Workplace pensions automatic enrolment: review of earnings threshold
Department for Work and Pensions consultation

Response from the Low Incomes Tax Reform Group ('LITRG')

1 Executive Summary

1.1 The Government's aim with automatic enrolment should be to encourage people to provide their own meaningful top up to the state pension, where they can afford to do so. Although maintaining alignment of the earnings threshold with the personal allowance has therefore taken a large number of people out of the scheme, it is arguable that they could not have afforded the contributions in any case – particularly given that the rates of contribution are set to increase substantially from October 2017 and October 2018[1].

1.2 In terms of affordability of contributions, we are surprised that there is no consideration of the National Minimum Wage (and indeed the higher rates of pay actually considered to be a 'living wage') and how the earnings threshold compares to those rates.

1.3 The interaction of employee pension contributions and Universal Credit awards requires careful consideration and the Government must provide appropriate guidance to employees, so that they understand the overall 'net cost' of being automatically enrolled.

[1] See The Pensions Regulator website 'How much you must pay': http://tinyurl.com/omk8nxp

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1.4 On balance, we prefer Option 3 – maintaining the link with the personal allowance, but suggest this is kept under review with further changes to that allowance; and in October 2017 and 2018 when increased employee[1] contribution rates come into effect.

1.5 Coupled with our preference for Option 3, we would suggest that employees' right to opt in is better promoted. Some people – perhaps lower-earning (possibly female) partners of a higher earner – may have the ability to save, if the household is able to afford overall to do so. If they were aware of the incentive of an employer contribution and their right to opt in, more might take this up. We recommend that as automatic enrolment continues, research is done to monitor opt in take up[2].

1.6 We recommend that the Government gives consideration to how all employees contributing to a workplace pension could obtain tax relief on their contributions – regardless of whether their employer operates net pay or relief at source arrangements. This seems an obvious area of unfairness and inequality between lower-earning employees to address. It is particularly important in terms of pursuing Option 3, as the consultation document currently states that all those earning over the personal allowance would get tax relief on their contributions under this option. This is not the case for those earning just over the personal allowance whose employers operate net pay arrangements.

1.7 We recommend that further detail is given on two areas in Annex D of the consultation document:

1.7.1 First, the wording of paragraph 5 of Annex D implies that there **will be** additional obligations on employers to provide information about automatic enrolment including opt in rights, in addition to existing legal obligations[3]. Is that correct and if so, what will those obligations be?

1.7.2 Second, what is the 'evidence' quoted regarding the impact on disabled people? It might be that some 'sub-sets' of people with disabilities are impacted more than others. Does the Government's evidence/analysis consider this point?

1.8 Reviewing the automatic enrolment earnings threshold does nothing to address the failure of some low-paid workers (those with multiple jobs, agency workers etc) to build up adequate retirement provision. Those earning below the lower earnings level in multiple jobs, for example, might not even accrue state pension entitlement. Addressing this problem probably lies more in ensuring some future means of aggregating earnings so that they build

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[1] Ibid – if employers pay only the minimum percentage required from them, in order to make up the overall required minimum, the rate of employee contribution increases from 1% currently to 3% from 1 October 2017, and 5% from 1 October 2018

[2] We note that the Department for Work and Pensions has published research (November 2014) on opt out rates, but can find no similar research on opt in take up. http://tinyurl.com/olps5or

[3] See for example information from The Pensions Regulator: http://tinyurl.com/ndz2vt6

up a national insurance contributions record, however, rather than in enrolling them into employer schemes for private saving.

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 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 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 Automatic enrolment trigger

3.1 ***Q1: Are there any other factors that should be taken into account in the review of the automatic enrolment earnings automatic enrolment trigger for 2015/16? If so please explain why they are relevant to the review.***

National Minimum Wage comparison and the 'living wage'

3.1.1 We are surprised that there is no mention of a comparison to the National Minimum Wage (NMW) in the consultation document. This is particularly as the consultation document does acknowledge that setting the threshold is a balancing act, with affordability of contributions being a key consideration[1].

3.1.2 From 1 October 2014, the adult rate of the NMW is £6.50 an hour, so someone earning fewer than 30 hours a week at that rate will currently be over the automatic enrolment earnings threshold.

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[1] For example paragraph 2 on page 9 says: 'If the trigger is too high then people who should be saving, or saving more may lose out. Set it too low and people for whom it makes little sense to save for retirement because they probably cannot afford to save… may be driven to opt out.'

3.1.3 Many in fact consider that a true 'living wage' is considerably higher than the NMW – with the UK living wage outside of London estimated to be £7.85 an hour (£9.15 an hour for all Boroughs in Greater London)[1]. The minimum income standards on which calculation of this living wage is based include what society generally views as essential expenditure to provide a minimum standard of current living, but which we understand does not include any element of surplus for savings or providing for the future in the form of a pension[2].

3.1.4 A person working full time at the NMW in a single job would be contributing £1,372 a year in income tax and primary class 1 national insurance contributions[3]. This represents net income of some £233 a week. A significant consideration in this consultation ought to be whether a person earning this amount would be able to afford pension savings to any significant degree such that they would build up a meaningful pot at retirement to supplement state provision.

3.1.5 We are particularly concerned in this regard about the proposed threefold increase in the effective rate of employee contribution from October 2017 (increased again from October 2018 to five times the current rate of contribution)[4]. A person earning the NMW might be able to afford the current rate of contribution, but may well be forced to consider opting out when these increases start to be felt in their take-home pay; in which case the contributions they are currently making will be left in a small pot producing a negligible and arguably meaningless return at retirement.

3.1.6 One possibility of alleviating the cost to employees would be to encourage employers to pay more than the minimum contribution required of them (indeed it is possible for employers to cover the entire minimum contribution, with no contribution from the employee). Care needs to be taken here, however, as we understand there is some activity in the marketplace promoting salary sacrifice alongside automatic enrolment[5]. Whilst this might generate savings for employers and for some employees, mostly in the form of reduced class 1 national insurance contributions on the element of salary sacrificed, great care needs to be taken for low-income employees. There can, for example, be complex interactions with the NMW meaning that low-income employees are excluded from such schemes, or complicated

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[1] See http://www.livingwage.org.uk/calculation

[2] The Minimum Income Standards used were originally based upon research funded by the Joseph Rowntree Foundation; see report 'A minimum standard for Britain' at http://www.jrf.org.uk/sites/files/jrf/2226-income-poverty-standards.pdf

[3] Based on 2014/15 rates. Annual salary £13,520, personal allowance for income tax of £10,000 (basic rate income tax at 20% on £3,520 = £704); primary threshold for class 1 national insurance £7,956 (primary contributions at 12% on £5,564 = £667.68). Total income tax and class 1 = £1,371.68.

[4] See footnote 1 on pages 1 and 2 of this response.

[5] See for example: http://www.krwaccountants.co.uk/item/cut-the-cost-of-auto-enrolment-pensions-with-salary-sacrifice.html

'better off' calculations for claimants of Universal Credit as it is rolled out. Coupled with the possible loss of or reduction in entitlements such as statutory maternity pay, this can be a minefield for misadvice.

3.1.7 We therefore recommend that these issues are kept under review.

Universal Credit (UC)

3.1.8 The roll out of UC is to be accelerated from early 2015[1]. Low-income workers who are automatically enrolled into pension schemes (or, per comments below, who may have the right to opt in and receive an employer contribution) may also be UC claimants. This roll out of UC coincides with further staging of automatic enrolment[2] so that by the time UC is fully rolled out, automatic enrolment should similarly be fully in place.

3.1.9 It is therefore important that employees being advised about automatic enrolment are helped to understand the interaction with UC. For the calculation of UC income, employees may deduct 100% of pension contributions[3]. If they are unaware of this interaction (that is, that a higher UC award might result from the deduction of employee pension contributions from assessable income), employees might opt out thinking that the cost to them of joining the pension scheme is higher than in fact it is if the UC impact is factored in.

3.1.10 This will become even more important as contribution rates to automatic enrolment pensions increase, as above. We therefore recommend that careful consideration is given to appropriate guidance for UC claimants alongside automatic enrolment. The Government should provide this via GOV.UK but also consider how it may be disseminated further via employers. This should also seek to guide employees about the impact of salary sacrifice arrangements used alongside automatic enrolment, as noted above.

3.2 ***Q2: Is it your experience that alignment with an existing payroll threshold reduces complexity? If so, please explain the impact upon you (or your clients) of***

a) freezing the trigger or

b) increasing in line with indexation.

3.2.1 Whilst we do not have direct experience with payroll matters, we would observe that alignment of the automatic enrolment threshold with the income tax personal allowance is

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[1] See DWP press release, 29 September 2014: http://tinyurl.com/m4uy7py

[2] Employers with 50 to 249 employees currently being staged, with employers of fewer than 50 employees being staged from 1 June 2015 to 1 April 2017. See http://www.thepensionsregulator.gov.uk/docs/detailed-guidance-2.pdf, page 7

[3] See Regulation 55(5)(a) of The Universal Credit Regulations 2013: http://www.legislation.gov.uk/ukdsi/2013/9780111531938/regulation/55

attractive as a 'simple' option. This is both from an employer, payroll management and software programming perspective – as well as being a familiar figure for employees.

3.2.2 There are arguments for maintaining such simplicity; particularly when we consider that employers will already have yet another threshold to deal with from April 2016 when the obligation will come in to start deducting repayments under the 'new' student loan regime[1].

3.3 ***Q3: Which of the four options do you favour and why?***

Option 3 – alignment to the personal allowance

3.3.1 On balance, we favour Option 3 – continued alignment of repayments with the income tax personal allowance – for simplicity.

3.3.2 There are various arguments in favour of other options, particularly Option 4 – using the Pension Commission benchmark replacement rate – but these introduce complexity and ultimately lower the starting point for auto enrolment. Given our comments above about the feasibility of low-wage employees being able to afford savings for the future, in reality those persistently earning between the lowest threshold of the proposed options (£9,876 for Option 4) and the highest (£10,500 for Option 3) seem unlikely to be able to build up any meaningful pension pot.

3.3.3 The automatic enrolment threshold should be kept under review, however. Notable trigger points for change might be if there were again any further significant increase in the personal allowance; and in 2017 and 2018 when the contribution rates will greatly increase. As noted above, the latter dates might see an exodus of lower-paid employees from schemes in which they are currently enrolled, if they are unable to afford the increase.

Devolution

3.3.4 A review might also be needed depending on the results of devolution of further tax powers to the Scottish Parliament (or indeed to the Northern Ireland and Welsh Assemblies in due course). The extent of devolution is still being debated, but if power were to be devolved such that there was an ability to vary the amount of the personal allowance for income tax, we could find that misalignment with the automatic enrolment threshold is once again introduced.

[1] Income-contingent student loans under the 'Plan 1' regime are already in repayment, based on deductions from PAYE earnings (using the national insurance definition) at 9% over £16,910 (for 2014/15, rising to £17,335 from 6 April 2015). Under the 'Plan 2' regime, the first employer-deducted repayments will begin from April 2016, using an earnings threshold of £21,000. Employers will therefore have to deal with both thresholds, as Plan 1 loan repayments will still continue.

Income tax relief

3.3.5 One further point we would query as regards Option 3 is that the consultation document (bottom of page 11, top of page 12) states, incorrectly, that *'given the central role that tax relief plays in building pension savings, it* [ie Option 3] *ensures that all those automatically enrolled can benefit from it'.*

3.3.6 Under the discussion of Option 1, the consultation document has already stated that someone earning the current personal allowance of £10,000 would be automatically enrolled and pay annual contributions of about £85. From this, we can therefore see that the above statement as regards maintaining the link with the personal allowance is not true for those whose employers operate a net pay arrangement scheme: someone earning £10,000 in 2014/15 would pay £85 to their pension but receive no tax relief under a net pay arrangement, as they have no tax liability.

3.3.7 The way we suggest this is resolved is that the Government introduce some means of claiming tax relief to be added to the pension pots of those in net pay arrangements schemes[1]. See our answer to question 5 below.

Opt in rights - guidance

3.3.8 Annex D to the consultation document says that *'… anyone who is not automatically enrolled because of an increase in the earnings trigger will retain the right to opt in with an employer contribution. Employers* ***will be*** *required to provide information about these opt in rights* [emphasis added].*'* This wording suggests that there **will be** additional obligations placed on employers, on top of their existing legal obligations to provide information on automatic enrolment – which includes notifying of opt in rights where applicable. Is this correct?

3.3.9 It would certainly be useful for lower earning employees to be reminded of the ability to opt in if circumstances mean they can afford pension saving. This could offer some relief to low-earning women, for example, who have a partner earning more but where the household overall can afford for her to contribute to a pension scheme to some extent – thus building up savings in her own name. This would be of greater benefit currently to those employees whose employers operate relief at source arrangements; though could be of equal benefit to all if our comments regarding tax relief for net pay arrangement schemes were to be taken on board (see below).

3.3.10 If our reading of the above is correct, we wonder what the additional information that employers are required to provide will contain, in what format it will be delivered and at what point? It would need to cover (as things stand at present) whether or not the scheme operates relief at source or net pay arrangements so that the employee is clear as to the overall benefit of opting in. We also wonder how compliance of providing the information

[1] And if those are defined benefits schemes, the tax relief should be treated separately – for instance, as a ring-fenced 'AVC' fund for the benefit of the individual non-taxpayer.

will be monitored, as there will be no obvious incentive for employers to encourage employees to opt in. We would recommend that the Department for Work and Pensions conduct some research into opt in rates as automatic enrolment beds in, as this could usefully inform what more might be done to encourage opt in, where appropriate[1].

3.4 ***Q4: What pensions tax relief arrangement do you (or your clients) use and why?***

3.4.1 This is not applicable for us to answer.

3.5 ***Q5: Are there any other options we should be considering?***

National minimum wage and living wage comparison

3.5.1 We do not put forward any further options for a change in the automatic enrolment earnings threshold – except to the extent that, as noted above, we believe some analysis should be done as to affordability of contributions as compared to the National Minimum Wage and what might be considered a 'living wage'.

Tax relief for those in net pay arrangement schemes

3.5.2 We would, however, pick up on the point made on page 9 (end of paragraph 5) in the consultation document that there is no means of claiming tax relief for non-taxpayers whose schemes use net pay arrangements. Here, there seems to be a natural unfairness as compared to those whose employers operate a relief at source scheme. Why not introduce a means of claiming relief for those in the former type of scheme? Next to the employer contribution, the ability to obtain tax relief is a key part of the attraction of saving into a pension. If tax relief is not available, low earners might be tempted to sacrifice the employer contribution for the ability to save elsewhere (for example, into an Individual Savings Account) rather than tie their money up for the longer term (generally to a minimum age of 55, or 57 from 2028[2]). This is therefore counter-productive to the aims of automatic enrolment, so we recommend that the Government address it as a matter of urgency.

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[1] In the same way that research has been published (November 2014) into opt out rates: https://www.gov.uk/government/publications/automatic-enrolment-opt-out-rates-findings-from-qualitative-research-with-employers-staging-in-2014

[2] See paragraph 2.36 of the Government's response to the consultation on 'Freedom and choice in pensions', July 2014: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/332714/pensions_response_online.pdf

3.5.3 Indeed, it is anomalous that an individual without any relevant earnings at all[1] can contribute to a personal pension (possibly ‘stakeholder’) scheme which operates relief at source and receive the benefit of tax relief. Each year, they may pay in £2,880 net and receive a grossed up contribution of £3,600 in their pension pot[2]. Yet an employee earning, say, £10,000 and contributing to an employer scheme operating a net pay arrangement does not benefit from tax relief.

3.6 ***Q6: Would any of the four options have a disproportionate or unreasonable impact upon any particular sectors of the population? Please explain why and how.***

Disability

3.6.1 We note that Annex D to the consultation document says: *‘The latest evidence also suggests that the proportion of people with a disability in the eligible group would remain broadly the same at 12% for all triggers considered.’*

3.6.2 We would have preferred to see more detailed consideration of disability issues, or at least some breakdown of the ‘latest evidence’ referred to. It may be that some disabled people within the overall 12% are affected more than others – for example, earnings levels might be different depending on the type of disability. It would be helpful if the Department could demonstrate that there is no disproportionate impact on any sub-set of people with a particular kind of disability.

Part-time earners, those with more than one job (agency workers etc)

3.6.3 None of the four options does anything to assist those in multiple part-time jobs, agency work[3] and so forth who might earn more than the automatic enrolment threshold overall, but not in any one position.

3.6.4 These same workers might also earn less than the lower earnings limit in each of their jobs, and thus not build up a contributions record to accrue state pension entitlement. Arguably, however, it is more important for the Government to consider some means of aggregating such employees’ earnings for the purposes of crediting their contribution record and thus earning them a state pension than it is to look at how they could top up their own savings provision by means of enrolling them with employer schemes. We therefore recommend the Government looks to the national insurance system to resolve this problem.

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[1] And who may in fact have no net tax liability at all – for example, someone may even contribute on another’s behalf, such as a grandparent for a grandchild. Yet tax relief is given even so.

[2] Section 190(4) Finance Act 2004

[3] Unless the worker is signed up to an ‘umbrella’ arrangement providing them with a continuous contract of employment for multiple assignments.

4 Qualifying earnings band lower limit

4.1 ***Q7: Are there any other factors that should be taken into account in the review of the qualifying earnings band lower limit for 2015/16? If so please explain why.***

4.1.1 We can understand the rationale for maintaining a lower earnings band limit that maintains *'… a de minimis gap that produces contributions in pounds not pennies…'*[1]. However, it should be noted as explained above that even if Option 3 is chosen, this does mean that an employee earning just over the personal allowance might be automatically enrolled but without any tax relief on their contributions – if their employer's scheme operates on a net pay basis. Based on 2014/15 rates, someone earning £10,001 a year would therefore contribute some £85 to a scheme into which they were automatically enrolled, but on a net pay basis would miss out on the additional £21 tax relief available to an employee whose employer operates a relief at source scheme.

4.1.2 We therefore reiterate our suggestion above that some means should be found of giving tax relief to all employees in this situation.

4.2 ***Q8: Has alignment with the National Insurance lower earnings limit caused any problems? If so please explain.***

4.2.1 We are not aware of any problems.

5 Qualifying earnings band upper limit

5.1 We are not answering questions 9 and 10 as our comments are restricted to those on low incomes who are unaffected by the upper limit.

LITRG
25 November 2014

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[1] Page 14 of the consultation document, final sentence