

Early Access to Pension Savings Response to HM Treasury consultation

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 – trivial commutation*

1.2.1. This short response focuses on a single area of the consultation – trivial commutation (para 4.3ff). By definition, this is an area likely to impact most on those pensioners with the lowest means.

1.2.2. The problems can be broken down into two areas, each of which we consider in more detail below:

- complexity and inflexibility of the law itself; and

- practical problems, such as lack of guidance and sources of advice and HMRC processes in obtaining a tax refund.

1.2.3. Ample evidence of both categories of problem is held on TaxHelp for Older People's (TOP) files. TOP has helped large numbers of pensioners in dealing with trivial commutations and their related processes¹.

2. Our response

2.1. The consultation asks:

- Is there a case for introducing further flexibility in the trivial commutation rules?
- What are the key barriers to transfer of small pots and are there any proposals from industry, consumer bodies or other interested parties as to how small pot transfers could be better facilitated?

2.2. *The case for further flexibility*

2.2.1. We would answer the first question above very much in the affirmative. Indeed, our recent submission commenting on draft 2011 Finance Bill clauses commented on two such issues.

2.2.2. First, we outlined the need to increase the £18,000 limit in two ways – an initial increase from 6 April 2012 (by which time it will have been fixed at that level for three years) and annually in line with inflation thereafter. In support of this recommendation, we highlighted that indeed a modest increase in the trivial commutation could increase cashflow to the Exchequer by opening the option to more pensioners.

2.2.3. Second, we proposed a further amendment to the legislation to remove the rule for commuting multiple small pension pots within 12 months of the first, which distorts pensioners' choice and seems an unnecessary imposition where there is already an overall monetary cap on the amount which can be commuted.

2.2.4. Annex A to this response provides the full text of our Finance Bill submission, with the further detail of our arguments on both points.

2.3. *Practical problems*

2.3.1. In answer to the second question, from the pensioner perspective the key problems are arguably practical issues of understanding and assistance. For example:

¹ TaxHelp for Older People is a service run by Tax Volunteers to make free professional advice on personal tax available to older people who could not otherwise afford to pay for it, registered charity no. 1102276

- For the pensioner of low means, there are few places from which they can seek affordable advice in terms of pension decisions.
- These problems are compounded by complex interactions with state benefits entitlement, such as the different treatment of capital sums from ongoing income – a key consideration in the context of trivial commutation.
- Tax issues – often a pensioner will draw a commutation payment in the same year in which they retire, paying more tax than they need to, had they deferred the encashment to the next year when their income is lower.
- Trivial commutation payments are usually over-taxed due to the application of the PAYE regulations to use an emergency basic personal allowance ‘week 1’ or ‘month 1’ code in taxing the lump sum. But this rule is poorly understood by pension providers and not always correctly applied. Moreover, all too often pensioners either do not receive a P45 or receive a P45 with incorrect details (for example with the full lump sum payment being shown as taxable, not taking into account the 25% tax-free element).
- HMRC’s P53 process for repayment claims in respect of the over-taxed lump sum is tortuous. HMRC staff are tasked with tailoring the P53 to the pensioner’s circumstances when taking a call requesting the form but often this is done incorrectly¹. There is no way to access the complete form, or download it and pensioners may not even be aware of its existence because understanding the repayment claim process is dependent on being guided towards it by the pension payer, resulting in inconsistency between providers.

Recommendation

- 2.3.2. Whilst HMRC’s PAYE automatic reconciliations process after the tax year end may mean that pensioners should not miss out on trivial commutation tax refunds in the long run (assuming of course the information sent to HMRC by the pension providers about the taxable element and tax deductions is correct), now is an opportune time to consider how these practical problems can be addressed. Ideally, the goal should be to prevent over-taxation of trivial commutation lump sums; or, if that is not possible, to improve the process by which those affected can obtain a refund to ensure it is received as simply and swiftly as possible.
- 2.3.3. With the proposed introduction of Real-Time Information, there will be changes to the PAYE regulations and therefore the ability to consider how PAYE is operated on trivial commutation. There is, in our view, also the opportunity for HMRC to gather more information from the pension companies – an indicator from them as to when a trivial commutation payment has been made – which could be used to improve their processes, for

¹ TOP has dealt with cases where even the box required for inserting the trivial commutation itself has been omitted.

example facilitating automatic issue of a repayment claim form or even automatic refund through in-year reconciliation.

- 2.3.4. Whilst we have been making some of these points at HMRC's Pension Industry Stakeholder Forum, we recommend that HMRC set up a sub-group of interested parties (both internally and externally) to compile a list of issues and recommendations for improvement.

LITRG

25 February 2011

Annex A**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.

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

1.2.1. We have reviewed the draft legislation on restricting pensions tax relief¹, 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 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 http://www.hm-treasury.gov.uk/d/restricting_pensions_tax_relief.pdf

- 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 2012/13¹.
- 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.

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 commuted². 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.

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.

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

- 2.1.1. 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.”

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);

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).

(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