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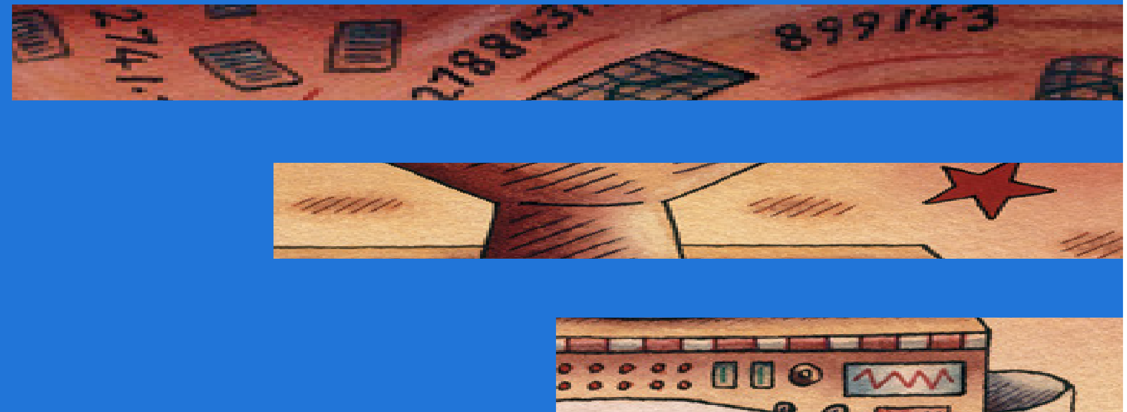

High income pensions taxation

ACA consultation response

25th February 2010

Karen Goldschmidt

UK Professional Pensions Awards

Actuarial Consultancy of the Year 2005 | 2006 | 2007
Investment Consultancy of the Year 2007

FT Business Pension & Investment Provider Awards

Actuarial Consulting 2007 | 2008
Investment Consulting 2007 | 2008

Corporate Adviser Awards

Best Member Communication Strategy 2008
Best use of Technology by a Corporate Adviser 2008
Best Strategy for Investment Advice on Pensions 2009

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2011+: the political imperatives

- Impact only on ‘high earners’
- Immediate £3bn pa tax-take
- Shadow Minister: *This damaging decision will hurt pension funds and further weaken our culture of saving. As we have made clear, we do not support this change, but given the dreadful state of the public finances we cannot pledge to reverse it at this stage.*

Daily Mail

Agenda for today

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- Engaging with the proposals
- Alternatives

Stated policy for implementation

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Fairness between DC/DB, DB/DB	Retirement 2010/11, 2011/12, +
Simplicity	Administration complexity, errors
Sustainability	Affordability Durability
Ability to plan	2D approach means need to plan remuneration, employment strategy ..

Themes of the consultation document

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High income measure	Year of retirement £130,000 cliff edge
DB value and quantum of benefit	Key issue for ACA
Collection process: scheme pays	Burden fundamentally underestimated
Impact	Cost to employer, scheme, member, industry Long term impact for pensions

The annual test for who is "high income"

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Income from employer	+	Personal income

If **£130K or more..**

Add on **Pension saving from employer**

If **£150K or more, then high earner**

Income threshold challenges

- Huge cliff edge at £130,000
  - Salary £120,000 and pension value £50,000
    Bonus of £10,000 = recovery tax £13,000 = total marginal rate 172%
  - Distortion in remuneration packages, employment, and “over- self-selection” away from pension
- Salary sacrifice add-back – unsustainable
  - existing employee on £140,000 sacrifices for £20,000: caught
  - new recruit joining on £120,000 + £20,000 pension: not caught
- Frozen thresholds and interaction with tax bands that may change - unsustainable

Defined benefit

- Value
  - Age Related Factors (ARF) v cash equivalent v (high) fixed
  - ARF: Quality eg pension increases, NPA tranches
- Quantum of benefit - holistic approach needed
  - Leaver measure (Cadbury style)
  - Revaluation
  - NPA
  - Enhancements
  - Exemptions?
- Pre 2011 mitigation
  - Panicked retirements before 6.4.2011

Normal pension age (example D2 in Consultation Document)

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- Q, **aged 54,** is in a 1/60ths final salary scheme where
- Benefits are payable unreduced from age 55 if retiring from service, or from age 60 if leaving active membership before age 55.
- 10 years' service, pensionable salary of £200,000
  5% pay rise to £210,000 (revaluation ignored here for simplicity):
- Pension accrued at 5.4.nn = £33,333 (=10/60 x £200,000);
- Pension accrued to 5.4.nn+1 = £38,500 (=11/60 x £210,000);
- Relevant age related factor is for [age 54/ NPA 60], say 18
- Deemed contribution (£38,500 - £33,333) * 18 = **£93,000**.

Example ctd

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- **A year later**, aged 55, Q receives a pay rise to £220,000 and subsequently retires from active service with unreduced pension.
- Pension accrued to 5.4.nn+2 = £44,000 (=12/60 * £220,000);
- Say ARF for age 55/ NPA 60 = 18.5;
  ARF for age 55/ immediate pension is 25
- Deemed contribution of (£44,000 x 25 - £38,500 x 18.5) = **£387,800**

Early retirement terms

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- Examples deal only with "nil reduction"
- Charge in every case where HMRC factors differ from the scheme's?
- Drastic difference between retirements 2010/11 and 2011/12. Need a transitionary tapered exemption, confirmed urgently
- What if anything should be protected?
  - Guaranteed "enhanced" from in-service
  - Enhanced only at employer consent, but a practice

Alternatives (if politically acceptable) Would AA be better than the proposal?

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Income test complexity In or out, cliff edges and taper	No income test No cliff edge Continued buy-in from high earners
DB: Age/ NPA related factors Year of Retirement	DB: 10 x multiplier Ignore Year of Retirement Flaws in legislation
0 to 30% tax	40% tax

Still involves annual double leaver (?) calculations – for all?
Still an upfront tax including a BIK element
Still potentially large amounts so “scheme pays”

Impact Assessment: HMT numbers

DC	OPS (most SSASs)	135,000	PP	55,000*	190,000
DB	Private sector	50,000	Public sector	60,000	110,000
					300,000

*maybe 100,000 with overlap

- Add 50% work for members who ask queries but are not impacted
- Cost (if not CETV) £305m one-off £90m annual so £720m in 5 yrs

Example of underlying assumptions: queries £20 each averaged across 450,000 individuals