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A trojan tax horse

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It has been more than a touch refreshing to see a Government listen to the industry before forming pension policy. The emergency budget introduced several interim measures with further consultation planned. On the changes to the tax treatment of death benefits and the requirement to take benefits at age 75 a new approach is needed. The Government has proposed many changes:

- No formal requirement to take benefits from a pension scheme at any age, although any benefits remaining uncrystallised after age 75 will be subject to tax charges.
- Alternatively Secured Pension (ASP) will be abolished and individuals currently in ASP will fall into the new regime, but only from 6 April 2011.
- Unsecured Pension (USP) will be split into capped drawdown and flexible drawdown.
- “Capped drawdown” will be broadly similar to the current USP as we know it but it will not necessarily have the same maximum income limit.
- Under “flexible drawdown” individuals will be able to draw unlimited amounts from their pension scheme subject to being able to satisfy a Minimum Income Requirement (MIR). Lump sums taken under flexible drawdown will be taxable at the individual’s marginal rate of income tax.
- A uniform tax charge of 55% will be applied to lump sum death benefits paid from pensions in drawdown, and to benefits that have not been put into drawdown where an individual is over the age of 75. This will replace the 35% tax charge currently applied to USP lump sum death benefits, and the (up to) 82% tax charge applied to residual ASP funds.

A return to drawdown like terminology would seem a sensible start. I never did understand why, in a world where security of assets was a concern, that you would adopt terminology that suggests you have an unsecured pension. It seems a simple point but when our regulator is rightly pushing for use of plain English, why not ensure where possible that regulation is drafted in the same spirit?

It is the uniform tax charge that is attracting most of the headlines. A J Bell has argued long and hard that the existing ASP tax rules represent cliff edge tax policy that is simply unfair. I can’t help but feel that the proposals on the uniform tax rate of 55% feel a little like a Trojan horse. It’s been introduced when we could be forgiven for accepting the package of changes as better than what we had before. Now that we have all had time to digest the detail, it seems the size of the cliff has reduced with the tax rate of 55%. However, in applying it to all clients with funds in drawdown we have just ushered a mountain of people closer to the edge which once again introduces the question of fairness. It might be a smaller cliff but it is still going to hurt if you or a loved one is unfortunate enough to fall foul of the Trojan horse.

The Government has not suggested this particular change is to be revenue generating as has been the case with the changes to the annual allowance. It is possible to introduce rules that importantly do not cost the treasury money but are fairer and easy to apply.

With no tax on death on pre crystallised funds and a 55% charge on crystallised funds the cliff edge is obvious. If fairness is a key driver for change why not introduce a simple charge to tax on all residual pension funds irrespective of the age and vested status of the client of say 20% – 25%?

Alternatively, establish a new Compulsory Crystallisation Age (CCA). This will be the back-stop for crystallising benefits and could be anything from 75 to 80. The tax charged on lump sum death benefits could then be:

- 0% from uncrystallised funds,
- 35% from crystallised funds before the CCA,
- 55% from crystallised funds after the CCA.

The current inheritance tax treatment of lump sum death benefits paid in USP should apply irrespective of whether the member is younger or older than the CCA.

These changes are simple to implement and more importantly are capable of being understood by savers. That is always a good place to start and let us not forget they are in line with the spirit of freedom, fairness and responsibility.

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

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