AMPS ASSOCIATION OF MEMBER-DIRECTED PENSION SCHEMES

AMPS Response to Treasury paper:

Restriction of pension tax relief: a discussion document on the alternative approach.

Summary

- AMPS supports adoption of the alternative approach of a reduced annual allowance (AA) to restrict pension tax relief.
- The correct level for the AA should be no lower than £50,000. Therefore, if the AA is set below this level to meet the current yield requirements dictated by the economic climate, commitment should be made to increase the AA when fiscal policy allows.
- A mechanism to make catch up contribution payments for missed contributions should be introduced, made all the more important if pension input periods are aligned to the tax year.
- The lifetime allowance (LTA) should not be reduced from £1.8m.
- Members with LTA protection should not have growth taxed.
- Full marginal rate tax relief should be retained.
- Employer contributions (in addition to personal contributions) should be refundable in order to avoid an AA charge.

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Introduction

The Association of Member-Directed Pension Schemes (AMPS) has been heavily committed to participating in the consultation processes regarding the implementation of the restriction of pension tax relief, commenced under the previous Government and continuing under the current Government.

AMPS made strong representation against the method that is now contained in Finance Act 2010 for restricting pension tax relief, arguing that a reduced AA would be a better method. This was in common with representations made by many other interested parties.

We are therefore delighted that the current Government has heeded the concerns expressed by the pensions industry about the current method and is prepared to consider the alternative approach of reducing the AA.

Fundamentally then in accepting that the economic situation does require a reappraisal of the affordability of pension tax relief, AMPS is in favour of adopting a reduced AA as the primary means of restricting pension tax relief.

We do of course have concerns about the ramifications of applying a reduced AA but praise the Government in seeking the pension industry's input on what issues arise and how they might be resolved before legislating.

We therefore welcome the opportunity to responded, via this paper, to the questions as set out in section 5 of the Treasury's discussion document.

Firstly though we make some general comments about the proposals.

General comments

In the AMPS response made in March 2010 to the previous Government's consultation document: Implementing the restriction of pension tax relief, we supported our call for the use of a reduced AA by setting out a case for the AA to be set at no less than £50,000.

The rationale being that an AA set at this level would:

a) be equivalent to the maximum contribution that could be made under the pre A-Day personal pension regime, so would not be regressive, and
b) according to our research and data submitted as part of the special annual allowance consultation, represent the average contribution made by those who did not make regular contributions.

We also made reference to research papers prepared by Adrian Boulding of Legal & General in which he asserts that an AA of £50,000 would yield the necessary savings for the Government and that set at this level (or 3% of the LTA) it would still give consumers a reasonable ability to accumulate funds up to the LTA providing that a disciplined approach was taken to making contribution throughout working life.

We are therefore very concerned that an AA in the region of £30,000 to £45,000 is being put forward by the Government albeit as one that might deliver the necessary yield.

We understand that delivering the necessary yield over the forecast period is of paramount importance but we do not have the modelling tools, assumptions nor the data to test different scenarios and therefore must trust and rely on the Government to calculate the appropriate figure given the features we are calling for. However, based on our earlier call for an AA of no less than £50,000 we would urge

the Government to look towards setting the AA at the upper end of the scale. Accordingly where we have made reference in this response to an AA of £40,000, this is for illustrative purposes only and should not be taken as our recommended figure.

In accepting that our called for features may drive down the AA figure in order to meet the required yield we would further urge the Government to consider that if it were not constrained by the overriding need to deliver the yield, what the appropriate level for the AA should be, such that as and when the economic climate improves the AA could be moved towards the desired level.

In advocating that the AA is the mechanism to be used now and in the future to control the extent of pension tax relief being granted and that it can be adjusted upwards or downwards to reflect economic conditions and fiscal policy, we strongly recommend changes to other aspects of the pension tax regime are kept to a minimum to avoid complex interactions with secondary mechanisms.

An exception to this is that we strongly urge the Government to introduce a mechanism to allow catch up contribution payments to be made in acceptance of the fact that few consumers are able to make sustained, regular, significant contributions and a reduced AA could prevent such consumers making up lost ground. We articulate this point in more detail later in our response.

AMPS would very much welcome the opportunity to provide further information and participate in ongoing consultation to develop the ideas and suggestion arising from this discussion paper.

Responses to Section 5 of the discussion document

1) AA last year exemption removal

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);

AMPS comments:
With regard to the removal of the exemption from the AA test in the year benefits come into payment, we can appreciate that retention of this exemption could give scope for avoidance behaviour. Furthermore as it is anticipated that taking of benefits in stages will become more prevalent as individuals seek to remain employed for longer, perhaps on a part-time basis, the traditional concept of a set year in which benefits come into payment is becoming outdated.

However, we are concerned that removal of this exemption will adversely affect small business owners. Such individuals may not have been in a position to have made sufficient pension contributions during their working life where profits are reinvested in the business, which helps the economy as a whole and therefore they should not be penalised. In such circumstances it is not unusual that when the individual wishes to retire, the proceeds from the sale of the business are used to make a one off contribution to a pension arrangement to make up for the inability to make regular contributions.

The removal of the last year exemption alone would not have such dramatic effect if the AA was maintained at £255,000 but combined with the reduced AA the impact is potentially great. Also, the suggestion that AA pension input periods be aligned to the tax year, rather than be variable, removes any scope for staggering payments between tax years.

Accordingly whilst it could be argued that the exemption for individuals in this position should be maintained, in the interests of simplicity we are not arguing for such an exemption. However, we strongly advocate, as set out in point 4 below, for there to be a facility to make catch up payments that would be available to all and therefore go some way to appease the issue for these particular individuals.

As AMPS only represent providers in relation to schemes set up as '(other) money purchase arrangements', we have no comment to make on '*the exemption for individuals claiming enhanced protection under the Finance Act 2004 tax regime.*' We understand that this issue only relates to defined benefit schemes.

2) Limiting flat rate factor abuse for DB schemes

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 calculation, or the use of age-related factors, in specific circumstances to capture the value of certain pension enhancements (Paragraph 2.11);

AMPS comments:

As mentioned, AMPS remit and experience does not directly cover DB pension arrangements. However, our view is that whilst there needs to be general parity between DB and DC, if simplicity is achieved through acceptance of a relatively small difference in the treatment to the benefit of DB over DC then this could be palatable. However we would support a change in using a flat rate factor if it would facilitate a higher AA.

3) Impact of flat rate factor on DB deferred members

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);

AMPS comments:

Answer as per 2 above.

4) AA exemptions and application

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);

AMPS comments:
Our most significant concern with the proposed reduction in the AA is that it is a 'use it or lose it' allowance. Whilst an AA of around £40,000 is not wholly unreasonable in terms of those individuals / employers who are able to make contributions on a sustained regular monthly or annual basis, it does not give enough scope for those who are unable to make significant regular contributions to make good missed contributions.

The post A-Day regime with its AA in excess of £200,000 and the ability to make a tax relievable contributions equivalent to 100% of income gave most individuals a significant opportunity to make catch up contributions. The ability to effectively double-up in a tax year through flexibility of the pension input period timing also allowed for one-off peaks in contributions over the AA. This was one of few successful aspects of Pensions Simplification in that it gave individuals much greater scope to make contributions of amounts and at times that suited their personal circumstances.

By now imposing a retrograde limit to that flexibility through the imposition of a 'use it or lose it' allowance of only circa £40,000 leads us towards one of the most restrictive pension regimes ever at a time when every effort needs to be made to empower more individuals to take responsibility for funding for their retirement. This is not helped if such flexibilities and control over amounts and timing of contributions is taken away. It should also be recognised that people may have been delaying making contributions expecting a large allowance to continue.

We do however accept that the current regime does not give sufficient scope for the exchequer to manage the cash flow aspects of the tax relief granted on pension contributions from year to year but we believe a 'use it or lose it' AA of circa £40,000 will swing the pendulum between flexibility and restrictions too far towards restriction.

We strongly recommend that consideration is given to a facility which will allow individuals to make catch up payments that will be a compromise between retaining some degree of flexibility for individuals whilst still adequately limiting the cash flow in terms of tax relief granted.

Whilst detail of how such a facility might work would need further analysis and consultation, in particular its operation within the defined benefit regime, we believe the following basis is worthy of consideration.

In essence it would work on the following basis. In the current tax year an individual could make tax relievable contributions of the lesser of the AA i.e. £40,000 or their income, plus up to the total of the cumulative balance of the tax relievable personal contributions that could have been made but were not made in the previous five tax years.

Example 1: Jill Bloggs

Tax Year	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Earnings	£30,000	£35,000	£40,000	£45,000	£50,000	£60,000
Annual Allowance	£40,000	£40,000	£40,000	£40,000	£40,000	£40,000
Maximum Personal Contribution	£30,000	£35,000	£40,000	£40,000	£40,000	£40,000
Actual Contribution Paid	£5,000	£5,000	0	£15,000	£10,000	£40,000
Balance	£25,000	£30,000	£40,000	£25,000	£30,000	0

Assuming the current tax year is 2016/17, Jill Bloggs could make a tax relievable contribution of £40,000. Having done so Jill can now look back over five tax years and make an additional contribution of no more than the cumulative total of the balance of the contributions that she could have paid in each of those years but did not i.e. £25,000 + £30,000 + £40,000 + £25,000 + £30,000 = £150,000. The balance from the earliest year must be used prior to balances from subsequent years.

Example 2: Jack Bloggs

Tax Year	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
Earnings	£15,000	£15,000	£0	£0	£15,000	£0
Annual Allowance	£40,000	£40,000	£40,000	£40,000	£40,000	£40,000
Maximum. Personal Contribution	£15,000	£15,000	£3,600	£3,600	£15,000	£3,600
Actual Contribution Paid	£5,000	£5,000	£0	£3,600	£10,000	£3,600
Balance	£10,000	£10,000	£3,600	£0	£5,000	0

In example 2, Jack who has no earnings in the current tax year could make a maximum contribution of £3,600. Having done so he can then make an additional contribution of £10,000 + £10,000 + £3,600 + £5,000 = £28,600.

We believe that this mechanism or similar for making catch up payments would significantly improve the proposals being made by softening the hard edges of the restriction. Furthermore, if designed in the right way should not result in greater out flows of tax relief.

Some key benefits of introducing a contribution catch up facility are:

- It provides a fairer treatment for those that are unable to make sustained substantial regular contributions.
- Allowing additional contributions in this manner would assist in the longer term goal of ensuring less reliance on the state.

- This mechanism will ease the situation for those affected by the proposed removal of exemptions to the AA. For example redundancy payments could be used for catch up contributions.
- It can be utilised by the self employed and others who have fluctuating earnings and profits to make good prudently forfeited contributions in lean years when circumstances allow.
- Also the self employed are disadvantaged in not knowing what their total earnings are until after the end of the tax year so could be a basis of allowing catch up payments in the following tax year once earnings are established.
- It allows scope for those that have a career break, for example during maternity / paternity leave, caring for a relative, retraining, health reasons or job loss.
- Where funds have been depleted through a divorce sharing order there would be scope for the donor to make good their depleted pension fund.
- Although it is expected that individuals will aim to not exceed the AA, where it is exceeded this would be a mechanism that may allow the excess to be retained in the fund as an allowable contribution.
- It may be a mechanism that could be utilised for allowing unused funds on death to be passed on from a relative's pension fund.
- The Government has indicated that it may look at allowing earlier access to pension fund money and therefore the mechanism may be appropriate as a means of allowing a subsequent re-building of a pension fund.

AMPS would welcome the opportunity to be involved in further consultation around such things as the tax relief that would be applicable on the catch up payments, its fiscal impact and operational aspects.

5) AA exemption on ill health or redundancy

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);

AMPS comments:

We believe that by providing a mechanism for catch up payments as outlined in our response to point 4 above, there will remain an opportunity for some increase in pension benefits to compensate for ill health early retirement or redundancy whilst controlling the extent of tax

relief given that would not otherwise be possible by allowing a complete exemption to the AA for these events.

6) Level of LTA and tax on growth

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);

AMPS comments:
We are against any adjustment to the LTA. The declared saving to the Exchequer can only be viewed as poor value compared with the work complexities that would result from a reduced LTA and the potential change to the benefits for protected individuals

Furthermore, recognising that an intention of these proposals is to change the primary means of restricting tax relief from the LTA to the AA, by default the LTA becomes relatively superfluous.

With the vastly reduced AA the prospect of many individuals being able to fund up to the LTA is significantly reduced. Those that may come close to breaching the LTA in the future may do so not through excessive contributions but through the skill and/or good fortune of making good investment choices. In relation to the objective of fairness we would question the fairness of penalising those who have achieved good investment growth.

Whilst there is an argument for removing the LTA completely because of its relative redundancy and the benefits this would bring in terms of simplification, we suspect that the Government would be nervous of complete removal of this secondary backstop position.

Furthermore we recognise that whilst individuals starting out on pension saving under a reduced AA regime are unlikely to exceed the LTA, the LTA mechanism needs to be maintained for those who have already accrued pension funds under the current regime, including those that registered for protection at A-Day. It would add complexity if the LTA were retained only for a particular group of individuals, though it could potentially be phased out over a period of years.

Whilst the LTA will have diminished relevance to new contributors it remains highly significant to existing pension plan holders. Of major concern to us is the prospect of the LTA being reduced. We are vehemently against any such proposal and the proposal does not seem to benefit from a material increase in receipts for the Exchequer. A reduction would be retrospective detrimental legislation by bringing individuals into a situation where they would now be subject to LTA charges when they had done the right thing by planning and abiding by the pre and post A-Day rules. It should be recognised that one of the biggest criticisms of the previous Government with regard to pensions was the constant tinkering with the rules which is particularly damaging when pensions are long term contracts. Making detrimental retrospective changes will just fuel individuals' reticence to commit to long term pension savings as proposals such as this one will provide evidence that Governments will not keep to promises made.

We also strongly oppose the prospect of the value of rights covered by primary and enhanced protection being frozen such that any increase in value would be subject to an LTA charge when benefits are crystallised.

As already stated retrospective detrimental changes are damaging to both the public's confidence in pensions and the Government. This change would be reneging on the pension's deal that had been struck. Whilst any Government will argue that any such 'deals' are subject to the country being able to afford to maintain those 'deals', we struggle to see how taxing growth in this way will help the cause in restricting tax relief during the current adverse economic climate or longer term. Nor provide the Exchequer with a revenue stream that will allow easement of restriction on pension contribution tax relief.

If implemented we predict that those individuals with protected pensions who have attained age 55 will crystallise benefits to avoid an LTA charge on future growth. The likely preferred mechanism of crystallisation for members of member-directed pension schemes being into Unsecured Pension having first taken the 25% tax free pension commencement lump sum. With zero income being elected under the Unsecured Pension the Exchequer would not benefit from any immediate income tax.

In addition we believe that introducing such retrospective detrimental rules will discourage use of pension vehicles for saving. Furthermore, it may encourage some to seek out opportunities to move money to other jurisdictions that will then yield no income to the Exchequer in the future. We believe that there is evidence of this behaviour borne out by the increased interest in QROPS as a result of the treatment and high tax charge on funds passed on to beneficiaries on death after age 75. We welcome the fact that the Government has issued a discussion document looking at changing rules around aspects of age 75 rule.

For example, those who are under age 55 and so cannot crystallise to avoid the LTA could transfer to QROPS and that transfer would trigger the LTA test. Even though they might remain UK resident and so retirement benefits would have to mirror the UK system, the LTA test would already have taken place at the point of transfer and so the LTA charge would have been avoided. A reduction in the LTA gives a clear message that the Government believes it is able to tax pension funds and so will undermine the UK pension market.

If the working assumption is that a reduced AA of £40,000 might be sufficient to deliver the required yield for the Government which as per paragraph 2.31 of the discussion document states that the estimated yield does not assume any reform to the LTA, then given that we cannot see any fiscal advantage of the LTA being adjusted, we struggle to see how reducing the LTA or imposing LTA charges on growth above the LTA would have the effect of being able to raise the AA higher than £40,000 by anything more than £600.

It should not be underestimated the adverse impact any rules changes will have on administration, documentation, processes, IT systems, training and advice, particularly with a short implementation period. Given that there are more critical changes to be made we believe that the LTA should be left at the current £1.8m level with no charge on growth above that level. The LTA is currently frozen at £1.8m until 2015/16 therefore in real terms the value of the LTA will be reducing anyway and therefore does not need to be accelerated by an actual monetary reduction.

We are also mindful of other potential pension reforms, in particular the aforementioned discussion around changes to the age 75 rule. AMPS will be contributing to that discussion and one aspect we wish to explore is the reintroduction of a facility that will allow unused funds following death to be passed on to beneficiaries' own pension funds. An LTA mechanism may well be an important feature of any such facility as a means of limiting how much an individual can inherit in this manner.

7) Capping tax relief at 40%

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);

AMPS comments:

We believe that the current principle that pensions are deferred pay is correct and should be maintained. As such, in sacrificing income today in order to receive income in retirement, full marginal income tax relief should be granted on the sacrificed income but equally full income tax should be charged on receipt of the pension income. In other words we support the basis of an Exempt, Exempt, Taxed pension regime.

Our starting point therefore is that income tax relief should not be capped.

It is inevitable that income tax rates will change from time to time and therefore retaining the current basis of full marginal tax relief allows the pension contribution tax relief to flex according to prevailing income tax rates.

Any capping will bring with it an added complexity which we believe should be avoided. Retaining the engagement of higher rate tax payers, particularly those in business positions that influence the provision of retirement benefit packages for their employees is an important factor in encouraging the uptake and adequate funding of pensions.

We would be surprised if retention of a 50% tax rate were to be a long term fiscal strategy and therefore believe that adding in additional complexity for what may be a relatively short term situation would be counter productive.

If a cap were to be introduced then in future years where income tax rates were changed there could be pressure to adjust the rate at which tax relief is capped causing increased concerns that the system is not stable and will be a disincentive for individuals to invest.

It would be nice to think that if a cap were to be introduced that this might be treated as a temporary austerity measure such that when the Government succeeds in turning the economic situation around then the cap could be removed. However, the reality is that once introduced it could be politically difficult to put through further amending legislation to remove the cap.

By creating another mechanism to control pension contribution tax relief in addition to the intended primary mechanism of the AA and the secondary one of the LTA is not good design. For clarity and simplicity one mechanism should be used. If tax relief in future years

needs to be further restricted or can be relaxed then it is far better to do this via adjustments in the primary mechanism of the AA.

If through retaining full marginal tax relief, when combined with any other agreed features of the new regime, it will result in a lower AA, then this might be acceptable provided that the mechanism for making catch up contributions as outlined in point 4 above is employed.

8) Adjustments for large one-off DB increases
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);

No comment

9) Pension input alignment
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);

AMPS comments:
The current facility of being able to select pension input periods does allow individuals wishing to fund for retirement through contributions that would exceed the AA, to make two contributions up to the AA in quick succession by adjustment of their pension input period. Whilst this could still be possible with pension input periods aligned to tax year only by making a payments either side of the tax year end, it will restrict the ability to make larger contributions at other times in the year.

Therefore in restricting the pension input period to tax year end only adds to the call for the catch up payment mechanism we are advocating in point 4 above.

One pitfall relating to a reduced AA (and alignment of pension input period to tax year if implemented) with effect from 2011 is a transitional issue.

For example, someone who has a pension input period ending 31 May 2011 might have paid a £255k contribution on 1 June 2010. This would be pre Emergency Budget so pre the announcement of the review, and might be expecting that the £255k contribution would be tested against a £255k AA for 2011/12 tax year. We note that paragraph 4.13 of the discussion document highlights this as an issue that will require transitional rules.

Therefore consideration needs to be given to transitional arrangements, or a longer lead time if transitional rules are not possible.

We also think it is relevant to mention in this section that where the AA is exceeded there should be provision for an individual to elect for a refund of the excess contribution, as for the Special Annual Allowance provisions introduced in April 2009. We can see no argument why

such a provision is not also available on employer contributions allocated to specific individuals and request that this provision is also included, particularly given any charge would need to be actually funded by the member (rather than discounting tax relief due).

10) Provision of statements requirements
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);

AMPS comments:
We do not believe that there is any significant burden to provide information relating to pension inputs.

11) Impact of providing statements
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);

AMPS comments:
Ditto point 10

12) Timeliness of information provision
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);

AMPS comments:
We are satisfied that (other) money purchase arrangements should be able to provide the information required within a reasonable period of time for the individual to then complete their Self Assessment return within the due time scales. The limiting factor for information will be in relation to DB or Cash Balance arrangements.

13) Impact on overseas pension scheme members
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).

No comments.

AMPS ASSOCIATION OF MEMBER-DIRECTED PENSION SCHEMES

About AMPS

The Association is a combination of two former associations from the self administered industry, the Association of Pensioneer Trustees (APT) and the SIPP Providers Group (SPG).

It was agreed to combine the two associations following the introduction of the Simplification and Taxation of Pension Schemes in order for the industry involved in the administration of, provision of and establishers of self administered arrangements to have a single cohesive voice rather than the possible fragmentation of a very professional group of pension specialists.

The Committee is drawn from all walks of the self administered industry and includes pension consultants, actuaries, lawyers and insurance company representatives.

AMPS represents approximately 200 member organisations operating or providing services to Small Self Administered Schemes (SSAS) and Self Invested Personal Pensions (SIPP).

It is estimated that in excess of half a million individuals have pension provision in a member-directed pension scheme. SIPP products are suitable for a wide spectrum of the population and the SIPP market continues to experience growth of 20% each year based on data taken from industry publication surveys. Estimates for funds under management in these products is in excess of £50bn

Employers sponsoring SSAS and SIPP membership are typically family-run businesses, employing up to 100 people, although the membership of these schemes is generally limited to the directors or owners of the businesses and their families.

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