Low Incomes
Tax Reform
Group
A voice for the unrepresented

HM Treasury consultation
Reducing the money purchase annual allowance
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 We strongly urge the government to think about savings for retirement coherently. For example, someone who saves up in a Lifetime ISA rather than a pension would benefit from 'tax relief' equivalent to the basic rate until age 50. Then, when accessing those funds at age 60 would be free to benefit from further 'tax relief' on putting them into a pension scheme. This runs contrary to the intention behind the money purchase annual allowance (MPAA) that someone should apparently not be able to obtain tax relief on the same savings twice.

1.2 Saying that, having a MPAA of £4,000 a year is preferable to the other possibility mooted in the consultation document of having no MPAA at all (and thereby effectively barring future pension saving for someone who had accessed their pension flexibly). With automatic enrolment applying up to state pension age, not permitting any further pension savings would not be sensible at all.

1.3 While it is heartening to note the figures supporting that an MPAA of £4,000 will affect very few savers, we fear there is a risk that these are based upon past/current savings patterns. It is therefore essential that if the MPAA is lowered to £4,000, it is kept under regular review at least every three years; particularly given that it is too soon to say what impact pensions freedom and the Lifetime ISA will have on savings patterns.

1.4 We outline why guidance on the MPAA currently provided on various government websites is disjointed, inadequate and worryingly potentially misleading. We urge that this is

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reviewed as a priority, before the reduction in MPAA from April 2017; and that it is kept under review as the programme of change for public financial guidance develops.

1.5 Finally, we recommend that if a tax charge arises as a result of exceeding the MPAA, then it should be possible for this to be paid out of the pension fund. Otherwise, those of limited means (and there are many in this category) might not be able to pay and could find themselves in financial hardship.

2 About Us

2.1 The 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 (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 General comments

3.1 We definitely agree with the statement in paragraph 3.6 of the consultation document that it would not be the right way forward to return to a ban on further defined contribution pension savings following withdrawals under pensions freedoms. People should be encouraged to save for retirement and there could be legitimate and sensible reasons for accessing existing pension savings (for example to pay off debts) and then replenish them later. Also, under automatic enrolment, workers will continue to be enrolled in workplace pensions up to state retirement age, so having no MPAA at all would not seem coherent policy.

3.2 Continuing on the subject of coherence, we would urge the government to ensure that thinking is joined up across the savings landscape. We might, for example, compare the individual who has saved into a pension against another person in otherwise similar circumstances who has saved up in a Lifetime ISA and received the 'government bonus' on those savings. If the latter person cashes in the Lifetime ISA at age 60, they would be permitted to put however much they like into a pension plan and receive tax relief on their

contribution. But the former saver would be capped at £4,000 a year of new pension saving. It is not at all obvious to us why the Lifetime ISA saver should benefit from the 'second round of tax relief' that the pension saver would be denied.

4 Question 1: Do you agree that a £4,000 MPAA would minimise re-cycling pension savings and that, coupled with ongoing monitoring, the new MPAA will allow the continued successful roll-out of automatic enrolment?

4.1 We understand that the Government is keen to dissuade 'tax-free cash recycling' which might mean that people seek to get further tax relief on money they have just taken out of a pension.

4.2 But with pensions freedom, an individual might decide to take money out of their pension (currently allowed at age 55) – for example, to pay off their mortgage or other debts. They might then decide to use their new-found surplus in disposable income to put money back into pensions to provide a nest egg for their old age when they eventually decide to reduce their hours or stop working.

4.3 The MPAA of £10,000 is unlikely to catch out too many people who might do this. But reducing it to £4,000 from April 2017 – equating to savings of £333 a month – is much more likely to cause problems for these people; especially if thinking about it in terms of someone choosing to save money they might have previously been paying into a mortgage.

4.4 For this reason, we think that if the MPAA is reduced to £4,000 per annum that close monitoring will be essential. This is particularly as it seems the amount has been chosen based upon what individuals did in the past, or currently do,[1] rather than a prediction of future events (other than to take into account the likely levels of pension contribution under auto enrolment). We are concerned, for example, that it is too soon to determine what impact (short, medium and long term) pensions freedom and the Lifetime ISA will have on savings patterns.

4.5 In this regard, it will be necessary to review trends in pension contributions and also monitor the MPAA in relation to changes in contributions likely to be paid under automatic enrolment, rather than just merely indexing the sum each year (though a commitment to regular uprating would be welcome).

[1] See para 3.11 of the consultation document, for example: https://www.gov.uk/government/consultations/reducing-the-money-purchase-annual-allowance

5 Question 2: Is there any evidence that setting the MPAA at £4,000 would impact disproportionately on particular groups?

5.1 The essential point here is that guidance will be essential so that savers understand that if they are treated as having accessed their pension flexibly, they know the limits on future savings.

5.2 Given that there is a greater probability of a £4,000 MPAA impacting at the lower end of the wealth scale than the £10,000 MPAA, particularly in the 'repayment of mortgage leading to surplus income' scenario outlined above, public financial guidance available to savers will need to make this issue very clear.

5.3 There is an acknowledgement in government that sources of public financial guidance are currently disjointed and a programme of change is underway to merge various bodies under a single umbrella.[1] However we understand that, at the earliest, this new body will not be up and running until the autumn of 2018. There is therefore a risk meanwhile that individuals may fall between different sources of financial guidance. For example, it is conceivable that guidance from the Money Advice Service[2] could lead an individual to conclude that they should pay off their mortgage and then use surplus income to save up for retirement. They might not realise that if they have separately accessed a pension flexibly, whether or not for the purposes of repaying the mortgage, that they could then be restricted on pension savings.

5.4 Guidance from The Pensions Advisory Service is also less than clear when relating to the MPAA[3] – their website page highlights in the top right hand corner the £40,000 annual allowance and carry forward of unused amounts. It is only when you read the detail further down the page that you come across the much-reduced MPAA figure.

5.5 Furthermore, the only information we can immediately find about the MPAA on the Pensionwise website is a page called 'Pension recycling'[4] tucked away under the 'More…' menu. This page merely gives a somewhat perturbing message about potentially triggering a large tax bill, links off to a GOV.UK page about pensions tax relief which is not particularly relevant to the matter in hand (sub-section 3 of that GOV.UK page on the annual allowance

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[1] See https://www.gov.uk/government/consultations/public-financial-guidance-review-consultation-on-a-single-body

[2] See for instance Money Advice Service guidance 'Should you pay off your mortgage early?': https://www.moneyadviceservice.org.uk/en/articles/should-you-pay-off-your-mortgage-early

[3] See http://www.pensionsadvisoryservice.org.uk/about-pensions/saving-into-a-pension/pensions-and-tax/the-annual-allowance

[4] https://www.pensionwise.gov.uk/pension-recycling

would be more useful)[1] and urges the reader to 'Get financial advice if you want to reinvest your tax-free money into a pension'. This neglects, however, to mention that it might not be the tax-free money from the pension itself that the individual reinvests in a pension – the MPAA rules apply to any money put back into a pension after the rules have been triggered. So the individual could easily be misled from this page into thinking there is no problem if they have used their pension lump sum to repay a mortgage, and then start to use future surplus income to save into pensions.

5.6 The Pensionwise page 'Tax you pay on your pension'[2] is no further help either. It has a heading 'If you continue to work' under which it might usefully be mentioned that automatic enrolment could apply and you could find yourself continuing to contribute to a pension (and what that might mean in terms of the MPAA); but there is no mention of ongoing pension contributions potentially having tax consequences.

5.7 Given the above examples, public financial guidance across the existing bodies should therefore be strengthened on the subject of the MPAA before implementation of the reduced limit in April 2017.

5.8 Finally, to protect those on low incomes, if someone were to pay more than the MPAA and find themselves with an unexpected tax bill, the rules should allow them to pay that bill from their pension savings (presently only permitted where the standard annual allowance applies and the tax charge is at least £2,000).[3] Otherwise, someone of limited means might not be able to afford to pay it and find themselves in financial hardship. This might be because, for example, they have directed all their surplus income to pension savings, or that their circumstances have changed between making the payment and finding out about the tax charge.

LITRG
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[1] https://www.gov.uk/tax-on-your-private-pension/annual-allowance

[2] https://www.pensionwise.gov.uk/tax

[3] Para 2.10 of the consultation document: https://www.gov.uk/government/consultations/reducing-the-money-purchase-annual-allowance