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View from the cliff

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Thomas Edison was apparently a very bright chap. An American inventor, he is credited with more than 1,000 patents so he must have been doing something right. He is also credited with coming up with the saying “the three great essentials to achieve anything worthwhile are hard work, stick-to-itiveness and common sense.”

The Coalition Government is showing its pension policy hand with announcements on restricting tax relief, auto enrolment and a universal state pension.

On the issue of tax relief, it is well documented that the Government announced the changes with the aim of building a simple and sustainable set of rules that still achieves the required tax relief saving of £4 billion.

Looking at recent figures released by HMRC we find that contributions by individual investors to Personal Pensions have been falling over recent years as follows:

2007-8	£5,600 billion
2008-9	£4,770 billion
2009-10	£3,970 billion

This is not a huge surprise. Up until the change in Government we were staring new disjointed and complex pension rules right in the face. In a number of previous articles I have suggested that any changes to pension rules should be tested against the following requirements:

1. a clear incentive system that everyone understands.
2. simple rules around what you can contribute.
3. clarity & flexibility on what you can do with your money when it is in the pension arrangement.
4. flexibility & fairness on how you get your money back out in retirement or on death.

The Government proposals for tax relief present an encouraging start for points 1 and 2. Tax relief at the marginal rate is by no means the perfect incentive system but it is probably as good as any alternative mentioned during the consultation process. Research A J Bell carried out with 900 advisers and clients backed this point with 59% of advisers and 55% of clients favouring tax relief at the marginal rate. Also, a reduced annual allowance was what the industry wanted; it is simple and easy to articulate.

Some industry commentators have suggested that tax relief has a limited shelf life. I fully understand the case behind this suggestion but I hope it proves to be misguided. One of the opening lines in the HM Treasury paper on changes to tax relief states “The Government has committed to making pensions tax relief affordable and to protect the public finances, and wants any reform to be fair and sustainable.” Let us all hope that the timescale for sustainability that the Government has in mind is long in nature. We are asking investors to make long term saving commitments. It is reasonable to suggest that the incentive system must be consistent over the long term or to put it another way, a little bit of stick-to-itiveness, is key.

We now await the outcome of the consultation process for removing the requirement to annuitise by age 75. Another set of proposals grounded in common sense would be very welcome. Our consultation response focussed on two key areas:

- The tax rate charged on lump sum death benefits paid from pension schemes;
- The appropriate level for the Minimum Income Requirement; and

Many readers will know that the tax treatment on death is a long term lobbying point of A J Bell. The Government has recognised that the 82% tax charge on lump sum death benefits paid from alternatively secured pensions effectively

forces individuals to annuitise at age 75. This cliff edge was clearly unfair and the intention to remove it has been welcomed across the industry.

During our research we put a number of tax proposals, including the Government's 0% tax on uncrystallised funds and 55% tax on all income drawdown funds, to a range of clients and their advisers asking them to consider which option was fairest.

Client responses

Proposal	Number	Percentage
0% tax on uncrystallised funds and 55% tax on all income drawdown funds	53	9.3%
25% tax on all uncrystallised and income drawdown funds	319	55.9%
0% tax on uncrystallised funds, 35% tax on income drawdown funds before age 75, 55% tax on income drawdown funds from age 75	199	34.8%

Adviser responses

Proposal	Number	Percentage
0% tax on uncrystallised funds and 55% tax on all income drawdown funds	31	11.5%
25% tax on all uncrystallised and income drawdown funds	49	18.2%
0% tax on uncrystallised funds, 35% tax on income drawdown funds before age 75, 55% tax on income drawdown funds from age 75	189	70.3%

The key points to draw from these responses are:

- The Government's current proposal is viewed as the fairest option by a small percentage of respondents;
- A majority of pension savers believe that applying a single rate of tax to all lump sum death benefits is the fairest option.
- A clear majority of advisers, perhaps because they are approaching this from an informed position in terms of the existing 0%/35%/82% framework, view the 0%/35%/55% proposal as the fairest option.

Increasing the tax charge applied to lump sum death benefits paid from income drawdown arrangements from 35% to 55% will simply create a new cliff edge. The cliff face may be slightly smaller, but many more individuals will be pushed towards it. The research response from clients suggests that clients favour an approach with no cliff edges.

When forming pension policy, a huge chunk of stick-to-itiveness and a little bit of common sense could go a long way. Edison also once said that "I never failed, it just happened to be a 2,000 step process." We could all do with avoiding the 2,000 step approach.

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

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