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Pensions Committee

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Pensions Consultation 2015
Pensions and Savings Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

30 September 2015

Dear Sir,

Consultation: 'Strengthening the Incentive to Save'

I am writing on behalf of the Pensions Committee of the 100 Group of Finance Directors with regard to the above-named consultation.

As you may know, The 100 Group represents the views of the finance directors of FTSE 100 and several large UK private companies. Our member companies represent around 90% of the market capitalisation of the FTSE 100, collectively employing over 7% of the UK workforce and in 2013 paid, or generated, taxes equivalent to 14% of total UK Government receipts. Our overall aim is to promote the competitiveness of the UK for UK businesses, particularly in the areas of tax, reporting, pensions, regulation, capital markets and corporate governance.

The 100 Group has grave concerns about the proposals for a potential major reform of pensions taxation, in particular the proposals for a move to a taxed-exempt-exempt system, which we believe would be fundamentally inappropriate for pension schemes and very damaging to individuals' willingness to save for their retirement. It would bring in accelerated tax revenues in the short-term at the expense of discouraging saving for retirement in the long term.

Given the fundamental nature of our concerns, we have chosen not to respond to the specific questions in the consultation paper, but rather to set out our key points below:

1. Taxation in retirement keeps pensioners engaged in political decision-making

One of the key advantages of taxing pensioners is that it keeps pensioners politically engaged in the fiscal decisions being made by their Governments. In the event of a move to a taxed-exempt-exempt system, pensioners would pay no tax, but would still have a vote. Given an ageing population, this would lead to a pensioner population increasingly keen to

vote for parties promising better public services and higher public spending as they would not be concerned by the higher taxation this would entail. This would not be a sustainable political settlement in the long term.

2. A move to taxed-exempt-exempt would have macroeconomic implications

At present, the taxes paid by pensioners in the future help to pay for future public sector and state pensions. If instead the tax in respect of future pensioners is taken from the working age population now and spent by the Treasury, there will be reduced tax assets out of which to pay public sector and state pensions in the future. Over time, this will make a taxed-exempt-exempt system unsustainable since it will lead to a longer term reduction in tax revenues.

3. Under a taxed-exempt-exempt system individuals may not trust the Government to keep future retirement income tax-free

A taxed-exempt-exempt system will only remain an effective incentive to save for retirement if individuals trust that pensions in payment will remain exempt from taxation. Pensions are an inherently long-term form of saving and the time before any tax benefit is seen may be longer than 40 years. Even if there were some way of guaranteeing that pensions will be exempt from tax in 40 years' time, individuals are unlikely to place much weight on an incentive that they will only experience many years later.

Given that it is not possible to bind future Governments to a promise of exemption from tax for pensioners, individuals are very likely to doubt whether the promised tax benefit will still be around when they reach retirement.

4. The overall existing personal taxation system should be reviewed as a whole

Whilst it is true that some aspects of the existing system of pensions taxation are complicated, the overall system of personal taxation is far more so. Many of these complexities arising from anomalies in individual's effective marginal rates of tax relief, for example because of the treatment of the personal allowance, child benefit and from 2016 the tapered annual allowance.

It would be more profitable for the Government to address these anomalies as a whole to create a fairer and simpler system of personal taxation, where individuals do not find that particular circumstances leave them with effective marginal rates of taxation of 70% or more. A move to a taxed-exempt-exempt system or a flat rate of tax relief for pensions would only add new anomalies to the system without addressing the fundamental problem of the overall structure of personal taxation.

5. The existing system of pensions taxation is not complex in principle

In essence, the existing system of pensions taxation is a simple one that has been made complex for employers, pension schemes and some individuals by repeated changes to the system. What is needed is better communication to ensure that individuals understand that, for the vast majority of people, the current system is not in fact complicated, since the annual and lifetime allowances will not affect them.

6. The Treasury's analysis of tax reliefs may be flawed

The analysis of tax reliefs on pension saving in Chapter 2 of the consultation paper is fundamentally flawed and overstates existing reliefs by including the relief on deficit reduction contributions. The inclusion of tax relief in respect of underfunded benefits that

have already accrued seems unjustifiable and no rationale is given. The Treasury's own footnote also indicates the 'particularly wide margin of error' in the figures.

In addition, the chart shows that pensions tax relief was already starting to tail off from 2010/11 onwards, even before the latest changes proposed for 2016. If there ever was a problem of excessive tax relief, then it appears that it may already be under control, and further reductions seem likely once the tapered annual allowance is in place.

We are very concerned that HM Treasury may decide to pursue a damaging course on the expectation that it could thereby liberate tens of billions of pounds of 'excess' tax relief on the basis of these flawed figures. A more rigorous analysis would be likely to show the expected tax receipts would be much lower and we urge the Treasury to carry out that analysis.

7. Pensions taxation reform could reduce funds for infrastructure investment

At present, HM Treasury is keen to incentivise pension funds to invest in infrastructure. A move to taxed-exempt-exempt would be likely to lead to considerable reductions in future pension savings, both because of increased opt-outs and because pension funds will now be derived from taxed rather than gross income. This will reduce the assets available for pension funds to invest in infrastructure (and indeed other assets) in future.

8. A taxed-exempt-exempt system would be likely to increase cash investments

In the event that pensions were taxed more like ISAs, it seems likely that individuals would simply prefer ISAs, and particularly cash ISAs (given that the preference of current investors appears to be cash over equity ISAs). The move from equity holdings in long-term pension funds to cash holdings in ISAs would significantly affect the investment profile of individual savers and could also have knock-on consequences for financial markets.

9. The Treasury should incentivise employers to provide pension for their employees

For most individuals, the most important incentive to contribute to a pension is the fact that the employer also makes a contribution to the scheme. However, a move to a taxed-exempt-exempt system could turn the employer contribution into an effective disincentive, given that members would have to pay an upfront benefit-in-kind charge on it.

The consultation focuses on the personal responsibility of the individual to save for their retirement, without noting the role of the employer in providing deferred pay for the individual. Without employer contributions to pension schemes, UK pension savings as a whole would be only a fraction of current levels.

HM Treasury should therefore also be thinking about how to incentivise employers to save for their employees' retirement. This will include providing a stable system that employers can rely on to remain in force for the long term and also that enables employers to release their employees into retirement on adequate levels of income. The system should also continue to allow relief from corporation tax on employer pension contributions.

A system under which large numbers of individuals are likely to opt out from pension provision to avoid tax penalties on their savings will not achieve these goals. Given the removal of the default retirement age, the fact that individuals have inadequate income in retirement is likely to exacerbate problems towards the end of working life.

If there are no advantages to employers in offering pension provision, then over time, they will reduce pension provision to the minimum level required under the employer duties legislation.

10. Further restrictions will disengage management from pension provision

The existing reductions to the annual and lifetime allowances as well as the further changes proposed for 2016 are already having the effect that management are being disenfranchised from pension schemes. This is affecting four or five levels down of management, not just senior executives, and is inevitably leading to management becoming disengaged from the pension provision for their workforce.

Any measure to restrict tax relief further would call into question companies' continued willingness to support their pension schemes when increasingly large sections of their workforce receive no tax benefit (or indeed are effectively subject to tax penalties) if they remain in their pension scheme.

11. Radical changes to pensions taxation will damage auto-enrolment

Auto-enrolment is doing much to bring individuals who were previously disconnected from the pensions system into the world of pension savings. Any change which effectively reduces members' income as a result of being a member of a pension scheme is likely to lead to far more opt-outs, especially once the phasing-in period has ended and contributions therefore represent a greater part of individuals' pay packets.

If taxation is levied on employer contributions, then members will suffer from the 'double whammy' of a tax charge on both their own pensions contribution and a benefit-in-kind charge on their employer's contribution. Pensions will therefore come with an upfront disincentive to save, which is likely to outweigh the benefit of automatic enrolment (even if the Government also provides a modest top-up).

Existing changes to pensions taxation have already led to many members opting out to avoid higher tax charges. However, a taxed-exempt-exempt system would strengthen the incentive to opt out even further and for a short-term gain in tax revenues could lead to a long-term move away from pension savings.

The fundamental changes of recent years (which include the single tier state pension and the new pensions freedoms as well as auto-enrolment) should be given time to bed down before any changes are proposed which could undermine the positive achievements of these policies in encouraging pension savings.

12. Taxed-exempt-exempt would be damaging to workers on low and average pay

Whilst the rationale for a radical reform to pensions taxation is often presented as being because too much tax relief is given to the highest earners, a move to taxed-exempt-exempt would be just as likely to impact those on average and low pay. In particular, many individuals on low levels of income in retirement pay little or no tax on their pension because their pension is close to the personal allowance.

Under a taxed-exempt-exempt system, they would pay higher tax on their income in their working life, but would see little benefit from the exemption from tax in retirement, since they would not have expected to pay much tax in any case.

13. Further changes are likely to lead to members demanding cash over pensions

Under the existing systems, many individuals affected by the annual and lifetime allowances are already offered a cash alternative to pension scheme membership and the percentage of the workforce affected is likely to increase as a result of the 2016 changes.
If a taxed-exempt-exempt system with a benefit-in-kind charge in respect of employer contributions is introduced, more individuals at all pay levels are likely to opt out of the scheme, and may well ask why cash alternatives are provided to management and not to them.

14. Accrued defined benefit funds present a particular problem

If there is a move to a taxed-exempt-exempt system, with employer contributions taxed as a benefit-in-kind, then there are particular issues in relation to accrued defined benefit funds. It would be particularly inequitable if individuals were to find themselves taxed on contributions to repair the deficit in their pension schemes, since this is for benefits that they have already accrued.

There is also a real concern that HM Treasury might seek to accelerate tax revenues from existing pension funds, for example by imposing a one-off tax charge to shift the scheme onto a taxed-exempt-exempt framework. Such a tax raid would be very damaging for members of both defined benefit and defined contribution pension schemes, but particularly so for members of defined benefit scheme, for whom there is no way of extracting the tax in a way that is fair to individual members.

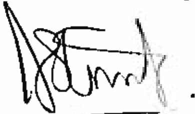
We would therefore argue strongly that no radical changes should be made to the taxation of defined benefit schemes.

15. Reforms to the annual and lifetime allowance would be more effective

Much of the complexity of the existing system could be reduced by removing the annual allowance in respect of defined benefit accrual and the lifetime allowance for defined contribution funds. The 20:1 factor for valuing defined benefit accrual for lifetime allowance purposes is also arbitrary and consideration should be given to a more actuarially justifiable factor related to the age at which the member accesses benefits. Such modest changes would be much more effective and much less damaging than some of the changes proposed in the consultation paper.

I trust that these comments are useful. I would be very happy to meet you in person, if it would be helpful to discuss some of these ideas in more detail.

Yours faithfully,



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