Low Incomes Tax Reform Group
A voice for the unrepresented

Work & Pensions Committee inquiry into pension freedoms[1]
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 After studying the comprehensive briefing note CPB – 06891, dated 3 October 2017, on the development and current situation of the new pension freedoms, we are pleased to take the opportunity to offer some ideas for the consideration of the Committee. These thoughts centre around tax as befits our remit to assist those on low incomes with issues they might have with taxation and the tax system.

1.2 The points we make here do not attempt to answer directly any of the bullets set out in the terms of reference, but they do try to draw the attention of the Committee to some major issues arising from pensions freedom. This includes the need for expert advice in steering the unrepresented through a minefield, where a misguided decision can have a serious financial impact on the later years of a saver's life, years in which they are likely to have little opportunity to recoup the losses of a financial mistake.

1.3 Tax can make a significant difference to the net amount accessed through pensions freedom.

1.4 We are concerned that none of the bodies providing guidance in this area appear to be qualified in tax matters.

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[1] Announced on 20 September 2017 http://www.parliament.uk/business/committees/committees-a-z/commons-select/work-and-pensions-committee/inquiries/parliament-2017/pension-freedoms-17-19/

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1.5 Pensions or lump sums accessed through pensions freedom may have a significant effect on the individual's (or family's) ability to access welfare benefits. Any guidance needs to also make this clear.

1.6 It is not clear how an individual might make the choice between saving for a pension or, instead, placing funds in a Lifetime ISA. This could deter people from saving for retirement.

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 Introduction

3.1 We should start by congratulating the author of the Briefing Paper on the regular inclusion of the issues of tax within the text. All too often, tax receives but token acknowledgement in consultations as if its existence were a minor consideration. Indeed in our response to the Financial Conduct Authority (FCA) on 27 January 2017 on the development of a Single Public Financial Guidance body we had cause to comment on the absence of the word tax from the entire document.[1]

3.2 Tax is a major component of any financial decision and requires balanced inclusion in determining the most suitable course of action. This is perhaps especially prominent in the crystallisation of pensions where decisions will be made which may have a major impact on,

[1] https://www.litrg.org.uk/sites/default/files/files/170127-LITRG-response-single-public-financial-guidance-body-FINAL.pdf

perhaps, another thirty years of life of the would-be pensioner but will also affect the financial resources of their family.

4 Availability of suitable tax advice

4.1 We represent low-income taxpayers, most of whom will also have a small capital base, and we are seriously concerned at the lack of tax advice available to those who cannot afford to pay for professional advice from either tax advisers or financial advisers.

4.2 Such individuals may well seek guidance from Pension Wise. But their advisers are neither trained nor qualified to advise on tax matters (indeed the recruiting advertisements said they did not even need previous experience of pensions) and, far from providing advice, they provide generic guidance following a 45 minute interview. This guidance may be incomplete, but may also encourage a particular course of action by a client with limited or no skills in tax or finance, potentially to their detriment. To date, the take-up of face-to-face interviews has been low[1] and it is unknown whether individuals have decided to access their pension savings without any advice or whether, instead, they chose to pay for professional advice.

4.3 Similarly, guidance from the Pension Wise and Money Advice Serve (MAS) websites can only give general guidance on tax, a highly complex code which has to be tailored to each individual and their circumstances. HMRC themselves cannot give individual advice (even if they had the staff and time) and the proposed new Single Financial Guidance Body (SFGB) looks likely to provide the oversight and co-ordination of advisory bodies rather than direct advice. We have suggested[2] that the SFGB should establish “warm handover” facilities between the various component agencies operating under its umbrella and these should include our two sister charities, Tax Help for Older People[3] and TaxAid.[4] This would enable expert advisers on other fields such as debt and pensions to gain access to qualified tax advisers.

5 Effect of pension transfer on state benefits

5.1 Advice on taxation matters is important not just for understanding the tax impact of different pensions choices and how they might be mitigated but also for the less obvious, but very necessary understanding, of the possible impact of a pension choice on tax and

[1] https://www.gov.uk/performance/pension-wise

[2] Op.cit.

[3] www.taxvol.org.uk which provides pro bono professional help to older people who cannot afford advisers’ fees.

[4] www.taxaid.org/uk which provides a similar service to working age people.

related benefits. For example, taking a lump sum as an Uncrystallised Funds Pension Lump Sum (UFPLS)[1] might have no direct tax consequences if the pensioner's taxable income remains below his or her personal allowance (£11,500 for 2017/18) but could have a deleterious effect on their benefits if the income or capital takes them above a threshold where benefits become restricted or simply unavailable. This can happen not just at the lower end of the income scale but also higher up if, for instance, an average earner starts to drawdown some pension income to supplement his salary and finds that he has crossed the threshold, £50,000, at which the family unit starts to lose Child Benefit under the High Income Child Benefit Charge (HICBC). We quote from our response to the FCA consultation on the SFGB:[2]

- 'Tax credits: Taxable income from pensions is also income for the purposes of tax credits, so you could end up with a tax credits 'overpayment' (debt) by taking pension withdrawals. This could also mean you end up with less tax credits in the following year.
- Other state benefits (including universal credit): One-off or irregular sums taken from pensions could be treated as 'capital' for the purposes of means-tested state benefits. Regular amounts taken from pensions are likely to be treated as income. Either capital or income treatment could have an immediate effect on your entitlement to state benefits, depending on your overall circumstances. 'Local' benefits like Council Tax Support could also be affected.
- Taking money from your pension could trigger a HICBC.
- More information on tax: The information provided should not just concentrate the individual as to whether or not the sums received are taxable, but should also inform how and when the tax due will be collected. It needs to be stated that it is highly unlikely that any tax collected under the PAYE system, particularly in respect of larger lump sums or irregular payments, will be correct.
- More guidance is needed on tax refunds – recent HMRC statistics[3] show an enormous number of people were taxed at the wrong rate. The figures may well be too low, as many people might not even know they need to claim a refund. And even if they do, there are many different forms – all several pages long – which are not explained very well on GOV.UK.'[4]

[1] An occasional or regular withdrawal of money from a pension pot.

[2] https://www.litrg.org.uk/sites/default/files/160608%20Public%20Financial%20Guidance%20-%20LITRG%20response.pdf, at page5

[3] See https://www.gov.uk/government/publications/pension-schemes-newsletter-78-may-2016/pension-schemes-newsletter-78-may-2016#pension-flexibility-statistics

[4] See https://www.gov.uk/claim-tax-refund/you-get-a-pension

5.2 On the direct impact of tax on a pension decision, we can again quote from our response to the FCA consultation on advising on pension transfers:[1]

5.2.1 'Tax and its impact on tax-related benefits are an integral part of almost all financial decisions. No IFA can give sound advice without taking into account what effect tax would have on any course of action. Pensions are no exception to this but now under pensions freedom, it becomes a major consideration. Whereas under the previous regime, annuity purchase was the only route available except for those with substantial pension pots who could risk the drawdown option, and therefore tax choices were limited to whether to take a tax-free lump sum or a higher taxable income, now a transferred pot has a much wider range of destinations which offer a variety of tax situations, both in life and at death.

5.2.2 For example, a part-time worker may wish to top up her income to the personal allowance limit by a series of UFPLS withdrawals; someone with a poor health prognosis may wish to leave his beneficiary a tax-free inheritance should he die before 75; the pensioner may wish to place the proceeds of a pot within the ISA shelter to benefit from tax-free income and potential tax-free growth, not to mention the recently acquired ability to pass ISA holdings within their tax shelter on to their spouse outside the estate; those still working but winding down may wish to use income drawdown to allow them to take variable income to top up their earnings without propelling them into a higher tax band. And so on.'

5.3 We mention these common examples because the average pension saver, especially those on modest incomes and with small pension savings, is unlikely to have the knowledge and skills necessary to understand the impact of tax on their decisions, let alone the full financial consequences (which are not within our remit). It is therefore essential that financial advisers and pension transfer specialist have a thorough grasp of the tax and state benefits implications of transfers.

6 Retirement savings strategy

6.1 As noted elsewhere, our expertise is in taxation rather than financial planning, but it does seem to us that taxpayers are faced with difficult, or near-impossible, decisions to take in relation to the way they might save for their future. Our response to the FCA's consultation in relation to handbook changes on the introduction of the Lifetime ISA[2] contained the following summary:

6.1.1 'Our main concerns centre around the tax differences between saving in ISAs and saving in pensions, presenting the average saver with an almost impossible decision. Complex

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[1] https://www.litrg.org.uk/sites/default/files/files/170720-LITRG-response-FCACP17-16-PensionTransferAdvice-FINAL.pdf, at page 3

[2] https://www.litrg.org.uk/sites/default/files/files/170124-LITRG-response-Handbook-changes-intro-Lifetime-ISA-FINAL.pdf, at page 2

calculations will be needed involving the relative advantages of the two routes as well as the inevitable uncertainty of an investment designed for both the long term and the short term. The former tax-exempt input into pensions and taxed outcome has, since pensions freedom. Become less clear-cut with the new possibilities of drawing serial tax-free lump sums or widely variable income drawdowns, giving the pensioner more control over their tax rates. It therefore becomes far from straightforward to compare the tax-free outcomes of an ISA plan with those of conventional pension schemes.

6.1.2 Furthermore, the taxed input into the proposed LISA can vary to the disadvantage of the saver whose salary increases so that he becomes a higher rate taxpayer. While for a basic rate taxpayer the tax relief on pension contributions was, at 20%, equal to the Government bonus of £1,000 for each year's £4,000 in a LISA, at 40% he is missing out on the extra 20% relief he would get on his pension contributions.

6.1.3 Not only should we note the taxation of the living but also take account of the taxation of the dead. ISAs will fall into the estate on the death of the saver and be subject to Inheritance Tax (IHT), either immediately or perhaps, later, having passed intact to a surviving spouse or civil partner; pensions written in trust will fall outside IHT and can be passed on to nominated successors either tax-free before age 75 or at the legatee's marginal rate thereafter.

6.1.4 We could add to the difficulties of calculating the relative dis/advantages the point that between age 50 and 60 when no further contributions can be made to the LISA (and no penalty-free withdrawals apart from a very small handful of first-time buyers) and therefore no Government top-up, the tax relief continues with pension contributions and quite possibly at 40% when many savers are at peak earning power and empty-nesters.'

6.2 Quite possibly some people will make no choice if they cannot decide which is the better option for them.

LITRG
19 October 2017