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The Hundred Group
of Finance Directors

Chairman
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Pensions tax relief
Room 2/E2
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Dear Sir/Madam,

Restriction of Pensions Tax Relief: Discussion Document on Options to Meet High Annual Allowance Charges from Pension Benefits

I am writing on behalf of the Hundred Group of Finance Directors with regard to HM Treasury's discussion document on options to meet high annual allowance charges from pension benefits.

Who we are

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 expresses 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, who may be making their own submissions.

Overall scheme pays policy

The Hundred Group is strongly opposed in principle to the idea that schemes should be required to pay members' tax bills and we are disappointed that the current consultation appears to take for granted that a scheme pays approach should be adopted and asks only which of two methods is preferable. We set out below in more detail our objections to the scheme pays approach, which we think is wrong in principle, impractical and difficult to operate and disproportionate in the burden it imposes on schemes.

In preparing our response, we have carried out a survey of a number of firms within the Hundred Group and this has provided some illustrative numbers as to how likely schemes are to have individuals who would fall within the scope of the scheme pays regime. Our results suggest that, even in very large schemes, very few individuals are likely to be in a position to need a scheme pays option (although, undoubtedly, if such an option were to be made available, more individuals would take advantage of it than would strictly need to).

Given that setting up the administration processes and systems needed to undertake the calculations is likely to impose a considerable burden on pension schemes, we question whether the scheme pays approach is the best route for dealing with the handful of individuals who might be affected. The existing HM Revenue and Customs ‘time to pay’ procedure could be a more cost-effective solution for all parties.

Because of the commercial and HR implications of the proposals, we trust you will have no objection to our copying our response to this consultation to the Department for Business, Innovation and Skills.

Principled objections to scheme pays

The Hundred Group does not believe that it should be the responsibility of a trust-based occupational pension scheme to pay tax on behalf of its members. Using pension scheme funds to pay a member’s personal income tax charge is a fundamentally improper use of trust assets. Just because the tax arises as a result of pension scheme accrual does not mean that the pension scheme should pay the tax bill. Share option schemes are not required to pay the tax that arises as a result of share options.

No doubt, some pension scheme members would welcome such a measure, just as they would welcome the opportunity (if given) to pay capital gains tax out of their pension scheme benefits rather than fund it directly themselves, but that does not mean that this is the right approach. Many individuals are now facing higher tax and NI bills than they or their employers had anticipated; but this is the only case in which it is proposed that payment should not come directly from the individual.

We are concerned that the availability of such an option could lead to discontent between employees, for example where an individual on a moderate income has to finance an unexpected income tax bill, possibly even requiring a bank loan, whilst they see senior members of the company being assisted in meeting their tax bills because the additional tax charge arose on their pension scheme benefits. We would also note that it seems likely that additional financial statement disclosures would be required for those highly paid employees whose additional tax is being paid from the pension fund and this is likely to lead to acrimonious comparisons and possible demands for equal treatment for all employees.

The purpose of a pension scheme is to provide retirement benefits for members, not to pay tax on their behalf. It would require overriding legislation to overturn basic and long-standing principles of trust and pensions law to enable trustees to pay out a part of members’ benefits to HM Revenue and Customs. Many schemes have a clause in their deed prohibiting reductions in benefits and, even with overriding legislation, there may still be a need for the trustees of such schemes to amend their trust deeds which will no doubt require expensive legal advice.

To summarise, in the words of one of our survey respondents: “It is totally against our policy and culture to take an approach that could be interpreted as company involvement in helping employees deal with their personal financial affairs”.

Need for scheme pays?

In order to assess what need there might be for scheme pays, we carried out a small but illustrative survey of Hundred Group companies. The full results are given in the table below.

Of the twelve companies who responded, eight indicated that they expected to have 50 or fewer members who would be affected by the £50,000 annual allowance, once the carry forward mechanism was taken into account. These schemes taken together have in the region of over 95,000 members in total. Eleven of the twelve expected to have fewer than

200 affected members. Only one scheme reported that it expected to see a significant number of its members (1,000 representing 10% of the membership) affected by the reduced annual allowance, once carry forward had been taken into account.

We also asked schemes to indicate how many members they expected to need to take advantage of the scheme pays option (if the threshold were set at £6,000). Six of the twelve respondents expected individuals to be able to meet the charge themselves or avoid it via changes to scheme design or reduced contributions. Another four indicated that a handful of members (15-40) might be a position where they might find it difficult to pay the charge.

Only the scheme with 1,000 affected members anticipated that a majority of those members might want to use scheme pays. It should be noted that the respondent commented that this was because it was ‘human nature to put off payment’. In other words, if a scheme pays option is introduced, more people will take advantage of it than might strictly need it.

Table 1: Numbers affected by annual allowance and unable to meet charge

Scheme	Affected by AA after carry forward	Company comment on need for assistance to meet AA charge	Total membership
1	Up to 200	We would expect most of them to be able to meet the tax charge from income or savings or avoid it by cutting back contributions	56,000 active members
2	40	None	950 active members
3	50	Don’t know	18,000 active members
4	50	30	1,250 active members
5	1,000	Our feeling is that, if given the option, the majority may want to make use of scheme pays because it is human nature to put off payment	10,000 members
6	30	15	50,000 DB members, 18,000 DC
7	15	None – some may have to realise investments (but only to a small degree)	3,200 UK employees
8	Between 26 and 42	All those affected earn a good salary and should be able to meet the AA. Perhaps 2 or 3 would find it more of a challenge.	2,700 active members
9	30-63 depending on inflation assumptions	15	1,356 active members (961 DB, 395 DC)
10	100	Nil, as we are changing our contribution structure to limit contributions to £50,000	9,500 members
11	80	40	3,000 active members
12	8	None	1,250 active members

Overall, these results suggest that, even amongst some of the largest schemes in the country, there will be very few people who might find themselves facing a tax charge that they were unable to pay. It is surely wrong to create a whole new administrative process that impacts directly on pension schemes to deal with the handful of individuals who might struggle to pay the tax themselves. We believe that HM Revenue and Customs already has suitable processes in place to deal with those few who are unable to pay tax charges. The scheme pays route would be an over-complicated solution to what is a very small problem.

We accept that a small number of companies may find themselves faced with more significant problems with a number of individuals facing higher tax charges. However, we believe that those problems can best be addressed by other mechanisms – such as the pension scheme being redesigned or the individual opting out of the pension scheme.

Cost of scheme pays

We also asked schemes to indicate how much they thought that an individual calculation under scheme pays could cost. Those who answered this question did not (in general) think that the annual transactional costs would be particularly high – especially given the low number of such calculations likely to be needed in each scheme.

However, a number of respondents drew attention to the costs of making the necessary initial process and system changes with figures in the region of £50,000 - £100,000 being given. We would question whether it is proportionate to require schemes to introduce such system and process changes for what may well turn out to be only a handful of affected members – especially where such a system might need to be maintained for thirty or more years under the tax deferral route. Again, we would suggest that this demonstrates that scheme pays is an over-engineered solution to a relatively small problem.

Table 2: Estimate of cost to administer single scheme pays calculation

Scheme	Do you have any estimate of how much it would cost to administer a single scheme pays calculation under either route?
1	Process/system changes could run well into six figures
2	Not much
3	Don’t know
4	[Our] DB scheme is administered by a third party administrator and most of the work involved in implementing “scheme pays” will be performed by them. Clearly they will look to recover this cost from their clients but [we] believe[s] that most of this cost will take the form of upfront investment in IT system improvements to automate the processes required to implement “scheme pays” rather than increased ongoing cost. It will then be a matter of commercial negotiation how these costs are recovered over time from each of the administrator’s clients. Given the economies of scale involved, our expectation is that the cost to administer each “scheme pays” calculation will be minimal.
5	Undertaking this exercise has been likened to implementing a divorce, where current NAPF charges are around £2,000 per case. The work involved is very similar - once you include all the relevant communications as well as calculations - & expect this figure to be reasonably realistic. However, this does not take into account the considerable initial expense involved in changing our systems to store the additional data required, as well as changes to our calculation routines.
6	Set up costs of £50-70,000 plus transactional cost of c £300 per case.
7	No – but not significant
8	£100,000 to install, then £50,000pa to run
9	We do not have an estimate of the possible cost. However, we consider that the cost will be in line with the cost of administering a pension sharing order and would therefore be manageable in view of the small size of the potential impacted population. The administration cost of the “scheme pays” proposals would also be balanced by the saving in administration costs for operating alternative solutions such as the spreading of pensionable salary increases.
10	No
11	We administer 3 schemes in house so it is difficult to isolate a cost for this.

12	No

Comments on specific questions

As indicated above, we object in principle to the introduction of a scheme pays regime. However, we assume that it would nevertheless be helpful if we were to supply our responses to some of the questions set out in the consultation for consideration in the event that the Government persists with this approach. Our replies are largely focused on points of principle, rather than of technical administrative detail.

1 The Government's current thinking is that it would be appropriate for individuals to pay the first £2,000 to £6,000 of any AA tax charge from their current income; and welcomes evidence to indicate an appropriate threshold figure. (Paragraph 2.9)

When the previous Government first considered introducing scheme pays as part of their consultation on the High Income Excess Relief Charge, it suggested a threshold of £15,000. It is not clear why the Government is now considering a much lower figure, since the existence of carry forward will take most people on incomes of less than £100,000 out of the scope of the tax charge altogether. We would favour a threshold of at least £10,000-£15,000.

We agree with the principle that individuals should pay part of any tax charge arising. The threshold should be set as high as possible (a) to remove as many individuals from the scope of scheme pays and (b) to ensure that individuals are made aware of the level of tax liabilities they are incurring. Otherwise, there is a risk that individuals will simply ignore the scale of their eventual tax liabilities because they do not need to think about it yet, leaving the pension scheme with the administrative burden in the meantime.

2 The Government welcomes views and evidence on whether individuals in DC schemes would have need of and / or would make use of a facility to meet AA charges from pension benefits. Views are also sought on whether restricting access to members of DB schemes only creates significant material administrative or communication issues for schemes. (Paragraph 2.11)

We expect that many defined benefit schemes with associated defined contribution arrangements would want to meet any charges from the defined contribution pot rather than by calculating a reduction to defined benefits. We tend to think that scheme pays should be available as an option for defined contribution arrangements to the same extent as defined benefits, albeit that we expect most individuals will tailor their contributions to a defined contribution scheme to avoid triggering the annual allowance charge.

3 The Government welcomes views on whether there are other exceptional circumstances in which it is appropriate to exempt certain schemes from facilitating payment of AA tax charges, including whether this would differ under the broad options. (Paragraph 2.13)

We understand that a number of companies are intending to modify their scheme rules to restrict annual accrual to £50,000. Given that this tallies with the Government's intention for individuals to 'aim off' the annual allowance, we believe that such schemes should be granted an automatic exemption from scheme pays so that they will not need to spend money investing in a process that they expect never to use (but may find that they have to if an individual makes contributions outside that scheme which then take individuals over the annual allowance – see further our answer to question 4).

4 The Government welcomes views on its proposed approach to multiple pension-holders. That is, that individuals are allowed to elect for a single scheme – in which they are an active member – to meet the AA charges each year; and that where the AA has been exceeded outright in a single scheme in a given year, that is the only scheme

that can be elected to meet the liability from their pension benefits. (Paragraphs 2.14 and 2.15)

The majority of individuals with multiple pensions accruing concurrently are likely to have them for one of two reasons.

First, the individual may have multiple schemes with the same employer e.g. a defined benefit scheme and a defined contribution scheme. In such cases, it would seem more reasonable for the company or pension schemes to determine from which scheme it is more administratively convenient to deduct the tax, rather than for individuals to make their own nominations.

The other likely scenario is where individuals are making additional contributions to a personal pension. Given that individuals had the option not to make those contributions, it is hard to see why their pension scheme should be penalised by having to operate scheme pays for contributions made outside their own scheme. This is particularly true in the case where accrual in the main pension scheme is capped at £50,000 pa (see our previous answer). In such cases, we believe that it should be the individual's private pension that should suffer the tax charge.

5 The Government welcomes views on whether it would adversely affect schemes, administratively or otherwise, to meet a charge that did not arise exclusively in that scheme. (Paragraph 2.16)

It would inevitably add to the administrative burden of the scheme required to pay the charge, especially given the Government's proposal that individuals should not be required to pay for the scheme pays process.

6 To inform the overall approach, the Government would be interested to see evidence on the numbers and characteristics of employees or scheme members respondents have identified as potentially eligible to meet AA liabilities from pension benefits. (Paragraph 2.17)

See our detailed comments under 'Need for scheme pays?' and Table 1 above.

7 The Government welcomes views on whether respondents agree that it would be insufficient to report the value of the charge to be offset without explaining the corresponding effect on pension benefits to members; and whether the level of detail and precision required varies across the options. (Paragraph 3.13)

Under the Government's proposals, the onus for explaining how the tax charge will impact on individuals' benefits has been placed firmly on employers and trustees. There is every likelihood that individuals will raise complaints in future (against employers, trustees or both) on the basis that they did not fully understand the implications and therefore made decisions they would not have done, had communications been clearer.

We believe that there should be the maximum flexibility available to schemes to communicate with members in a way that is appropriate to that particular scheme. If, however, the Government were to require a standard form of communication, then we believe that this should go hand-in-hand with a blanket exemption for trustees from liability in respect of any complaint raised against them in relation to that communication.

8 The Government welcomes views on whether it is necessary for individuals in the year of benefit crystallisation to have access to the option to meet their liability from the pension benefit, and if so how to ensure that this process works sensibly for both schemes and members. (Paragraph 3.22)

We have no specific comments on this question.

9 The Government welcomes views on whether there are other circumstances in which the application of either option may need to be given specific consideration? (Paragraph 3.23)

We have no specific comments on this question.

10 The Government welcomes information that explains how and why these might work differently in practice, and where that leads to different impacts for scheme members, or scheme administration. (Paragraph 3.24)

A basic assumption has been made that schemes will generally have a year to implement the tax charge. However, this timescale is unrealistic in areas which have their own additional legislative or regulatory deadlines, such as divorce or transfers out. This will place yet another huge burden on the administration of pension schemes.

11 The Government welcomes views and evidence to indicate where legislating for a standard approach would reduce burdens, or be necessary to ensure that the policy intent is delivered; and whether there are areas where the Government should be even less prescriptive. (Paragraph 3.25)

If a scheme pays option is pursued, then schemes should be given the maximum flexibility as to how they operate the process in a way that is least expensive to the scheme.

12 The Government welcomes views on any practical or administrative issues that may arise from implementing these options to meet charges from pension benefits, bearing in mind that the Government believes it is necessary to introduce a facility to meet high AA charges from pension benefits. In particular it is interested in the benefits and burdens associated with each of the options, and whether there are significant differences between the two. (Paragraph 3.26)

As indicated above, we disagree with the Government that it is necessary to introduce a facility to meet high annual allowance charges from pension benefits.

We also question the suggestion in paragraph 3.9 that individuals should not have to pay an administrative charge when they choose to avail themselves of assistance to meet their tax liabilities. Charges are levied when pensions on divorce calculations are carried out and the work involved is likely to be of similar extent. As noted above, the costs for carrying out individual transactions are not likely to be particularly significant when compared to the substantial costs for making the initial changes to processes and systems; however, it seems surprising that members should be required to make no contribution at all to a calculation that is only being done at their request and for their benefit.

The consultation provides no rationale for the decision to prohibit the imposition of member charges. If the Government's concern is that requiring members to pay an administrative charge up front would mean that the initial threshold for scheme pays would have to be lower, this could be prevented by allowing schemes to make a deduction for the administrative charge from the member's benefits at the same time as making a deduction for the member's tax liability.

In terms of which of the two options, 'pay now' or 'pay later', is preferable, we would on balance prefer the 'pay now' option (although we are aware that some companies express the contrary view).

If the tax deferral option were differently constituted, it might have been more appropriate. We do not see why it should be for the scheme to track, probably for decades, tax liabilities that are properly a matter to be settled between individuals and HMRC. Schemes are likely to undergo radical changes over the next 30 years, and the existence of deferred tax liabilities to be tracked and then debited from members' ultimate benefits could cause considerable complexities many years down the line.

In many cases, once individuals have incurred a tax liability for exceeding the annual allowance, they are likely to take preventative action to avoid doing so in future (especially where the threshold below which they have to pay the tax immediately is set relatively high) and therefore tax liabilities will not arise in future years. Schemes could therefore be left tracking for years a single year's tax liability which they are unable to settle under the member chooses to retire.

On balance, therefore, we believe that the 'pay now' option is the lesser evil of the two scheme pays approaches, although we do not believe that either approach should be implemented.

13 The Government welcomes views on whether there are particular advantages to this approach of rolling-up AA excesses, rather than AA charges. (Paragraph 3.28)

We have no specific comments on this question.

Please let me know if I can be of further assistance to you. We would be happy to assist HM Treasury further in determining its policy.

Yours faithfully,

Eddie Weiss

E L S Weiss
Chairman
The Hundred Group – Pensions Committee