AMPS ASSOCIATION OF MEMBER-DIRECTED PENSION SCHEMES

AMPS Response to the Consultation Document:

Implementing the restriction of pensions tax relief.

Summary

- AMPS does not support the implementation of the proposed legislation to restrict pensions tax relief.

- The proposed legislation is being driven through too rapidly; would create extensive complication and would be damaging to HM Government's wider objectives of encouraging individual's to make adequate provision for retirement through use of pension arrangements.

- AMPS will support HM Government in a more measured consultation process to determine how best to achieve pension policy objectives, including consideration of the issues around pension tax relief's.

- Support, as an interim measure, the use of a reduced Annual Allowance as an immediate and effective means of restricting pensions tax relief.

- We suggest that the Annual Allowance should be set at a level of between £50,000 and £60,000 and preferably expressed as a percentage of the Life Time Allowance.

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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 pensions tax relief, including representations regarding the anti-forestalling provisions.

We applaud HM Government for carrying out consultations with interested parties. However, through our involvement in the consultation process we have come to the conclusion that the proposed legislation to restrict pensions tax relief should not be implemented. We set out our rationale for taking this position in this paper.

However, we do recognise that the economic situation does require a reappraisal of the affordability of pensions tax relief and therefore we recommend that full and proper consideration is given to limiting pensions tax relief through the existing mechanism of the Annual Allowance. Our points for consideration in this respect are also set out in this paper.

As AMPS' position is that the proposed legislation should not be implemented, our response does not specifically answer the questions asked within the consultation document.

Rationale for not implementing the proposed legislation

1. Excessive complication
The significant changes made to pensions in April 2006 were introduced under the banner of 'Pensions Simplification'. It stripped away layer upon layer of pension legislation that applied differing restrictions on different types of pension arrangements.

Fundamentally the new pension regime allowed any individual to have a maximum pension entitlement of up to the Life Time Allowance. The way in which individuals could build up a pension entitlement was essentially limited by an Annual Allowance. The level at which the Annual Allowance is set allows individuals flexibility with regard to the timing of how pension entitlement is accrued and eliminated the need for the complicated pre simplification rules around accelerated accrual such as carry back and carry forward, and dynamised final salary.

In order to achieve simplification there was acceptance that general principles would apply over precision, for example, use of a general factor of 10:1 for valuing defined benefit accrual regardless of factors such as age.

It is recognised that the Government's aim for the proposed legislation was for it to be fair for individuals as well as equitable between different types of pension arrangements. However, it must be recognised that to achieve absolute fairness there is a balance to be struck with regard to simplicity.

AMPS considers that the proposed legislation introduces too great a complication for individuals and for pension schemes to implement.

As evidence of the degree of complication, we hesitate to use the applauded fact that HM Government has consulted with interested parties as a negative, however, it should be recognised that the extent of the consultations carried out indicates just how complex the proposed legislation is to implement.

Consultation included establishing and running various consultation groups, which included a Stakeholder Group, Industry Operational and Delivery Group, Industry Information and Communications Group and a Defined Benefits Valuation Group. In addition a number of consultation workshops have been held to gather opinion on issues such as 'scheme pays' as a means of collecting high personal tax charges that may arise from the proposed legislation.

2. Uncertainty for individuals

One area of complexity that the proposed legislation brings is in the assessment of an individual's total relevant income which will determine their treatment under this legislation.

It is recognised that the tax relief given on contributions is an important factor in an individual's decision making as to whether to make a contribution / accrue pension benefits and to what extent. However, the actual tax relief they will get will depend on their total relevant income during the tax year. Total relevant income cannot be determined until after the end of the tax year. If an individual finds that their total relevant income is in excess of the proposed limits it will triggering a personal tax bill on pension contributions / accrual. This subsequent personal tax bill may well result in nullifying the tax advantages anticipated that lead to the original decision to make the contribution / accrue benefits to the extent that, given the choice, an individual would not have made such contributions had they been able to appreciate the personal tax bill it would subsequently generate. Yet there is no choice as there is no process to allow the retrospective unwinding of contributions / accrual. Therefore there is uncertainty for individuals and indeed unfairness in this proposed legislation.

Complexity is also being created around whether there should be certain exemptions for individuals who ordinarily may not exceed the relevant earnings limit but do so due to a redundancy payment, for example. There are also issue regarding whether and how allowance can be made for enhanced contribution / accrual in the year of taking pension benefits.

The complexity of assessing relevant income and the uncertainty as to whether a personal tax charge will be generated following the end of the tax year is also generating a serious problem for financial advisers or those wishing to provide employees with guidance.

3. Unfairness

Whilst the Government has approached limiting higher rate tax relief to those with total relevant income of over £150,000 and have sought to eliminate some uncertainty by only including the value of employer contributions in the relevant income definitions if income exceeds £130,000, it still remains that there will be different treatment.

For example, an individual who has relevant income of £140,000 and relevant UK earnings of £100,000 would still be able to make contributions of £100,000 and receive full higher rate tax relief on all their contribution (i.e. claim back all higher rate relief on those £100,000 earnings). Whereas, if they have earnings of £155,000, higher rate tax relief is curtailed, and if £180,000 they will get no higher rate tax relief, even on the first £1 of contribution.

As already outlined in the previous section there is an inherent unfairness in individuals not being able to retrospectively adjust their pension contribution / accrual, particularly for those that unexpectedly fall within the relevant income limit.

4. Adverse cost impacts

We have not undertaken a detailed analysis of the impact assessment as we are not in a position to give an assessment of the overall cost impact across the wide range of parties affected. However, we do consider, in our opinion, that the cost impacts given in appendix E of the consultation document are a significant under-estimation. We are concerned that even if it could be demonstrated that the cost impacts on the pensions industry were significantly higher this would not materially influence the Government's policy.

We would like to take this opportunity to emphasis that the effects of introducing complexity will have a significant impact on administration procedures, IT systems, staff training, product and sales literature, customer services to name but a few.

5. Damage to pensions saving

Much attention has been focused on the practical aspects of implementing the proposed legislation. We do not believe enough emphasis has been placed on assessing the behavioural impact of these changes.

Whilst we cannot provide definitive data on this subject nor have the resources to gather such data the feedback we are receiving is that high earners are now disenfranchised from saving for retirement via pension arrangements.

Although it may be in the Exchequer's interests that the proposed legislation indirectly results in more than the targeted top 2% of high earners from being affected, our key concern is how this disenfranchisement will manifest itself more widely.

We assert that high earners, in particular business owners / directors, who have become disenfranchised from pensions will be disinclined towards expending time and resources on adequate provision for employees.

Furthermore, the negativity towards pensions being expressed by these disenfranchised high earners, who are often in positions of influence, will permeate to those on more moderate earnings and will hamper HM Government's wider objective to encourage more individuals to make adequate provision for their retirement.

We believe that HM Government should closely assess to what extent the proposed legislation will drive individuals and companies to seek alternative, more favourable, tax jurisdictions for their pension and non-pension savings and investments. Whilst the proposed legislation is aimed at reducing immediate tax expenditure, if there is a significant movement of monies out of the UK as a result, then HM Government's anticipated savings will be offset by a fall in tax receipts.

A further factor that is damaging the public's view of pensions is that these changes severely dent confidence in the Government maintaining the established tax deal that is entered into over a long term. The tax deal being that individuals can forgo taxed income today in favour of locking it within a tax favourable pension arrangement and accept that the income generated will then be taxed as income at rates applicable at that time. In other words income tax deferral. The proposed legislation erodes this long held tax deal by introducing an element of double taxation on income and raises concerns that further erosion of the tax deal will occur in the future. This results in a lack of confidence in locking income in within a pension.

6. Too short a legislative time frame

We are extremely concerned that the proposed legislation is being rushed through which we consider will manifest itself in;

a) unintended consequences which will jeopardise the intent to make the proposed legislation fair and,
b) poorly drafted legislation which may leave loop holes which could result in HM Government not realising the tax saving it anticipates.

We understand the desire and need to bring about tax savings as soon as is practical and hence the drive to include the proposed legislation in the Finance Bill 2010 for implementation in 2011. However, given;

a) the complexities of implementing this legislation as evidenced through the extensive consultation meetings to date,

b) the necessity to commence drafting legislation before the end of the consultation period,
c) the short period between the consultation close date of the 3rd March 2010 and the likely issuance of the Finance Bill given limited time for thorough analysis of consultation responses, and
d) the potential for limited attention to detail during the various courses of the reading of the Bill due to the inevitable distractions of the general election.

We believe that there is every danger that further amending legislation will be required in order to put right failings of the original legislation. Such amending legislation will inevitably create further complexity and have additional cost implications.

7. Consideration of future pensions policy changes
The continual changes to pensions legislation as evidenced by changes being made in every Finance Act since the 2004 Finance Act which brought in pensions simplification has added to the damage being done to the public's confidence in pensions as a long term savings arrangement which requires some semblance of stability.

It would appear that whatever the political balance of power is after the general election that all of the political parties may wish to carry out some major pensions reforms which could re-examine the whole nature of the tax reward / deferral system applicable to pensions today. It would appear inevitable that changes will need to be considered to recognise increasing longevity, demographics, the demise of private sector defined benefit schemes and disparity between private and public sector pension provision to name but a few.

With this in mind AMPS would urge that HM Government does not push through these complex proposed legislative changes given the issues outlined above, but seeks to realise its key objective of limiting the extent of tax 'expenditure' arising through pension tax relief through implementation of a simpler mechanism. Albeit if only as an interim measure whilst a more long term and stable pensions strategy can be developed, consulted on and implemented.

The mechanism AMPS puts forward for consideration is to utilise the existing mechanism of the Annual Allowance but at a much reduced level to the current Allowance of £255,000 (wef 6/4/2010).

Rationale for proposing a reduced Annual Allowance.

1. Simplicity
The Annual Allowance is a well established mechanism that is well understood.

2. Certainty
As the application of the Annual Allowance is independent of other factors such as relevant income, it is relatively straight forward to establish whether contributions / accrual will exceed the Annual Allowance and that where it is exceeded the excess will be subject to a fixed tax charge of 40%. However, crucially an individual may request that the scheme returns excess contributions under the refund of excess contribution lump sum provisions allowing individuals to unwind their position.

3. Fairness
The application of the Annual Allowance applies equally to all with no cliff edges with regard to its application. All high earners can claim some higher rate relief, but capped to the same level (rather than some make potentially very large contributions with higher rate relief, and some others get none).

4. Cost effective
As the Annual Allowance is an already established mechanism the cost impact of implementing a reduced Annual Allowance will be significantly less than introducing the proposed legislation. We

would anticipate there being low impact with regard to changes to administration procedures, IT systems, staff training, product and sales literature, and customer services.

5. Less damaging
We anticipate that the Government may not be keen to accept the reduced Annual Allowance proposals on the basis that it will still allow very high earning tax payers to claim higher rate tax relief on pension contributions all be it to a lesser extent.

However, as we have stated we believe that the proposed legislation is having a significant damaging effect. In particular the breaking of the pensions tax deal resulting in potential double taxation of income should be avoided. Whilst there may be arguments that the tax deal needs to be reappraised we believe that this should be undertaken as part of a whole scale pensions policy review rather than a piece-meal erosion of core principles.

Therefore whilst a reduced Annual Allowance may not meet the Government's entire intended objectives of the proposed legislation through higher rate tax relief remaining available to all, it would;

a) help avoid the damaging effects of disenfranchisement of high earners toward pensions,
b) meet the other key Government objectives, and
c) allow time for proper consideration of how best to implement any future changes in pensions policy.

6. Quick to implement
As the Annual Allowance is already established in law, a reduction in the Allowance will be simple and quick to implement, with little risk of unintended consequences or loop holes occurring through poorly drafted legislation.

At what level should the Annual Allowance be set?

We believe that there are two key considerations in setting a reduced Annual Allowance.

a) It should still allow individuals sufficient flexibility to contribute / accrue benefits, and

b) It should derive a similar saving in tax relief expenditure to that anticipated by HM Government from the implementation of the proposed legislation,

We are aware that a number of proposals have been put forward by other representative bodies as part of their consultation response which also advocate a reduced Annual Allowance as a viable alternative to the proposed legislation. Suggestions have been made that the Annual Allowance should be set in the region of between £45,000 and £60,000.

We assert that the Annual Allowance should not be set at less than £50,000 but would encourage a higher limit to be set.

We would regard £50,000 as being the absolute minimum acceptable level based on two points:

1) Given that an aim of pensions simplification was to provide greater flexibility, we believe that a reduction in Annual Allowance should not be more restrictive than the pre simplification pensions regime. Under the pre simplification regime the maximum contribution to a personal pension was limited to a maximum of 40% of the earnings cap. The current notional earnings cap is £123,600, 40% of which is £49,440.

2) As part of AMPS representations regarding anti-forestalling provisions, in particular in putting forward an argument to make allowance for those that make non regular contributions in

excess of the Special Annual Allowance of £20,000, we provided analysis of data that supported setting the Special Annual Allowance for non regular contributions at £50,000 (as opposed to the £30,000 that was put in place). Our case was that in setting the limit at £50,000 our data showed that of those that made non regular contributions in excess of £20,000, 50% of contributions made were below £50,000. AMPS would be happy to re-submit this evidence if required.

However, it should be recognised that a £50,000 Annual Allowance makes no provision to make accelerated 'catch up' payments as was achievable through the carry forward of unused relief provision available under the pre simplification regime. We would therefore suggest that it would not be unreasonable to set the Annual Allowance at a level higher than £50,000 in recognition of the reduced flexibility as compared against the pre simplification regime. We would suggest £60,000.

This should also have the benefit, on the basis of AMPS data referred to earlier, of providing a buffer to ensure that the majority i.e. more than 50% of those that make non regular contributions in excess of £20,000, will not be affected by this change.

We therefore put forward that an Annual Allowance set at £60,000 should be considered appropriate to maintain a sufficient degree of flexibility in making pension contributions.

With regard to determining what level the Annual Allowance would need to be set at to derive similar tax savings for HM Government, AMPS does not have the resources to undertake such analysis.

However, we are aware of such analysis having been carried out by an AMPS member firm. Adrian Boulding, Wealth Policy Director at Legal & General carried out some modelling of scenario's which was presented in a paper dated 22nd May 2009 in which he asserts that an Annual Allowance set at £50,000 would yield a similar tax saving to that of the proposed legislation.

A case for setting the Annual Allowance at 3% of the Life Time Allowance
Adrian Boulding has also produced a recent paper in which he presents a strong argument for setting the Annual Allowance at 3% of the Life Time Allowance. His further paper looks at the issue from a consumer perspective and essentially concludes that setting it at 3% would have the following advantages:

a) be fair for consumers in still giving a reasonable ability to accumulate funds up to the Life Time Allowance
b) would require a disciplined and lengthy approach to pensions saving which is assumed to be a desirable trait
c) the impact of the Allowance would bear most heavily during years of high earnings thus restricting higher rate tax relief,
d) setting the Annual Allowance as a percentage of the Life Time Allowance will ensure the Annual Allowance will be automatically up rated when the Life Time Allowance is reviewed.

Apply the 3% recommendation would set the Annual Allowance at £54,000 based on the Life Time Allowance of £1.8m for 2010/11.

AMPS could source and provide copies of Adrian Boulding's papers if this would be beneficial.

Conclusion

In this paper we have set out our rationale as to why we do not support the implementation of the proposed legislation.

However, in recognition that HM Government needs to achieve certain objectives that has lead to the proposed legislation, we understand the need for a viable alternative proposition.

We have set out our case that a sensible and effective alternative would be to reduce the Annual Allowance to a level in the region of £50,000 to £60,000, with strong consideration to be given to representing the Annual Allowance as a percentage of the Life Time Allowance.

We would accept that this measure may only be an interim measure and we would strongly urge HM Government to work towards creating a long lasting, stable pensions regime.

AMPS has welcomed the opportunity to be involved in the consultation process and would welcome further opportunities to enter consultations on adoption, perhaps even early adoption in 2010 that would remove the complexities of the anti-forestalling mechanisms, of a reduced Annual Allowance or indeed other relevant issues.

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 pensions 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.

Distribution
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