Work and Pensions Committee
Protecting pension savers: five years on from the Pension Freedoms:
Accessing pension savings
Response from the Low Incomes Tax Reform Group (LITRG)

1 About Us

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

1.2 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.

1.3 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.

2 Introduction

2.1 Pension freedoms since April 2015 have allowed people to have flexible access to their pensions, but often they do not understand the tax and related benefits impacts.[1]

2.2 As a result, they make costly mistakes such as triggering unexpected tax liabilities or losing benefits. Our response to this call for evidence concentrates on how such unfortunate situations might be avoided. We have therefore limited our comments to those questions of relevance to these points.

[1] We summarise the issues to look out for in our July 2019 'Pension Pitfalls' article: https://www.litrg.org.uk/latest-news/news/190711-pension-pitfalls

CHARTERED INSTITUTE OF TAXATION
30 Monck Street, London, SW1P 2AP

REGISTERED AS A CHARITY NO 1037771

Tel: +44 (0)20 7340 0550
E-mail: litrg@ciot.org.uk

www.litrg.org.uk

UK REPRESENTATIVE BODY ON THE
CONFEDERATION FISCALE EUROPEENNE

3 Question 1: Do people have access to a range of pension options to meet their needs for later life and how might these needs change in future?

3.1 People have a range of pension options. However, the problem with choice is that it brings complexity. Given the low level of financial education in the UK and the lack of availability of affordable advice,[1] many people are likely to have difficulty navigating their way through the options.

3.2 We illustrate below how we have seen people unwittingly make poor pension decisions as a direct result of not understanding the tax and welfare benefits consequences of their decisions. Also, at para 7.3 below, we mention that phased retirement can bring further complexity – the 'once and done' pensions decisions of the past having been replaced by a multitude of decisions at different points in time.

4 Question 2: Are there other pension options, not currently available in the UK, which would better meet people's needs in later life?

4.1 No comment.

5 Question 3: Are there barriers to providing other pension options which meet a need and are not currently available in the UK?

5.1 No comment.

6 Question 4: Are people receiving the guidance and advice they need to make informed decisions about how they access their pensions?

6.1 From some unfortunate cases we have seen via enquiries submitted to our website, we think that the answer here is no – at least, not in all cases.

6.2 While we can make no comment about whether people's decisions are suitable for their circumstances from a financial planning perspective, we have seen cases where people have made poor decisions relating to their pensions from a tax and benefits perspective. It seems that many are simply unaware of the consequences of their actions and are then left in a difficult position after the event.

6.3 The following two queries to our website demonstrate this. In both, the high income child benefit charge is a concern (coming into effect where child benefit is claimed and the

[1] Even getting advice on the tax consequences of pension decisions is not necessarily accessible to those with low-to-moderate means. See our comments in response to HMRC's 2020 call for evidence, *Raising standards in the tax advice market*: https://www.litrg.org.uk/latest-news/submissions/200826-raising-standards-tax-advice-market-call-evidence

adjusted net income of the claimant or their partner exceeds £50,000[1] in a tax year). The second also demonstrates the potential impact on benefits (in this case, tax credits).

> **Query 1:** "I have received a tax bill for £2,517 which I cannot pay. It is for high income tax on child benefit… I took my pension… which pushed my total income just above £60,000. The money was spent on essential home improvements… we have 3 children to support…. We feel this is very unfair as all other years our income is well below the threshold for the high income tax. My wife does not even have a permanent job. Please help as we don't know what to do…"[2]

> **Query 2:** "I am a single [parent] of 3 and work part time receiving both child and working tax credits. I recently went through a divorce in which I was ordered to pay my [ex-partner a large sum of money] or lose the house…. I opted to cash in my pension and use the money to pay [my ex-partner] off…. We were receiving £800/month in credits but I have just noticed that it didn't get paid this month, and this is because the revenue have taken my pension cash in as income, although my [ex-partner] has had it. What can I do?"[3]

6.4 People might also draw their pension early – perhaps simply because they can take a lump sum and keep the money in a savings account so that it is more readily accessible to them than when it is left in their pension. In so doing, they might not only be incurring unexpected tax liabilities which might have been mitigated or avoided completely with basic planning, but are also moving funds from a 'protected environment' for means-tested benefits purposes.[4] As in the case of tax credits being impacted illustrated by query 2 above, we believe that many people will be unaware of this issue.

---

[1] The threshold for the charge to be considered is £50,000 of adjusted net income, though technically a charge will not apply where the figure is below £50,100 as the charge is calculated on whole percentage points – i.e. a 1% withdrawal of Child Benefit for every round £100 of adjusted net income between £50,000 and £60,000.

[2] Received 6 February 2019.

[3] Received 27 October 2020.

[4] Rights to funds held in registered pension schemes are disregarded for universal credit – SI 2013/376, Schedule 10, para 10, except in the case where there is a mixed age couple one of whom has reached state pension age in which case notional income is assessed based upon that member of the couple's untouched pension pot values as if an annuity had been taken (see example at H5177 in Advice for decision makers, Chapter H5: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/965132/admh5.pdf).

Welfare benefits impacts of pension decisions

6.5 For those claiming welfare benefits, there is only minimal public-facing guidance available on how exercising pension freedoms can affect a claim. Some guidance was published in March 2015,[1] but this is somewhat vague. For example, for those under the qualifying age for pension credit, it says:

> 'If you or your partner do take money from your pension pot, it will be treated as either income or capital, depending on, for example, how regularly you withdraw it.
>
> It is your responsibility to tell the Department for Work and Pensions (DWP) – and your local council where appropriate – if you or your partner take any money from your pension pot.'

6.6 Further down the page, under 'more guidance' the page advises:

> 'DWP staff can explain the rules around the treatment of income and capital, but this will not be a guarantee of your entitlement to benefits – each case is decided on its own individual circumstances. DWP staff use the detailed information in the Decision makers' guide.'

6.7 For some benefits, including universal credit, the *Decision makers' guide*[2] has been replaced by *Advice for decision making: staff guide*.[3] The relevant chapter of this for pension income is *H5: Unearned income*[4]and, for capital, *H1: Capital.*[5]

---

[1] See DWP guidance, *Pension freedoms and DWP benefits*, 27 March 2015: https://www.gov.uk/government/publications/pension-freedoms-and-dwp-benefits/pension-freedoms-and-dwp-benefits (linked to from Pension Wise: https://www.pensionwise.gov.uk/en/benefits)

[2] https://www.gov.uk/government/collections/decision-makers-guide-staff-guide

[3] https://www.gov.uk/government/publications/advice-for-decision-making-staff-guide

[4] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/965132/admh5.pdf

[5] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/890315/admh1.pdf, the relevant part of which is H1021:
"A payment is capital if it is
1. not made or due to be made regularly and
2. made without reference to a period.
The payment is income if this does not apply."

6.8 However, there is precious little information aimed at the individual to help them work out the potential impacts of their pension freedoms in relation to universal credit and so they are seemingly left to simply rely on 'DWP staff' explaining the rules to them but with no guarantee that explanation will be applied in their own case.

6.9 Broadly, if withdrawals are 'regular', they will be taken into account in full as unearned income when working out the claimant's universal credit award. The amount so taken into account will be, as we understand it, the gross amount without deduction for any tax payable thereon.[1] This is not made clear, however, in the public-facing guidance on benefits impacts of exercising pension freedoms.[2]

6.10 We also understand that it is irrelevant whether or not the withdrawal is all or part of a pension commencement lump sum (which would be non-taxable[3]), or whether the withdrawal is an uncrystallised funds pension lump sum (25% of which would be tax free). In either case, the tax-free part would not be taken into account for tax credits as income[4], but it appears that such amounts could be treated as unearned income for universal credit if they form part of a series of regular withdrawals which 'look like' an income stream. The existing public-facing guidance is, however, silent on this point.

6.11 If DWP treat pension withdrawals as capital in nature, the award (or potential award) could be affected in a different way. For universal credit, capital of between £6,000 and £16,000, affects their award by including an amount of tariff income in the assessment.[5] Capital of over £16,000 ends entitlement to universal credit (or precludes entitlement to an award being made to a would-be claimant).

6.12 It also needs to be made clear to claimants that money withdrawn from a pension, even if assessed as income for universal credit at the time of withdrawal will become capital if it is

---

[1] See DWP's ADM H5, para H5004:
'All retirement pension income should be taken fully into account for UC; there are no comparable deductions for Income Tax and NI in UC.'
(https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/965132/admh5.pdf)

[2] https://www.gov.uk/government/publications/pension-freedoms-and-dwp-benefits/pension-freedoms-and-dwp-benefits

[3] Section 636A ITEPA 2003

[4] See HMRC Tax Credits Manual TCM0120140 for confirmation of this: https://www.gov.uk/hmrc-internal-manuals/tax-credits-manual/tcm0120140#IDAUEVAH

[5] This is due to the 'tariff income' rules, which assume for every £250 (or part thereof) over £6,000 that the claimant has £4.35 a month of income from that capital. See https://revenuebenefits.org.uk/universal-credit/guidance/entitlement-to-uc/capital-rules/#Tariff%20income%20rules

not spent by the end of the assessment period after the one in which it was received.[1] Again, there is no mention of this in the public-facing guidance on pension freedoms.

Recommended actions

6.13 We think that more guidance could be provided by Pension Wise on its website and by its advisers on all of the above points. For example, there is nothing at all on the Pension Wise website[2] about the high income child benefit charge. This is concerning, given that lack of awareness about the charge can lead to taxpayers accruing significant debts to HMRC without their knowledge. When HMRC eventually catches up with them, not only might they face unaffordable payment demands but they could also be charged penalties for the failure to notify.[3]

6.14 Furthermore, we would recommend the DWP gives clearer guidance for the public on the benefits treatment of withdrawals made under pension freedoms. In this respect, it is worth noting that 'mixed age couples'[4] now have to claim universal credit rather than pension credit, so the guidance needs to be clear for both benefits.

7 Question 5: What role should the Money and Pensions Service (MaPS) have in supporting people accessing their pensions for the first time, including through pension dashboards?

7.1 We understand that some in the pensions sector have advocated a stronger push for people to get guidance from Pension Wise on their pensions prior to taking action – for example, via an auto-appointment system. While guidance is better than nothing, we would, as indicated in our paper *'A better deal for the low-income taxpayer'*,[5] prefer to see a system where people can get free or low-cost **advice.** Such a service could be set up by MaPS with some funding to a charity established for the purpose, following along the same lines as the tax

---

[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/890315/admh1.pdf, the relevant part of which is H1050.

[2] Either on the tax (https://www.pensionwise.gov.uk/en/tax) or benefits (https://www.pensionwise.gov.uk/en/benefits) page.

[3] Becoming liable to this charge triggers an obligation to notify HMRC of liability to income tax, under s7 TMA 1970, by 5 October after the relevant tax year.

[4] That is, where one member of a couple has reached state pension age but the other is still of 'working age' – we explain more about this on our website for advisers, revenuebenefits.org.uk: https://revenuebenefits.org.uk/universal-credit/guidance/who-can-claim-universal-credit/pensioners/

[5] See https://www.litrg.org.uk/latest-news/reports/201204-better-deal-low-income-taxpayer, 18 f.

charities, TaxAid[1] and Tax Help for Older People[2] (through which expert tax advice is provided through a combination of staff and volunteers from the tax profession).

7.2 We would also reinforce that people need support not just when accessing their pensions 'for the first time', but may well need it throughout their retirement. This is because they might, for example, choose to activate different pots at different times. Indeed, if they take various sums by way of drawdown, using pension freedoms, they will need to keep their situation under much closer review than in the past when purchasing an annuity was the only real option open to many people. The 'once and done' decision of the past has largely been swept away by pension freedoms.

7.3 In tax and benefits terms, people are also more likely these days to phase their retirement, perhaps moving to part time work before winding down altogether. This might make life more complicated for the taxpayer in terms of evaluating their overall current and future financial position (and hence the best way of planning to draw pension benefits taking full account of likely tax and benefits consequences of their actions). This reinforces that support is needed on an ongoing basis, not just when first looking at drawing on pension savings.

7.4 ***HMRC's role in supporting people***

7.4.1 There is also a question of whether HMRC have a role to play in warning people of the tax consequences of pensions decisions. There is some guidance on GOV.UK, 'Tax when you get a pension',[3] but this is at a very high level and is unlikely to help someone plan their retirement income and adequately anticipate tax liabilities on pension withdrawals. Like Pension Wise, as mentioned above, it also does not mention the potential to trigger a high income child benefit charge. Nor does it appear that HMRC have made any other attempts to identify and warn those potentially falling into this specific trap.[4]

7.4.2 As a minimum, HMRC should attempt to use data they have to ensure that people pay the right tax when they have made a pension withdrawal. Again, at the risk of labouring the point, the possibility of having triggered a high income child benefit charge is not mentioned in the forms which allow taxpayers to claim a refund of PAYE on pension withdrawals (the forms do not even ask whether the taxpayer or their household claims Child Benefit).[5] With

[1] www.taxaid.org.uk

[2] www.taxvol.org.uk

[3] See https://www.gov.uk/tax-on-pension

[4] See Written Parliamentary question UIN162553, tabled on 3 March 2021: https://questions-statements.parliament.uk/written-questions/detail/2021-03-03/162553

[5] The form to use depends on exactly what the taxpayer has done, but it might be a P55, P53Z or P50Z.

pension withdrawals being possible from age 55 (or even from age 57 from April 2028), it is quite possible that potential pensioners might have ongoing Child Benefit claims.

8 Question 6: Should the Money and Pensions Service offer enhanced guidance or limited advice for people making decisions about their pensions?

8.1 Yes, see answer to question 5, in that we think MaPS could help to establish a free or subsidised advice service for those with smaller pots.

9 Question 7: Can the success of auto-enrolment in helping people save into pensions be replicated for people in retirement through investment pathways?

9.1 We understand that auto-enrolment has been successful due to harnessing people's inertia, so it is possible that the same principle could be applied at decumulation stage. We think there is a tendency for people to stick with what is familiar and feels most safe – for example, cash ISA subscriptions far outstrip that in stocks and shares[1] – but they may not provide the best return in the longer term.

10 Question 8: Including costs, what information do consumers need about different retirement products to make an informed choice?

10.1 As well as planning considerations such as their own and their family's personal circumstances and the suitability of potential products in meeting their needs, consumers need to be fully briefed about the current and future potential tax and benefits consequences of different retirement products.

11 Question 9: Are pension schemes communicating options effectively to members and are there material differences between trust-based and contract-based pension schemes?

11.1 We have not reviewed scheme literature relating to pensions options in detail, however we advocate consistency, clarity and simplicity (as far as possible) in all such communications.

12 Question 10: Can the issues around small pots be solved through behavioural changes by savers?

12.1 To some extent, it might be possible to get savers to take action to consolidate small pots if they could be persuaded to take an interest in the issue. The real question would seem to be what would drive the behavioural change needed to achieve this? We think it is more probable that an automated solution would achieve results – or again one that harnesses inertia such that small pots will be consolidated in a certain way unless the saver takes action.

LITRG
6 April 2021

[1] See HMRC ISA statistics, updated 25 June 2020: https://www.gov.uk/government/statistics/individual-savings-account-statistics