



HM TREASURY



HM Revenue
& Customs

Pensions Tax Consultation: *Implementing the restriction of pensions tax relief*

DEFINED BENEFIT VALUATION WORKSHOP

19th January 2010

9am - 12.30pm

Church House, Robert Runcie Room

SUMMARY OF DISCUSSION

Introduction

Mike Williams, director of Personal Tax and Welfare Reform in HM Treasury gave an introduction to the event and a brief overview of the consultation.

Session 1: Valuing the deemed contribution to Defined Benefit schemes

Stuart Glassborow, team leader of the Assets, Savings and Wealth Team in HM Treasury gave a presentation on the options for valuing the deemed contribution to Defined Benefit schemes. Participants discussed these issues in groups. The consultation questions for discussion and some of the main points raised were as follows:

1.1 Do you agree that age-related factors (ARFs) are the best approach for valuing the deemed contribution? If not, which alternative method do you think is preferable?

- In answer to this question there was a broad consensus that ARFs were the best approach. ARFs can be designed to be a simplified version of the Cash Equivalent Transfer Value approach (CETV). They

are reasonably fair and if simple enough, individuals would understand their own calculations. Also, the availability of factors would allow advance planning. It was stressed that ARFs should not be allowed to become too complicated. Though when designing ARFs, the view was expressed that the age bands should be small – smooth changes preferred to broad banding.

- There was some sympathy for the use of flat factors due to their simplicity. However, it was recognised they are crude and do not reflect individual characteristics such as age. Although currently used for the lifetime allowance (LTA) and annual allowance (AA) these affect a relatively small number of people but many more will be affected by the restriction of pension tax relief and the aim is to ensure fairness.
- CETVs were agreed to be too complex. Although they are familiar to schemes, nobody in discussion favoured the use of CETVs to value a member's deemed contribution. The drawbacks mentioned included the inconsistency between schemes as different actuarial bases are used and market related issues, since CETVs depend on the investment strategy of the scheme and market conditions at the date of calculation. CETVs are unpredictable and may change at any time. Timing of the calculations would also be a problem. Due to their complexity, CETVs would impose a large volume of work as many senior people may be affected. A point in favour of CETVs is that they are already used for similar calculations for divorce purposes, so the mechanisms would not need to be completely reinvented.

1.2 Have we fully captured the main administrative implications of CETV and ARFs?

- The view was expressed that HM Treasury / HMRC may have underestimated the cost of the administrative burden, for both the CETV and ARFs approach. Relevant aspects of the delivery process to be considered included the fact that members will request projections at the start of the period as well as calculations at the end of the period resulting in a double burden on the scheme. There

would be complexities in the process to deliver the implementation of the restriction of tax relief and burdens associated with imposing regulatory duties and the 'scheme pays' process.

- To use ARFs, accurate benefit statements would be required from the scheme and currently they are not always sufficiently accurate. The schemes would also need to provide information on the different tranches for different normal pension ages (NPAs).

1.3 Should the individual or the scheme carry out the ARFs calculation to compute the deemed contribution?

- Although most participants expressed the view that the individual should remain responsible for the final calculation, many felt that the scheme may as well do the final calculation as they will need to do several other calculations. Where individuals are members of more than one scheme, each scheme could provide an indicative figure and the individual would be responsible for the final calculation. In either case, the burden of work will fall mainly on the scheme. There was a general consensus that individuals may make mistakes in these calculations, so that accuracy requires as much as possible to be done by the schemes / employers rather than the individuals.
- The question was raised as to who would pay for the extra work? Individuals or companies? Perhaps there could be a schedule of charges (to be paid by the members) as there is for divorce.

At the end of this session, Trevor Llanwarne (the Government Actuary) suggested further discussion on two points:

1. How common will it be that an individual has more than one tranche of benefit with different NPAs? This could be either because they are a member of two schemes with different NPAs, or have two tranches within one scheme based on different periods of service.
2. The tax year runs annually from the 5th April but many schemes calculate benefits based on the renewal date. How problematic will this be?

Responses indicated that this could potentially be problematic not because of the date but because the volume of work which will be concentrated into two months of the year. Also, it can take time for administrators to get salary information from employers which may make it difficult for administrators to get the required information to members within three months.

Feedback to the Treasury on both these points is welcome.

Session 2: Setting and reviewing the Age Related Factors scale

Matthew Robinson (HM Treasury) gave a short presentation on the two questions posed on this topic. The questions for discussion and some of the main points raised were as follows:

2.1 Should GAD have a role in advising the Treasury on setting and reviewing the ARFs scale?

- There was a consensus that GAD was the appropriate organisation to advise the Treasury on setting and reviewing the ARFs scale and it was felt that a transparent system should be used. Participants felt consultation was needed and the underlying principles for setting the ARFs scale should be clearly stated.

2.2 How should the ARFs scale be reviewed, taking into account predictability and fairness?

- There was a range of opinion on how frequently the scale should be reviewed. There was a preference for a fixed timescale however, rather than reviews triggered by a change in market conditions. One group expressed the view that a fixed timescale with discretion for an early review should be built into the legislation. This would allow the ARFs scale to be reviewed if significant changes in market conditions occurred and it would be preferable to attempting to define a particular trigger.
- The range of opinions on the review interval included 1-yearly, 3-yearly and 5-yearly. To avoid sharp changes annual reviews may be favoured although some people favoured 3-yearly reviews. There

was no consensus on the timescale. Following a review, the changes should not be implemented mid-year.

- A number of participants felt that it would be important to know the factors as far in advance of the tax year start as possible.

Session 3: Age Related Factors design and enhancements

Matthew Robinson (HM Treasury) gave a presentation on ARFs design. The questions for discussion and some of the main points raised were as follows:

3.1 Do you agree that a two-way ARFs scale is preferable to a one-way scale?

- In addition to the options presented in the consultation, some participants suggested a one-way ARF table based on the term to NPA. However it was recognised that this would carry with it the same disadvantages of a one-way table based on age and that a two-way scale based on NPA and actual age dealt with those better. Schemes would however need to inform people of their NPA as not all members will have this information and in some cases there will be multiple tranches of benefit with different NPAs. One discussion group was adamant that only two-way tables would work properly.
- Questions were raised on a number of technical points such as (1) treatment of early retirement with actuarial reduction where the scheme early retirement factor may not be consistent with the assumptions made in the ARFs (2) the situation where established practice led to employer funded early retirement and the fairness of applying the tax restriction in these circumstances (3) the complication of calculations with different benefit tranches.
- It was noted that some of these points could be usefully followed up in further more technical discussions.

3.2 Which other influencing variables should an ARF scale include in an average sense, bearing in mind the objectives of fairness and simplicity?

- In answer to this question, factors to include in an average sense were considered to be the proportion married, level of spouse's benefits and quality of pension increases. Some also suggested a risk factor for the scheme.

3.3 Are there instances in which enhancements should not be subject to restriction? If so, why is this justified in the light of the principle of fairness? How should the exemption(s) be crafted to avoid opening up scope for avoidance?

- In answer to this question most participants suggested that ill health early retirement and death benefits should not be subject to the restriction. In general, it was felt that individuals should not be penalised where the enhancement is out their control and where there was therefore clearly no scope for avoidance. An additional consideration for ill-health benefits is to consider the fairness to people who do not meet their scheme definition of ill health.
- Whatever exemptions are allowed on DB schemes it was felt there should be corresponding scope for exemptions on employer contributions in DC schemes.
- Redundancy was felt to be slightly different as there is some scope for avoidance. However, most participants agreed that whilst one option would be to take redundancy benefits out of the income definition, pensioned redundancy benefits should be included in the pension benefit value.
- It was suggested that a further possible exemption should be applied when a scheme is winding up and in surplus. If no contributions had been made by employer or employee and entitlement was built up before the PBR then a reasonable set of exemptions should be formulated to avoid restrictions when scheme assets are allocated.