For the attention of:
The Correspondence and Enquiry Unit
HM Treasury
1 Horse Guards Road
London
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By online submission only

28 September 2021

Autumn Budget and Spending Review 2021: Representations from the Society of Pension Professionals

The key points made in our representation submitted in January 2021 remain, in our view, relevant now. The following submission is updated only in a minor way.

Introduction to the Society of Pension Professionals (SPP)

1. SPP is the representative body for the wide range of providers of advice and services to pension schemes, trustees and employers. The breadth of our membership profile is a unique strength for the SPP and includes actuaries, lawyers, investment managers, administrators, professional trustees, covenant advisors, consultants and specialists providing a very wide range of services relating to pension arrangements.

2. SPP is the only body to focus on the whole range of pension related services across the private pensions sector, and through such a wide spread of providers of advice and services. We do not represent any particular type of provision or any one interest, body or group.

3. Many thousands of individuals and pension funds use the services of one or more of SPP's members, including the overwhelming majority of the 500 largest UK pension funds. SPP's membership collectively employs some 15,000 people providing pension-related advice and services.

Introduction to this submission

4. The SPP supports fiscal policy which advances the pension policy goal of embedding sustainable long-term retirement saving. We believe that embedding long-term retirement saving will be achieved through the further development of auto-enrolment and incentivising greater levels of saving, whilst seeking to avoid (or at least minimise) disruption for individuals and businesses.

5. Any changes to pension arrangements will be costly for affected businesses to implement, many of which are under financial and resource pressures arising from or following the coronavirus pandemic. The costs to employers and pension providers arise not only from the disruption caused by diverting staff to work on the project, but also from the actual expense of developing new IT systems and the myriad changes to procedures and documentation.

6. Whilst we recognise the fiscal challenges currently faced by government, we would encourage careful consideration of the rationale for disincentivising pension saving through any reduction in pensions tax relief, given the potential fiscal savings (which we believe to be relatively limited).

7. We would also stress that pensions tax relief is complex, and the wider implications of any changes may not be immediately apparent. Seemingly straightforward changes may be far more complicated and costly to implement than might appear to be the case. If changes to the system are to be considered, government should take their time and consult widely. The implications of the Tapered Annual Allowance (TAA) for the NHS Pension Scheme is one example of an unintended consequence that can damage trust and confidence in pension saving.

8. Recognising that you will receive a large number of representations, we have briefly set out below some key points to consider prior to any review of the pensions tax system. However, we would be very happy to discuss these topics with you in further detail.

The cost of pensions tax relief

9. The cost of pensions tax relief is complex to assess, but in reality the true cost is significantly less than the amounts often quoted.

10. The gross cost of pension tax relief quoted by HMRC for 2017/18 was £37.2 billion[1], but most of this relates to employer contributions to defined benefit occupational schemes, including a significant amount of deficit repair contributions. These deficit contributions relate to pensions for historic service, rather than current contributions for particular individuals, and are paid by employers as required by the DB funding legislation.

11. The figure for individual member contributions to DB and DC schemes, including contributions to personal pensions and payments by the self-employed, is considerably lower at £6.3 billion. The amount that could be raised by government through amendments to pensions tax relief needs to be viewed in this context.

12. The net cost of pensions tax relief quoted by HMRC for 2017/18 was £19.0 billion, but this is arrived at by simply deducting income tax on pensions currently payable. These pensions relate to an entirely different cohort of individuals, and the tax payable on these pensions bears little or no relation to the reliefs currently being provided.

13. In reality, most of the amounts quoted as pensions tax relief are simply tax deferral, and for most savers the only part of pensions that is truly relief from income tax is the 25% lump sum, though there are also national insurance benefits.

Practical issues with fundamental reform of pensions tax

[1] Table 6: Registered pension schemes cost of tax relief - GOV.UK (www.gov.uk)

14. The current system for UK pensions tax relief is "EET", under which relief on pension contributions is provided at an individual's marginal rate of income tax, with the pension then taxed as income in retirement.

15. It is important to recognise that any alternative system that does not provide relief at an individual's marginal rate (i.e. TEE or a single rate of relief) would be extremely difficult to apply to defined benefit (DB) schemes. For the appropriate rate of relief to be determined, the "deemed contribution" would need to be calculated for the benefits earned each year. This is problematic for DB, as the true value can only be known during retirement. This makes it virtually impossible to apply TEE or a single rate of relief to DB Schemes in a way that is fair and transparent.

16. Any system that does not provide relief at an individual's marginal rate would also carry a significant risk of unintended consequences when applied to DB. For example, it could lead to penal taxation (particularly for those in public sector DB schemes where opting out with a cash alternative is not an option) where the valuation method places a high value on the DB pension in a particular year. In essence, this is similar to the problems faced by the NHS Pension Scheme under the TAA, except that it would apply to all DB members, regardless of their income.

17. In theory, an alternative system could be applied more easily to defined contribution (DC) pensions. For example, tax relief for DB could continue to be given at marginal rate, whereas DC could switch to a flat rate approach. However, we assume that the underlying policy objective is to treat individuals consistently and there is a question as to whether it is possible to deliver a split approach that is fair to both DB members (mainly in the public sector) and DC members.

18. Another challenge with this approach is that many people have both DB and DC rights. Any split tax structure would need to take into account the "other" type of benefit, and there is no easy way of doing this without undermining the tax savings that the government might achieve. A further important consideration is that some benefit structures do not fit neatly into the category of DB or DC.

Other potential impacts of reductions to pensions tax relief

19. If we assume the policy remains to embed long-term retirement saving, it is important to continue to support automatic enrolment and avoid any changes that risk undermining or reversing its progress. There also need to be clear incentives if greater levels of savings are to be achieved.

20. Any change to the way that tax relief is given which results in reduced take home pay is likely to trigger those affected to consider whether to remain in pension saving, so there is a risk of increased opt-outs and the creation of a culture where opting-out is justifiable in the minds of individuals. This issue might especially arise if workers suffer immediate tax consequences on employer pension contributions.

21. If tax relief is reduced, some individuals may decide, and be able to afford, to increase their pension contributions to make up for that. Whilst this would be a positive for long term saving, in the short term this will divert money that might otherwise be spent in the economy, and so may slow the recovery.

22. The low savings rate means there is already an issue with employees unable to afford to retire with consequent impacts on productivity and opportunities for younger employees. Any reduction in tax relief is likely to exacerbate this.

Pensions Tax Relief Administration

23. For reasons SPP set out in its response to your Call for Evidence on Pensions Tax Relief Administration, submitted 13 October 2020, we believe that it is important that employers are able to continue using the net pay arrangement for providing pensions tax relief. Should a policy change in this area be necessary, we feel strongly that the Call's suggested approach 1, paying a bonus using RTI data, has more to commend it than the Call recognised; and we believe that is the right solution to go forward with. We recognise that there may be a significant delay while this is organised but believe that it is most important to get any reform right.

Conclusion

24. We would be pleased to discuss any part of this submission on more detail, as required.

SPP representation ends