Restricting Pensions Tax Relief
Comments on draft Finance Bill 2011 clauses

1. Introduction

1.1. *About us*

1.1.1. The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes.

1.1.2. The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

1.2. *Our comments on the draft legislation – trivial commutation*

1.2.1. We have reviewed the draft legislation on restricting pensions tax relief[1], focusing on the changes to trivial commutation and related limits.

1.2.2. When the proposals to reduce the lifetime allowance ('LTA') were first announced, we were concerned at the potential impact on those on low-incomes arising from a measure designed to limit the tax-advantaged pension saving rules for wealthier taxpayers. We therefore

[1] http://www.hm-treasury.gov.uk/d/restricting_pensions_tax_relief.pdf

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welcome the proposed decoupling of the trivial commutation limit from the LTA. However, this submission queries the proposal to fix the limit at £18,000, suggesting instead an increase to £21,500 coupled with annual inflationary increases. We also go on to address what we view as a further unnecessary restriction on trivial commutations – the 12 month commutation period.

1.3. ***Further background***

1.3.1. Trivial commutation, introduced as a method of avoiding the cost of administering payment of small amounts for pension providers, has become a popular way of cashing in rights in small pensions.

1.3.2. Current draft Finance Bill 2011 clauses fix the trivial commutation limit at £18,000 for 2012/13 thereby de-linking it from the LTA. As noted above, that is welcome news to the extent that the problems inherent in linking the trivial commutation and related limits to a decreasing standard lifetime allowances are at least recognised.

1.3.3. However, by the end of 2012/13 the trivial commutation limit will already have been fixed at £18,000 for three years. The current draft clauses allowing HM Treasury to increase the limits from time to time are welcome, but LITRG believes they do not go far enough. Not to have some mechanism for automatic increase in the limit would, in our view, be unfair and could significantly erode the value of the benefit of this provision over time.

1.4. ***Proposed initial increase from £18,000***

1.4.1. LITRG regards the sum of £21,500 as a reasonable level at which to fix the trivial commutation and related limits for the year 2012/13[1].

1.4.2. On that basis we propose below a change to the existing draft clause which substitutes the amount of £21,500 for £18,000 and a new clause which provides for it to rise each year in accordance with increases in the retail prices index (RPI).

1.4.3. Indeed, this modest increase in the trivial commutation and related limit could increase cashflow to the Exchequer. Three-quarters of the commuted lump sum is taxable and for most pensioners this will probably be at the basic rate of 20%. Increasing the threshold from the current £18,000 to £21,500 would open up the opportunity to many more pensioners and in turn yield an additional £525 per basic rate pensioner taking up the option.

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[1] This sum is calculated based on average UK retirement income of £17,200 including state pension (Source: Mindful Money Article dated 5 October 2010 quoting Robin Stoakley of Schroders UK). State pension is assumed to be at the mid-point between single and married couple amounts thereby indicating occupational or personal pension of £10,700. Taking 10% of that figure to be "trivial" for this purpose and annuitising this at a multiple of 20 produces a "capital" value of £21,500.

1.5. ***A further proposal – removing the 12 month restriction***

1.5.1. Finally, LITRG believes that the 12 month period during which trivial commutations must be made - the commutation period - is at least insufficient and probably unnecessary in view of the overall cap on the amounts that can be commuted[1]. Experience shows that many have been unable to commute all of their trivial pensions as they have either overlooked very small amounts, or have become aware of, for example dependent benefits, outside the commutation period. Ideally, LITRG would like to see the removal of the commutation period entirely, or, if this is not possible, an extension of the period from 12 to 24 months will be of considerable help.

2. Suggested new clause and revisions to draft Finance Bill 2011 clauses

2.1. Here we set out our proposed changes to the draft clauses covering both our proposed immediate and annual inflationary increases in the commutation limit and our preferred option for the 12 month commutation period to be removed altogether.

2.2. ***Increase in the commutation limit***

Initial increase from £18,000 to £21,500

2.2.1. In all instances, replace £18,000 with £21,500 (ie, draft Schedule 2, paras 4(2), 5(2), 6(2) and 7(2).

Annual increase by RPI

2.2.2. In the draft Schedule 2 at paras 4(3), 5(3), 6(3) and 7(3), for—

> “The Treasury may by order substitute for the amount for the time being specified in sub-paragraph 2 such larger amount as is specified in the order.”
>
> substitute—
>
> “If the retail prices index for the September before the start of a tax year is higher than it was for the same month in the previous tax year, the Treasury shall by order substitute for the amount for the time being specified in sub-paragraph 2 such amount as represents that amount increased by the same percentage as the percentage increase in the retail prices index, rounded up to the nearest multiple of £10 if the result is not itself a multiple of £10."

[1] By comparison, there is no such time limit imposed on those wishing to commute payments tax-free under larger schemes, nor is there a similar time limit imposed on winding up lump sums or related death benefits.

2.3. ***Removal of the 12 month commutation period***

2.3.1. After the draft Schedule 2, Lifetime Allowance Charge, insert:

Schedule 3, Trivial commutation lump sums

(1) Schedule 29, paragraph 7, of the Finance Act 2004 is amended as follows—

(a) For sub-paragraph (1)(a) substitute—
"it is paid when no trivial commutation lump sum has previously been paid to the member (by any registered pensions scheme) or, if such a lump sum has been previously paid, the total of such lump sums does not exceed the commutation limit specified in sub-paragraph (4)."[1]

(b) Omit sub-paragraph (2);

(c) For sub paragraph (3) substitute—
"The nominated date is the day within the period of three months commencing on the date of first formal valuation of the amount referred to in sub-paragraph (1)(a) as may be nominated by the member (or, if no such date is nominated, the date of that valuation)."

LITRG
9 February 2011

[1] References from this point on are to original paragraph / sub-paragraph numbers and are not adjusted to take account of numbering changes consequent upon the deletion of sub-paragraph (2).