PENSION CAPITAL STRATEGIES
Innovative Alternatives

30 April 2010

# THE PCS ALERT
The latest in DB Pensions

## ARE POLITICIANS ABOUT TO BURY PENSION SCHEMES FOR GOOD?

Dear Sid


This Government have attacked pension schemes on numerous occasions since they came to power 13 years ago. But, quite possibly, the biggest attack of all is about to be launched. Depending on its outcome, it is possible that we will look back on this General Election as the pivotal moment when politicians managed to bury pension schemes for good.

Pensions for high earners have long been an easy target for politicians. The rot started many years ago when caps were introduced on pensions for high earners. Gordon Brown's tax simplification changes in 2006 were anything but simplification and the rot spread, But the latest plans on taxing pensions for high earners are the most devastating yet. If brought in, these changes will not only mean the end of pension saving for high earners, but will most probably see the death of occupational pension schemes for all. Not only does this problem affect final salary pensions, this latest attack also strikes at defined contribution pension schemes.

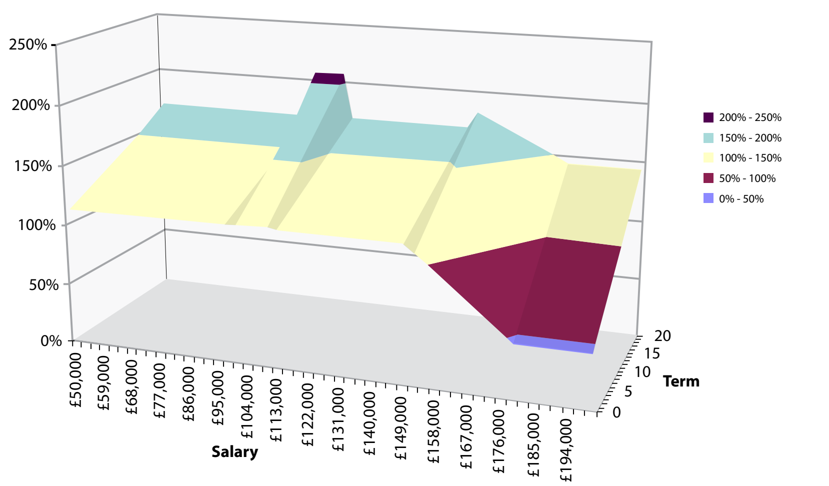
At the heart of the problem is the issue of income tax relief on pension contributions. Both Labour and the Liberal Democrats want significant cuts in tax relief for high earner pension contributions. This entirely misses the point that pensions are designed to be taxed at the point of payment. If pension contributions are also taxed when they are deducted from salary there will be little point in making pension contributions at all. The double taxation hit will mean that, for many high earners, pension schemes make no sense at all.

Alongside our colleagues from JLT iimia Wealth Management *(financial advisers regulated by the FSA and specialising in personal financial advice)*, PCS has built a number of pension models to examine the impact of the new tax rules on high earners.

**Pension Tax Relief Changes from 6 April 2011**

Comparison Graphs

| | |
|---|---|
| **Types of Arrangement to Compare** | |
| Base Arrangement | Cash |
| Comparison Arrangement | Post 2011 |
| **Inputs** | |
| **Salary Range** | |
| Lower Salary | £50,000 |
| Upper Salary | £200,000 |
| Salary Band | £3,000 |
| **Benefit Offered** | |
| Amount or % | Amount |
| Amount | £1 |
| Percentage | 10% |
| **Corporation Tax** | |
| Corporation Tax | 28% |
| Proportion of deferred corporation tax credited to member | 20% |
| **National Insurance** | |
| NI increase assumed for 2011 onwards | 0% |
| **Assumed Investment Return in Deferment** | |
| Return in Deferment | 5% |
| **Income Tax on Retirement Benefits** | |
| Tax on retirement income | Marginal |
| If Fixed Rate | 40% |
| Percentage as Cash | 0% |
| **Tax Payable on Returns outside Arrangement** | |
| Tax on return in deferment | Marginal |
| If Fixed Rate | 40% |
| **Employee Benefit Trustee - National Insurance on Benefits** | |
| NI on retirement income | Marginal |
| If Fixed Rate | 11% |
| **Base Provision for Comparison** | |
| Base Arrangement | Cash |
| Term to Retirement | 0 |




Our analysis of these models leads us to the following conclusions:

- Most employees with total taxable earnings over £180,000 would be better off taking extra salary as cash rather than pension contributions.
- Many employees with total taxable earnings between £130,000 and £180,000 will be better off taking extra salary as cash rather than pension contributions (unfortunately the analysis for such employees is extremely complicated and it is impossible to generalise on the situations when pension contributions might still be attractive).

This situation is doubly complicated by the fact that it is necessary to consider all taxable earnings (not just those from a main employment) and for many employees, who receive a large part of their earnings in bonus and fluctuating pay, they simply won't know what their total taxable earnings will be until after the tax year is over.

Where pension contributions do still make sense for high earners, then it will likely have to be by means of salary sacrifice arrangements in order to capture the maximum tax efficiency. Moreover, because of the uncertainty attached to the calculations and the flexibility required on the payment of contributions the only sensible vehicle for such contributions will likely be a Self-Invested Personal Pension or SIPP.

**Action required**
It makes no sense for companies to pay employees (particularly key employees) in a way which is tax inefficient. At PCS we are therefore of the view that companies should review their pension arrangements and should:

- take all employees on a salary of >£130,000 per annum out of company pension schemes altogether.
- Such employees should be provided equivalent cash alternatives and a salary sacrifice facility (probably into a group SIPP or possibly an offshore trust) so that those employees for whom pension contributions still make sense, can still contribute to a pension.
- All employees should be warned that if their total earnings exceed £130,000 they may be better off not making any pension contributions
- All employees who might be adversely affected by the penal tax rules should be offered the opportunity to opt out of the company's pension arrangements and be given an equivalent cash alternative instead.
- Given the horrendously complicated nature of the tax rules, high earning employees should be offered individual financial advice to help them make the right decision on pension contributions.

Unfortunately this action will be both expensive and hugely disruptive, but Government policy has left companies with little alternative.

**In conclusion …**
Why is that politicians create ever more complicated rules for pensions? - it is all so unnecessary and simply buries everyone in expensive red tape. Unless there is a change of Government on Thursday, companies will be faced with having to abandon pension provision for their key employees and also having to provide sophisticated financial advice to high earners so they can make sense of it all. This will not be cheap and is yet another burden on industry at a time when UK plc cannot afford it.

Why is it too, that at a time when we need to increase and encourage saving, the politicians insist on introducing policies that look set to destroy pension savings? We need a Government that is committed to restoring pension provision in the UK and once again encouraging people to save for their retirement. Whilst the Government promotes its much trumpeted pension savings scheme - NEST, it does not come clean on the issue that the derisory low rates of contributions that will be paid into NEST will provide only derisory levels of pension.

This Government has done no favours for occupational pension schemes and may be about to bury them altogether. We fear that once companies are forced to take all their high earners and key employees out of their pension schemes, then enthusiasm to maintain them for other employees will be hugely reduced. Faced with the additional costs of NEST and having to cease pension provision for all key employees, we believe many companies will simply abandon occupational pension schemes entirely and rely simply on the inadequate NEST scheme.

If we get to a point when the only pension that employees can look forward to is from the Government's NEST scheme then that will be a very sad day for pension provision in the UK. Ironically, in attacking high earners' pensions, the Labour Government could end up destroying good pension provision for everyone and the lower paid could be the ones who suffer most.

Yours sincerely,

Charles

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