Low Incomes Tax Reform Group
A voice for the unrepresented

Freedom and Choice in Pensions
Response from the Low Incomes Tax Reform Group ('LITRG')

1 Executive Summary

1.1 We welcome any reform of the rules for access to pensions savings, hitherto restricted to poor products which have the appearance of being designed mainly to enhance the benefits to the pensions industry and financial advisers. Complicated and irrational rules with incoherent and inconsistent restrictions and limitations have made it hard for individuals to plan sensibly for their own needs and properly understand their choices.

1.2 While understanding the Treasury's cautious desire to make sure that people's financial assets last at least as long as their lifetime, nevertheless we do believe that those who have struggled to put something aside for their retirement can largely be expected to take a sensible view of the management of their capital and income in their later life and should be trusted to do so.

1.3 It is those who have made no effort to cater for old age who should be encouraged and directed: these are the people who in the significant majority simply expect the State to provide.

1.4 The expectation that the quid pro quo of tax relief on input into pensions savings is a degree of control over outputs has merit, but not to the extent that it should impose a straitjacket on the way in which those savings are converted into retirement income. The existing degree of control works mainly in favour of a pensions industry where annuity products are fixed at rates which make it unlikely that savers will live long enough to break even on their investment, let alone make a profit.

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1.5 There is also an important point about fairness and consistency across the whole saving population; under the present system there are different options according to how rich or poor the saver is.

1.6 Those who have amassed large pension pots currently can, usually from age 55, preserve their capital via drawdown and select, within limits, how much income to take each year, depending on their particular needs. When they get older they can opt to take an annuity of any kind at a much more favourable rate or pass on the remains of their drawdown fund tax-free to a dependent to be used for pension purposes.

1.7 Those with small savings can presently make a request for a trivial commutation lump sum payment, albeit not until age 60, and get their money back at marginal rather than penal rates.

1.8 The majority, however, with only moderate pots under, say, six figures have neither of the above choices, too little to set up an income drawdown plan but too much to recover their savings by trivial commutation, and are effectively forced into annuity purchase, leaving them in a seller's market. So the principle of equality of treatment for all fails.

1.9 It seems to us that there are two key issues at the heart of the proposed reforms:

1. provision of a decent range of suitable financial products available to replace the present limited annuity/income drawdown options; and

2. easy access to information, unbiased and laid out in plain English, to help the retiring population make and understand the consequences of an educated choice suited to their needs and lifestyle.

1.10 This second point may well be harder to construct than the first. The savings industry is ingenious at designing a wide (and often incomprehensible) selection of products to attract savers' money but there is at the moment no reliable single free source of independent information which can give sound guidance to a public largely ignorant of both financial and fiscal matters[1].

1.11 Beside these two essentials, the other questions within the consultation document sink to minor administrative detail.

2 About Us

2.1 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

[1] The FCA funded Money Advice Service (MAS) is presently too small to cope with the total population of annual retirees, and is yet to prove itself in terms of expertise.

benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.

2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3 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.

3 The detail

3.1 *What products does the retirer buy?*

3.1.1 The design of financial products is outside the competence of LITRG but we would wish to see that any innovations are at least constructed with the interests of the consumer at heart rather than the provider and offer a fair deal in return for the capital involved; that they can cover the range of needs and desires of the customer; that they are clear and transparent; and that they do not carry excessive costs or create unfair or unexpected tax charges.

3.1.2 Our sphere of interest lies obviously in the last point. For example, those currently in receipt of annuities are generally taxed under Pay As You Earn (PAYE) which produces a standard stream of income around the year and is a system broadly understood by the majority of taxpayers. If the "pensioner" now derives his income from products taxed under the range of other systems, corporation tax, capital taxes, savings rates and so on, he will need to understand not merely his own responsibilities, for example self-assessment, but also how the operation of different forms of taxation can affect his financial vehicles. An obvious example is the lack of any ability for non-taxpayers to recover tax related to dividends and insurance-based products. We would welcome the restoration of the ability to recover such taxes in order to give investors a fairer rate of return from their pension investments.

3.1.3 A further point worth pursuing is whether money purchase annuities will receive the kiss of life. Not widely known or taken up, there are very beneficial tax advantages to be obtained from them. Nowhere have they been mentioned. Has the Treasury thought of the implications in circumstances where large numbers of individuals use their pension pots to buy these annuities, or to encourage the insurance industry to develop such products to become more widely available and publicised?

3.1.4 Clearly a variant on income drawdown would be a capital drawdown version which could take advantage of the AEA for CGT. One wonders how the Treasury would view that?

3.1.5 The 55% tax charge was designed to make pensions savings an inefficient way of passing on wealth to one's heirs. With the proposed changes to pensions decumulation, is there still an argument for this impost? The aim to liberate the saver from central diktat and give him the opportunity to make his own decisions as to the best way to deploy his savings sit ill with the threat of penal charges should he die without using up all his assets. Since the proposals visualise people being taxed simply at their marginal rate while living on whatever form of income they choose, it would seem consistent to take the same view at death and just add any pots left into the estate like any other assets and run the risk of IHT if there is a surplus beyond the nil-rate band. After all, they are now merely personal wealth once they have been extracted from the pension company's grasp and converted into whatever appropriate (or indeed inappropriate) product the retirer chooses. They are no more ring-fenced than, say, his ISAs or his easy-access account with the Much Binding Building Society.

3.2 ***How does he get free, impartial, independent advice?***

3.2.1 There is a real hiatus here in the consultation document on what is perhaps the most important part of the liberalisation process. 1.10 talks of a guarantee of free, face-to-face guidance and a duty imposed on pension providers to deliver this "guidance guarantee". There is remarkably little detail on such a vital part of provision of choice to people who have largely never had to make such momentous financial decisions such as "how am I going to finance the remaining possibly 30 years of my life without a job?"

3.2.2 Given that we are talking about nearly half a million people retiring every year, we are looking at major resources of qualified expert advisers, not attached to financial service providers (which would otherwise fail the impartiality requirement), and relatively easily accessible across the UK for face to face meetings. Imposing a duty on providers of pension products falls at the first fence because their legal duty is to their shareholders, a duty which fails if they refer the retirer to their rival across the road. Even if they managed such altruism, where do they find the staff with the wide range of knowledge of all markets and products needed to "guide" the individual? The word guide is in inverted commas because it raises the position of IFAs. By definition their job is to advise on financial products. The Government is proposing merely guidance on the products. Presumably the idea is that someone places a range of options on the table, explains the pros and cons of each one and then leaves the individual to decide. These ideas are also made in 4.11 and 4.12.

3.2.3 An IFA would normally spend about two hours on an initial consultation with a new client just on a factfind and discovery of their (often undefined) hopes and intentions. That would be for determining an investment plan or perhaps one or two financial products, not financing with limited fallback the rest of an unknown life. It would seem reasonable to double that time for the adviser to research suitable avenues. So we would need two million hours a year at some £200 an hour minimum to finance the scheme. The Government offer £20 million, a shortfall of £380 million each year if the £20 million is continued – not offered yet.

3.2.4 There is no existing agency in the country either voluntary sector or independently funded, like the Money Advice Service, which has the proven skills, qualifications or resources to offer such an extensive and continuing service. IFAs have a living to earn so cannot offer a pro bono service. The pensions industry also has a living to earn and cannot be impartial and independent.

3.2.5 This guarantee needs a lot more thought, discussion and much greater funding if it is to have any real value.

3.3 ***Brief thoughts on the other points raised***

3.3.1 Linkage to State Pension Age – it would seem a reasonable precaution to guard against resources expiring before the pensioner to maintain the minimum crystallisation age at ten years below the SPA. It would also reinforce the point that savings via a tax-relieved pensions route are intended for provision in later years, not just a convenient savings account to be dipped into when some unexpected demand arises.

3.3.2 By the same token, the various rules that require that pensions are annuitised, and/or relief for pension contributions ceases, at age 75 will need consideration. Within the new liberalisation regime, there is an argument that there should be no upper age limit. However, we recognise that this would be complex to achieve in the short to medium term so would suggest a similar linkage at ten years above SPA, while the complexities are ironed out.

3.3.3 Merging of scheme rules and tax rules – a necessary simplification if there is going to be coherence and consistency across the retirement scene. There are more than enough complications as it is and the aim should be to make the choices universal and comprehensible (with a little “guidance”) to the majority of the population, especially as a new and probably less financially aware segment is being brought into the area via auto-enrolment. It might also solve part of the Government’s worry over Defined Benefit schemes by making it less tactically attractive to transfer out for earlier access.

3.3.4 A final point not covered by any of the above surfaces in Q8. This seems to suggest guidance should be available at key points *during* retirement. It is not clear whether this means free guidance as at initial crystallisation. If so, this runs up against the problems of cost and resources mentioned previously. It also would appear to give an enormous advantage to those seeking financial guidance on occasion for their pension-inspired assets over those who have to pay for such advice in seeking guidance for assets acquired by other routes. And who is going to be able to say whether the savings accounts or equities laid on the adviser’s table came from the former or the latter course. We suggest that practicalities would only permit free “guidance” at the first hurdle. This would imply that thereafter the individual is on their own – as circumstances change over time, it is vital that guidance is available to individuals at critical times during retirement.

LITRG
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