an early opportunity to discuss our concerns with you or with your officials.

I am sending a copy of this letter to the Financial Secretary of the Treasury and to Mr Paul Cottis at HM Revenue and Customs.

Yours sincerely

Edward Weiss
Chairman
The Hundred Group – Pensions Committee

cc. *Stephen Timms, Financial Secretary to the Treasury*
Paul Cottis, HM Revenue and Customs

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Budget Changes to Tax Relief on Pensions

1. Change in A-Day Settlement

When the new simplified pensions taxation regime was introduced on 6 April 2006, all individuals (including higher earners) were promised a simpler and more flexible taxation regime. A-Day, and in particular the lifetime allowance, encouraged a flexible approach to retirement saving. Such a fundamental reversal now, with no warning or consultation, is a significant blow to stability in an area where long term stability is key to good scheme design, employee confidence and increasing pension savings across the private sector.

One of the changes introduced at A-Day was the removal of restrictive annual contribution limits and the introduction of an annual allowance. Many individuals changed their pattern of contributions as a result of this change and postponed the payment of contributions into their pensions as there was now no need to make contributions on a regular basis. Some even postponed large contributions until the year before retirement because they were aware that the annual allowance did not apply in this year.

The changes set out in the Budget represent a reversal of the flexibility offered by A-Day. Individuals with an income of £150,000 pa or more may find themselves in a worse position than they would have been prior to A-Day, because they have postponed their contributions in the legitimate expectation of being able to pay more in the years leading up to retirement. Such individuals are being penalised for using the flexibility introduced at A-Day.

2. Complexity of Legislation

The Budget proposals will require extremely complex legislation and guidance. In addition to the anti-forestalling measures contained in the Finance Bill, there will also be a need for detailed legislation and guidance relating to the 2011 changes, and especially the measures for dealing with accrual in defined benefit schemes. Introducing this legislation will lead to considerable costs for HMRC itself and for the employers and individuals affected in understanding the implications of these changes for their pension provision. This is contrary to the principles of the new simplified pensions regime, principles that have already been undermined through the changes made in each year's Finance Bill since the A-Day changes were first introduced.

Complexity of itself is undesirable, both for pensions and for the tax code and will divert resources away from addressing pre-existing pensions problems. The effort wasted in addressing the complexity created by new pensions legislation and in taxation diverts attention from other more important issues.

It seems unlikely that the additional tax-take from these measures will be significant or will be such as to justify this complexity. Most affected individuals will simply look for other more tax-efficient means of investment outside the scope of registered pension schemes.

3. Costs of Implementation

We understand that the intention of the Budget proposals is that the additional tax charges will be payable by the individual through their self assessment form rather than through PAYE. However, it cannot be assumed that this means there will be no costs to employers.

Any increase in costs to employees or employers increases the overall tax burden of operating in the UK and reduces our international competitiveness.

Employers are likely to need to review their reward arrangements in the light of these changes (and probably make alterations to their provisions). This task will be made more difficult (and the solutions potentially more complex) by having to consider the very different potential overall tax positions of employees (even ones with the same salary). This will not be straightforward because of the requirement to consider total income. An employee may have other income that his or her main employer does not see including pensions, rents, investment income or income from a second employment (e.g. as a non-executive director).

In addition, employees are likely to ask their employers for the necessary information to enable them to calculate the increase in accrued benefits in defined benefit schemes. This means that employers will have to devote resources to dealing with these changes.

Companies have only just finished putting in place the pensions and payroll system changes necessary to administer the A-Day tax structures. They will now have a new set of upper earnings limits, special annual allowances and annual accrual calculations to cope with. This will have a significant impact on the administration and communication of pension arrangements and involve considerable cost.

4. Incidence of Double Taxation

It has always been a principle of pensions taxation that the building up of benefits in pension schemes will be taxed only once, on the payment of pension income in retirement. Both the contributions going into the scheme and investment growth within the scheme are effectively exempt from tax.

Under the Budget changes, pension scheme benefits will effectively be taxed twice for those on incomes in excess of £150,000 pa. First, payments into the scheme will be taxed either by the restricting of higher rate tax relief on contributions to defined contribution schemes or by a benefit-in-kind charge on the growth of benefits in a defined benefit scheme. Second, these employees will also be taxed at the full marginal rate on their eventual pensions.

Surely this is double taxation, and therefore inequitable.

5. Impact on Defined Benefit Schemes

It appears likely that the impact on individuals in defined benefit schemes will be particularly significant. Whilst the Treasury has not yet consulted on the details of how defined benefit schemes will be treated from 2011 onwards, it seems likely that individuals will have to pay a benefit-in-kind charge based on the increase in the value of defined benefit accrual. This charge could well be a significant immediate sum in return for an increase in benefit that the member will not receive until retirement (when the member will also have to pay tax on the resulting pension). In some cases, this could even result in a tax charge greater than their entire cash income in the current year, in other words a marginal tax rate in excess of 100%.

It is likely that such a development would render defined benefit schemes unattractive to most individuals with income of £150,000 pa or more, because of the need to pay immediate tax on any increase in defined benefit accrual. It may well turn out that this will lead to an overall change of culture in terms of pension provision, with employers turning away increasingly from defined benefit provision (and indeed possibly from any form of pension provision). The Hundred Group believes that this change is likely to accelerate the demise of defined benefit schemes, as there will be no incentive for senior managers to continue them. This would adversely affect lower paid scheme members.

6. Irregular Contributions

The Budget proposals, in particular the anti-forestalling measures, are based on an out-of-date view of how individuals prepare for retirement. They assume that individuals make a normal, regular pattern of contributions which does not change from year to year. In fact, this is increasingly untrue for all individuals (not just those with income of £150,000 pa or more).

Individuals change their contribution pattern for a number of reasons, including availability of one-off bonuses or redundancy payments, opportunities in the investment market, personal reasons, such as the need to pay divorce settlements, make mortgage payments or pay off credit card debt, decisions as to flexible benefit options etc. Individuals who happen not to have had a regular pattern of contributions over the last few years, but who nevertheless have made irregular contributions as and when their personal circumstances allowed, will now be penalised with tax charges if they wish to continue to contribute to their pension as they have done previously. Those who have made a regular contribution on an annual basis will also be penalised.

We understand that it will be down to the judgement of individual tax inspectors to assess what counts as normal regular contributions for the purposes of the anti-forestalling legislation. This is likely to lead to the same pattern of contributions being treated differently by different tax inspectors.

7. Arbitrariness of Measures

The measures proposed are arbitrary in their application and will affect some individuals disproportionately. For example, an individual with income of £180,000 who wishes to make a one-off contribution to his or her pension scheme of £30,000 would now be subject to the special annual allowance charge. From 2011, he or she will lose higher rate tax relief. Another individual on an income of £140,000 can currently pay the whole of his or her salary into a pension scheme without any liability to the special annual allowance charge and will receive higher rate tax relief on the contribution. That will continue to be true post 2011. This seems inequitable.

The rationale for using a test based primarily on income rather than on size of pension contribution has not been made clear, nor for the particular figures chosen. In particular, the £20,000 limit for the special annual allowance charge seems unduly restrictive. For an individual on an income of £150,000 pa, this represents a contribution limit of 13%; for an individual on an income of £180,000 pa, a limit of 11%. These figures are significantly lower than the old limits on contributions to personal pensions that applied before A-Day (which ranged from 17.5% to 40% depending on the age of the individual), and are below the old occupational scheme limit of 15% that applied solely to employee contributions.

The reference to years before the current tax year when considering whether an individual has income in excess of £150,000 will also give rise to anomalies. One employee on £120,000 in the current tax year may be affected because he earned £150,000 in a previous year. A colleague on an identical income who never reached this level will not be subject to the rule. This means two individuals on equal income in 2009/10 would be differently taxed.

The anti-forestalling measures, as currently drafted, appear to inhibit mobility of labour. A person with earnings over £150,000 who is making significant pension contributions to their current employer's pension scheme may be deterred from moving to a company that operates a stakeholder plan because he or she would become subject to the £20,000 limit.

8. Further Developments

Whilst the Budget measures might appear to affect only a small number of higher income individuals, the Treasury should not disregard the likely undermining of confidence in the pensions taxation system as a whole. Individuals who currently have or aspire to have income of £100,000 pa may well wonder whether the removal of higher rate tax relief will be extended to them in due course. Members of pension schemes expecting a tax-free cash lump sum at retirement may also wonder whether this too will have been restricted by the time they get to retirement.

For the UK to have a thriving occupational pension system, it needs to have a stable legislative and taxation system underlying it. The Budget measures are seriously destabilising to a pension system that is already under threat, and are likely to have dangerous repercussions both for employer pension provision and for individual take-up of pensions.

9. Conclusions

It will be clear that The Hundred Group has great concern about the impact of the Budget measures on the provision of pensions by Hundred Group companies. We believe that these proposals will further undermine confidence in pensions amongst both employers and employees and will lead to fears of further breaking of the A-Day settlement by the Treasury. This will impact on all members of pension schemes, not just those directly affected by these proposals.

Further, these measures (together with the increase in the higher tax rate from 40% to 50% and the removal of the personal allowance for high earners) will impair the UK's ability in a global market to locate highly skilled employee groups.

Aside from our concerns about the general policy intention, we also have concerns about the arbitrariness of the proposals, which will affect some members disproportionately, and the incidence of double taxation to which we have drawn attention. We also believe that the complexity of the proposals (and the associated cost) is disproportionate to the likely additional tax-take that the measures will generate.

We hope that it will be possible to meet in the near future to discuss our concerns in more detail.

The Hundred Group
June 2009