



The Coalition Government has pledged to simplify taxes and to remove at least one regulation for every new one it makes. The final rules for the 2011 restriction on pension tax rules will be an acid test as to whether this stated change in approach is genuine

Government will face a challenge to honour its commitment to tax simplification in finalising rules for restrictions on pensions tax relief from 2011

8 September 2010: Along with employers and much of the pensions industry, the Association of Consulting Actuaries (ACA) has welcomed the Government's recognition that the previous government's "high earner" plans to restrict tax relief on pensions savings made from 2011 were developing into a regime that it acknowledges would "have unwelcome consequences for pension saving, bring significant complexity to the tax system, and damage UK business and competitiveness". The current Government has indicated that it may move to a different approach based on a reduced Annual Allowance (AA), and its Discussion Document indicates that simplicity is high on the agenda. However, the ACA says there are compromises that must be made in sticking to the principle of simplicity whilst making the policy work in practical terms.

Stuart Southall, Chairman of the ACA, commented:

"A reduced Annual Allowance (AA) is relatively simple to operate for defined contribution pension savings. But there is much for the Government to pin down on the defined benefit side. We urgently need a decision as to whether it will go ahead with the Annual Allowance approach, and then all the key details of how the regime will work must be quickly finalised."

The design of the new AA tax will influence the shape of defined benefit pensions for the foreseeable future as exceeding the AA will attract a penal rate of tax. The ACA has suggested features that make it more straightforward for companies to maintain defined benefit or hybrid arrangements. For example, the ACA has asked for prior year benefits to be indexed without counting against the reduced AA, so that Revalued Career Average schemes only have to compare current year benefits against the AA, rather than looking back at all previous years' entitlements.

"If indexation is not allowed for, it will be more difficult and administratively onerous for employers to offer defined benefit pensions in the future. Low paid workers particularly value the certainty that comes with defined benefit

arrangements and it would be a shame if tax aimed at those on higher earnings disadvantaged those on lower earnings by making it more onerous for employers to comply with the new regime,” noted Stuart Southall.

The ACA response to the Treasury and HMRC discussion paper highlights that some of the most important defined benefit tax questions relate to the year an individual draws benefit.

ACA is concerned that little is known as yet about the tax calculation when individuals draw benefits early: this should be consistent with the planned simple “flat factor” tax calculation while the benefits build up, using an approach that can be easily understood and planned for. Whilst the ACA recognises that the Government might be concerned over abuse of ill-health exemptions, the ACA has suggested some measured compromises in its response which would minimise the tax on genuine ill-health cases whilst not creating opportunities for abuse.

More generally, the ACA believes allowing limited carry forward, or back, of excess pension accrual over the AA will minimise the impact on moderate earners of “spikes” such as a salary increase on promotion or redundancy.

These and similar concessions would help in the Government’s aim to protect those on lower or middle incomes who could otherwise face big unexpected tax bills (which could wipe out much of the pension giving rise to the tax).

Karen Goldschmidt, Chair of the ACA Pensions Taxation Committee commented:

“There is an argument for a special light touch regime for retirements in 2011/12. Members currently planning retirement will have no idea how they might be taxed – indeed they may not know there is a possibility they will be taxed. And the information they and their employers need is coming through very late in the day – inevitable given the political history of this proposed regime.

“Perhaps the biggest challenge will be to design a tax information and collection system that avoids costly administration for employers, pension schemes and individuals: this includes the paperwork exchanged, the mechanisms for paying the tax – and making sure that, as much as possible, after an individual has left pensionable service and become a deferred pensioner, the requirements to test for the new tax are very, very limited.”

Carrying on the call for simplicity, ACA asks that any anti-avoidance measures should be kept clearly defined and tightly focussed, to help employers understand and operate the regime.

The ACA’s evidence to the HMT/HMRC on their discussion document ‘*Restriction of pension tax relief*’ is available at www.aca.org.uk (see: recent publications).

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Note for Editors

About the Association of Consulting Actuaries (ACA)

The Association of Consulting Actuaries (ACA) is the representative body for consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body. The ACA has 1750 members working in around 75 firms. ACA Members are all qualified actuaries and all actuarial advice given by members is subject to the Actuaries' Code. The ACA forms the largest national grouping of consulting actuaries in the world.