

Article

Utter Madness

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What is madness? In the context of Government policy on pension incentives the answer is to have erroneous perceptions and to reason correctly from them. What do I mean? Read on with a simple question in mind, can we achieve the same end result with a simpler solution?

The Government announced, in the 2009 Budget, their intention to introduce measures to reduce the tax relief on pension contributions available for those earning more than £150,000 per annum. The measures are to take effect from 6 April 2011. Most will have sympathy with the logic behind this change. People in the UK with the highest income levels currently benefit disproportionately from pensions tax relief, with those in the top 1.5% income bracket receiving 25% of the tax relief.

The proposals suggest that tax relief for those earning between £150,000 and £180,000 be tapered down so that those earning £180,000 or more would only receive basic rate tax relief on pension contributions.

At the time of the Pre-Budget Report in 2009 the Government announced a formal consultation period ending on 3 March 2010, HM Treasury produced a detailed consultation document covering 124 pages setting out a number of proposals relating to the restriction of tax relief, and HM Revenue & Customs published draft legislation to accompany the Treasury document.

To start, there are a few general principles that you should understand in relation to Government policy in this area.

- Tax relief is provided to produce a secure income in retirement and a tax-free lump sum. It is not provided to support pre-retirement income, asset accumulation or inheritance planning.
- Tax relief on pensions is more favourable than that available under other savings vehicles because pensions are less flexible.
- The cost of tax relief must be affordable and sustainable.

In their proposals, the Government made it clear that:

- They recognise that strong incentives are needed to encourage people to save.
- Many higher rate taxpayers pay basic rate tax on income in retirement and even those with the highest income in retirement pay basic rate tax on a substantial amount of their retirement income.
- Higher rate taxpayers receive 65% of tax relief on pension contributions but represent 19% of pension savers.
- The proportion of tax relief received by those earning over £150,000 was between 8% and 12% pre A-Day, but has since risen to around the 25% mark.
- They want to re-balance the incentive system so that those with the highest individual incomes contribute most to ensuring sound public finances.

Looking at the new proposals it looks simple when you read that the proposed restriction on tax relief will work through a three-stage process:

Step one – Looking at the individual's income

Individuals with pre-tax income of less than £130,000, including their own pension contributions and charitable donations, are not affected. Individuals with pre-tax income of £130,000 or more, including their own pension contributions and charitable donations, will only be affected if the sum of their pre-tax income and the value of employer funded pension benefits is £150,000 or more.

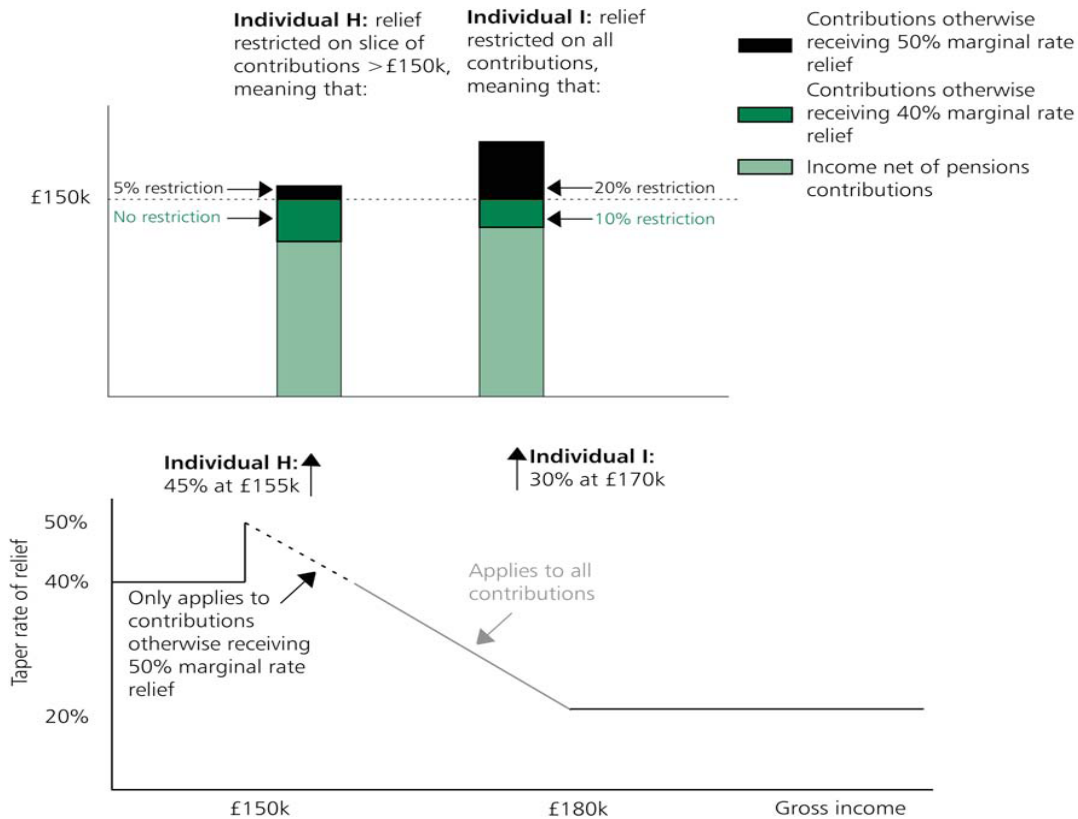
Step two – Determining the appropriate rate of tax relief

The Government plans to restrict tax relief on pension contributions by the introduction of a taper for those with "gross income" between £150,000 and £180,000. This taper needs to be structured in such a way that it copes with situations where tax relief is being granted at two different rates.

Step three – Applying the restriction on tax relief

The taper will establish a maximum level of tax relief for all income levels between £150,000 and £180,000 via a series of stepped changes. It would appear that the Government are proposing to deal with this at the £1,000 level so that the maximum rate of relief at any income between £150,000 and £151,000 is 49%, £151,001 and £152,000 is 48% and so on. Any tax relief that would have been above this amount will be reduced to the maximum rate of relief.

Graphically how does this work?



You must of course add to all of this an appreciation of the complexity of the anti-forestalling regime. I am sure I will not be the only one who will own up to being more than a little confused.

It could of course have been different. Approaches such as reducing the annual or lifetime allowance were discounted because they would constrain the tax privileges for everyone and would allow the highest earners to receive more per pound saved than basic rate taxpayers. I am willing to bet that a reduction in the annual allowance to say £30,000 or £50,000 would not have had the general public up in arms. More importantly it would be simple.

As a general point to finish, the 2004 Simplification impact assessment showed the estimated additional cost of simplification, including tax relief on increased contributions, higher lump sums and more flexible benefits as:

- 2006-07: £25 million
- 2007-08: £70 million
- 2008-09: £165 million

Latest estimates show the 2008/09 additional cost to be around £10 billion, just a little more than £165 million. Getting pension incentives right for savers in the UK does involve getting the numbers right. Madness or what?

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Please note this document is intended for trade and national press individuals.

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