

Written evidence submitted by Association of Consulting Actuaries

Executive summary of the ACA's thoughts on your three questions:

1. What is the role of tax reliefs in rebuilding the economy and promoting economic growth and efficiency? Does the current regime of tax reliefs perform this role well?
 - (a) Pensions tax relief is used by over three quarters of the employed population. It has substantial scope to support the rebuilding of the economy; but this should not be at the expense of pensions tax relief meeting its primary goal of providing adequate later life income.
 - (b) Pensions tax is generally effective and supports saving for moderate as well as higher earners. The introduction of automatic enrolment has brought many lower earners into pension saving and increased the annual cost of tax relief. Overall, the ACA views this as a very successful policy.
 - (c) In principle, there might be scope for specific reliefs to be introduced to support specific policies, for example "green" savings, investing in Britain or in infrastructure, support for first time house-buyers or to smooth the finances of the self-employed. However, it is not the ACA's role to propose social policy. We would caution against allocating the same money simultaneously to multiple purposes.

2. What are the areas for simplification?
 - (a) The pension tax regime is very complicated and simplification would be welcomed, but care is needed to ensure that tax law is neither too complicated as to be unwieldy and unworkable nor too simple as to fail to accommodate the different pension schemes that employers and individuals operate. Our experience of "pension simplification" in Finance Act 2004 is that, unless done carefully, simplification can have unintended consequences that can be very complex.
 - (b) The anti-avoidance aspects of pensions tax are overly onerous, largely stemming from legislation not necessarily reflecting Parliaments intentions in sufficient detail.
 - (c) If done with caution, pensions tax could be better integrated with social care and later life care costs.

3. What is the best way to tackle tax reform, including what changes might be needed at HMRC to support implementation, and how should the Government consult with stakeholders and parliament?
 - (a) The current "EET" (Exempt, Exempt, Taxed) approach to pension schemes has been in place for a very long time and it works. There may be benefit in communicating the value of the tax relief as a "bonus" as has been done in auto-enrolment, but we would be very cautious about fundamentally changing from EET to TEE (or any other alternative format).
 - (b) HMRC has lost too much of its human interaction as a consequence of its drive online. We encourage HMRC to return in part to skilled and knowledgeable staff interacting personally with practitioners on policy matters and more complex day-to-day issues.

Full response

4. We are writing on behalf of the Association of Consulting Actuaries (the ACA) in response to the call for evidence on Tax after Coronavirus. Members of the ACA provide advice to thousands of pension schemes, including most of the country's largest schemes and are all qualified actuaries. All actuarial advice given is subject to the Actuaries' Code and the advice given to clients is independent and impartial. ACA members include the scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes. Members also advise thousands of smaller pension arrangements and individuals (many in self-employment) as well as advising life and general insurers.
5. The questions you asked are substantial and ideally would need more time for reflection than the committee's timetable allows. We have therefore restricted our comments to high-level comments at the start of a debate, but we would be very happy to provide further support as the committee's thinking develops.
6. The amount of tax to be raised and its targeting are political questions and the ACA is politically neutral. However, as a general comment, we believe that especially in the current environment tax measures designed to promote growth and efficiency and "build back better" should be built up through both an intergenerational and intragenerational lens that balances the burden of taxation all areas of pensions and saving, including social care.
7. For example, taxpayer funded social care costs of c.£22bn p.a. in 2018/19 could reasonably double by 2040 if, as projected in a recent Lancet study¹ the UK's "over 80" population could rise from around 3 million in 2020 to 5 million by 2040). This will need to be financed equitably in a way that will help to protect the needs of vulnerable members of society for generations to come.
8. Major change to pension tax reliefs might bring in significant funds to the Treasury at the short term, however there is a risk these run counter to longer term savings. It might also exacerbate inter-generational issues if an older generation has enjoyed extensive tax relief on pensions which are no longer available to a younger generation of workers (and which is also expected to support older generations).
9. In the remainder of this response, we have commented on three of your specific questions:
 - (a) What is the role of tax reliefs in rebuilding the economy and promoting economic growth and efficiency? Does the current regime of tax reliefs perform this role well?
 - (b) What are the areas for simplification?
 - (c) What is the best way to tackle tax reform, including what changes might be needed at HMRC to support implementation, and how should the Government consult with stakeholders and parliament?

¹ <https://vizhub.healthdata.org/population-forecast/>

What is the role of tax reliefs in rebuilding the economy and promoting economic growth and efficiency? Does the current regime of tax reliefs perform this role well?

10. One of the main tax reliefs is relief for pension schemes and pension contributions. Because of the size of the relief, restricting it has been and remains a target for governments of all political persuasions. Understandably, there tends to be significant public debate about pension tax relief, but the position is often more nuanced than the headline comments might suggest.

Pension tax relief benefits a very large part of the population

11. Pension tax relief is a large amount², but it encourages employers and workers to save for retirement. It is also a very widely distributed tax relief that benefits most people in the UK: 77%³ of UK employees are in a workplace pension scheme, 60%⁴ of pensioners receive a pension from an occupational pension scheme and 17% of pensioners receive a pension from a personal pension scheme. Without this relief, any resulting fall in private provision would probably necessitate larger state pensions, which already costs the Treasury around £96bn⁵ a year.
12. When money saved into a pension scheme comes out, it is usually as a taxed pension. Pension schemes therefore allow individuals to defer income and associated tax payments into old age when they take that income. The tax-free cash sum is a genuine tax saving, but this is a policy decision about encouraging people to participate in pension schemes. “Band shifting” of tax band between working life and retirement is a more complex issue, which we discuss further below.
13. There is a valid discussion about the extent to which the relief is effective in delivering secure retirement income as the system is generally poorly understood. We believe that employers, who generally have advice from consultants, do understand the tax relief, and since the employers design the remuneration packages they will include pension provision if it is tax efficient. (There is a debate about recent worsening in tax relief implicitly excluding decision-makers from belonging to the pension scheme thereby weakening the boardroom’s commitment to a shared workplace pension scheme.) The current “EET” (Exempt, Exempt, Taxed) approach has been in place for a very long time. There may be benefit in communicating the value of the tax relief as a “bonus” as has been done in auto-enrolment, but we would be very cautious about fundamentally changing from EET to TEE (or any other alternative format). Better communication could help pensions to play a more prominent role in reward packages and so potentially help to promote economic growth and efficiency as the economy recovers. Actuaries are well placed to help you with the issues here.

It provides significant benefits for individuals on moderate as well as higher incomes

² The cost is sometimes quoted as around £35 billion, see HMRC’s table PEN6, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/833859/Table_6_Cost_of_Pension_Tax_and_NICs_Relief_2012-13_to_2017-18.pdf. However, the methodology is subject to significant debate and the source document notes that “Costs are subject to large revisions and have a particularly wide margin of error.”

³ <https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/workplacepensions/bulletins/annualsurveyofhoursandearningspensiontables/2019provisionaland2018finalresults>

⁴ <https://www.pensionspolicyinstitute.org.uk/research/pension-facts/table-14/>

⁵ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/839411/Great_Britain_National_Insurance_Fund_Account_-_2018_to_2019.pdf

14. The current system favours people who save into a pension while paying 40% tax (or more) as a worker and who draw that pension in retirement while paying only 20% tax as a pensioner. (This advantage does not apply to someone who remains in the same tax bracket in retirement as they were in work.)
15. Although this is often seen as a tax break exclusively for the more affluent, there is also a similar effect for 20% taxpayers for whom a higher proportion (or indeed all) of the individual's resulting retirement benefits might be within the personal allowance (£12,500 pa) when paid out, and so would be fully tax-free on distribution. This is a genuine and substantial tax relief for a large number of individuals on moderate incomes. Removing or reducing tax relief on contributions could worsen the position for all these individuals.
16. This means the distributive effects of pension tax relief are currently quite nuanced, with the most significant benefits for those who are able to defer income into a lower tax band in retirement. Both higher and more moderately paid people in both the private and the public sector currently benefit from this.

Pension schemes have wider benefits for the economy and society

17. If allowed to operate effectively, occupational pension schemes can provide significant benefits to workforces, the community and the economy. For example, in times of economic and employment stress defined benefits pension schemes can provide insulation by sometimes providing more generous early retirement terms thereby allowing older workers to leave the workforce with economic security. This helps alleviate rising unemployment and potentially is one mechanism to help inter-generational adjustments in the economy.
18. In order to be effective in insulating against economic and employment stress, schemes must be adequately funded and allowed and encouraged to have the funds to deliver when the rainy day comes. Squeezing support for pension schemes to make them as lean as possible damages their capacity to fulfil their wider roles described here. (In the DC world there is not the similar scope for targeting use of funds, but the DC fund does provide a cushion, as we are seeing presently.)
19. The proceeds of pension funds, including the benefit of the tax reliefs, can also serve a longer-term aim. For example, pensions in general can help to fund the increasing burden of long-term care. However the rules for authorised benefits do not always fit with the variable requirement for income that could occur over later lifetime and there is a danger that pension fund money is then ineffectively earmarked several times over to finance regular income in old age and also to pay for long-term care. Each £1 in the pension pot can only be spent once, and there is a debate to be had about the extent to which pension fund savings should support each of those potential objectives.
20. The tax regime has been changed so that increasingly, defined contribution (DC) funds are being used by some older retirees as a means of passing wealth down to younger generations. This exacerbates the issue of overextending the objectives.

21. There are many ways which pension tax could support specific potential social policies, through additional reliefs on contributions or the businesses pensions invest in. For example, to encourage “green” investment, investment in British business or infrastructure, or doing more to support first-time house buyers. However, these are policy decisions for the government and parliament to make.

What are the areas for simplification?

22. Pension tax needs to be improved, and where possible simplified, but this needs to be done in a careful and considered way in consultation with the pension industry.

Current complexity is a result of using tax law to effect social or economic policy

23. Complexity often arises because taxation is often used not merely to raise revenue but to implement policy. Economic or social policy is achieved through differences in taxation, perhaps to support a vulnerable group, or to encourage certain behaviours and discourage other behaviours. However, this can have unintended consequences as it is challenging to both achieve simplicity in tax law and simultaneously use it to provide a number of complex nudges of economic or social policy.
24. Pension tax appears a strong example of this. For example, the Government's consultation document on changes to the pensions tax regime made in the *Forward*⁶ to the original green paper in December 2002, which culminated in the current pension tax regime introduced in April 2006, said:

For too many people, pension planning has been an incomprehensible maze. So the Government has published proposals for a radical simplification of the tax rules for pensions to help people make clear and confident decisions about their pension savings. These proposals will be designed to mean increased flexibility about when and how people can draw benefits from their pension. The new rules will be simple, durable and readily understood.

25. Surveying the tax rules on pensions today, many people would still see pension planning as far too complex. In particular, what started as simple principles (when the ideas were circulated in 2003) were overlaid with a complex anti-avoidance framework and measures to limit the cost of tax-relief that very few people understand and now these complexities affect far more people than originally intended. The recent problems with doctors' pensions illustrate that where these complicated rules bite, they are hard to operate, are hard to understand and can have unintended consequences.
26. There have also been a further number of different tax rules to allow for the variety of different circumstances in which pension schemes have to operate, but which have added to their complexity.

Stability has a value

⁶ https://webarchive.nationalarchives.gov.uk/20100104174903/http://www.hmrc.gov.uk/consult_new/pensions_consult.pdf

27. Pension saving requires a long-term commitment by the individual and the employer. Therefore, it is essential that people understand and have trust in the system.
28. A well-designed stable tax law, even if it has to have some unavoidable complexity within it (but not avoidable complexity), is better than a poorly designed one that is ostensibly simpler but which is frequently amended in material ways by successive governments as each reacts to passing events. Frequent substantial amendments to legislation undermine savers' confidence in the pension system. The changes can also add complexity to the system because pensions work over decades and often need to consider past legislation as it existed at the time.
29. As noted at the start, it is not our role to suggest rates of tax or where tax might be redistributed. However, in terms of the mechanisms that could be used, and in particular in case government might choose to take relief from pensions and use a new tax structure to achieve this, we would suggest reading our response⁷ to the 2015 HM Treasury consultation on methods of delivering such tax relief. There are important technical features about different possible methods that are not well understood, and which we hope we clarify in our 2015 letter.
30. The Treasury's 2015 consultation was about changes to the structure of pension tax relief and concluded that the current system should remain. This 2020 consultation by parliament is in light of the fiscal challenges for the country arising from Covid-19. We have given reasons above for maintaining the spend on tax relief. In addition, we would strongly caution against imposing any ad hoc tax cuts on pension assets because of the damage it would do to the trust that employers and savers need to commit to locking money away in pension schemes for decades.

What is the best way to tackle tax reform, including what changes might be needed at HMRC to support implementation, and how should the Government consult with stakeholders and parliament?

Quality over quantity

31. We would prefer quality over quantity of legislation, even if it means that legislation is slightly slower in arriving on the statute books.
32. Auto-enrolment into pension schemes and the UK statutory residence test for tax purposes are good examples of legislation which has taken time to develop and discuss, and which has generally worked as intended. Both had:
 - (a) Clarity and political consensus about the objectives of the legislation, to minimise the "political football" effect;
 - (b) Adequate gestation periods, in the case of auto-enrolment over several years, which involved significant consultation with the respective pension and tax practitioners who would have to work with HMRC;
 - (c) Time spent making sure the legislation said what Parliament intended it to say.

⁷ <https://aca.org.uk/aca-responds-to-pension-tax-consultation/>

Reducing tax avoidance through better legislation

33. Parliament has a role to play in reducing tax avoidance through taking time with legislation. Tax avoidance is defined as using the rules of the tax system to gain a tax advantage that Parliament never intended, and so it operates in the gap between what Parliament thought it meant to say and what the Act of Parliament actually says.
34. If the intention of Parliament has been clearly expressed in tax law then that gap would not exist and tax avoidance cannot arise, so more considered legislation, which ensures that the law says what Parliament intended to say, would help to reduce tax avoidance. Swiftly enacted legislation that Parliament has not had time fully to consider is more likely to create opportunities for tax avoidance.

A better dialogue with HMRC

35. As practitioners, we sometimes find it difficult to engage with HMRC and HM Treasury because HMRC has moved in recent years to interacting very heavily through its website and call centres. Neither is optimal for having an informed discussion about technical issues with experienced professionals.
36. To an increasing extent, HMRC is streamlining its role and outsourcing its operations to taxpayers and their advisers through compulsory obligations such as self-assessment, Real Time Information reporting and Inline eXtensible Business Reporting Language (iXBRL) for company accounts. There is also a more recent consultation in March 2020 on large business notification when taking an uncertain tax position. This has shifted costs onto taxpayers. It has also reduced HMRC's exposure to real life issues arising from operating pension tax compliance - and has resulted in technical expertise being built up in pension and tax advisers; we believe this resource of expertise should be tapped more efficiently when considering and preparing legislation.
37. There also appears to be a lack of resources at HM Treasury and HMRC to maintain existing tax laws. This means that when problems arise with the operation of legislation (which bodies such as the ACA flag from time to time), unless these cause a material loss for the public purse or significant political pain, it can be hard to get official and ministerial resources to focus on amending legislation to correct problems.

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