DEVON & SOMERSET
FIRE & RESCUE AUTHORITY

REPORT REFERENCE NO.	**HRMDC/10/15**
MEETING	**HUMAN RESOURCES MANAGEMENT & DEVELOPMENT COMMITTEE**
DATE OF MEETING	**20 SEPTEMBER 2010**
SUBJECT OF REPORT	**RESTRICTION OF PENSIONS TAX RELIEF**
LEAD OFFICER	**Director of People and Organisational Development**
RECOMMENDATIONS	***That the report be noted.***
EXECUTIVE SUMMARY	The last government in the Finance Act 2010 announced that from April 2011 the amount of pension tax relief that an employee could get would be reduced. The new coalition government has further considered the issue of pensions tax relief and is proposing further reforms in this area to support the government's commitment to tackling the fiscal deficit. This involves reducing the annual allowance for pension relief and the Government is seeking feedback from representative groups, employers, pension schemes etc on such a change. The Service is concerned about the impact that this would have on employees who are 'middle earners' rather than 'high earners' and has responded to the government discussion paper.
RESOURCE IMPLICATIONS	
EQUALITY IMPACT ASSESSMENT	
APPENDICES	Appendix A: Treasurer response Appendix B: Director of People and Development response
LIST OF BACKGROUND PAPERS	

1. **INTRODUCTION**

1.1 Within occupational or public service pension schemes the employer takes the pension contributions from the employee's pay before deducting tax (but not National Insurance contributions). The employee then pays tax on what is left. An employee's contribution towards a pension is subject to an 'Annual Allowance'. For the tax year 2010-11 the annual allowance is £255,000. Tax is paid at 40 per cent on any contributions that are made above this Annual Allowance. There is also a Lifetime Allowance currently set at £1.8M.

1.2 The last government in the Finance Act 2010 announced that from April 2011 the amount of pension tax relief that an employee could get would be reduced if an employee's income was £150,000 or more and from December 2009 a 'special annual allowance' was introduced to stop people making large additional pension contributions and getting higher rates of tax relief on them ahead of April 2011. The special annual allowance affects employees if one of the following applies:

- Total pension savings including employer contributions are more than £20,000
- An employee changes the amount they normally save towards their pension on or after 22 April 2009
- An employee has an income is £150,000 or more in the current or either of the two previous tax years

The previous government made a further adjustment to the special allowance so that it applied to incomes of £130,000 or more.

1.3 The new coalition government has further considered the issue of pensions tax relief and is proposing further reforms in this area to support the government's commitment to tackling the fiscal deficit. The Government has reservations about the approach adopted in the Finance Act 2010 and believes this could have unwelcome consequences for pension saving, bring significant complexity to the tax system, and damage UK business and competitiveness. Therefore, an alternative approach involving the reform of existing pension tax relief, and in particular a significant reduction in the annual allowance is being considered.

1.4 The government is seeking to ensure that it raises at least the same amount of revenue through any restriction in the pensions tax relief as has already been accounted for in the public finances over the forecast period with the previous changes in the Finance Act 2010. The provisional analysis suggests that one option would be for an Annual Allowance in the region of £30,000 - £45,000.

1.5 The Government has recognised that various features of a much lower annual allowance would need to be revised to ensure it operated fairly and effectively. The Government have therefore published a discussion document on an alternative approach to the restriction of pensions tax relief. The issues include:

- How pension accrual in Defined Benefit Pension schemes would be valued;
- The options to protect basic-rate taxpayers, and to support employees who see a one-off 'spike' in pension accrual eg through a promotion;
- Whether and how there could be flexibility for individuals over paying any charges that arise;
- How compliance and delivery would operate in practice.

1.6 During the summer period the Government has sought feedback on this discussion document so that decisions could be made to take through legislation in the autumn within the Finance Bill 2011. Feedback submissions were required to be received by the 27th August 2010 and the DSFRS Treasurer and Director of People and Development responded. The respective documents are attached in Appendix A & B.

JANE SHERLOCK
Director of People and Organisational Development

Restriction of pension's tax relief

Response to discussion document on an alternative approach

General Comments

As an employing Authority it is difficult for Devon and Somerset Fire and Rescue Authority to provide responses to the more detailed questions raised within the discussion document, or on the more pension technical issues, however it does wish to make some more general comments about the principles of the proposals and its concerns to our staff.

In general, whilst it has to recognized of the need for the government to seek alternative taxation revenues to assist with the overall financial deficit, care has to be exercised to ensure that changes to pension taxations relief is balanced against the potential for the changes to be so severe as to act a significant barrier in our quest to recruit and retain the most talented individuals to the most senior positions in our organization.

Policy Design

The Authority is very concerned that based on the range of proposed changes to the annual allowance (AA), of between £30,000 and £45,000, coupled with the proposed changes to the flat rate valuation factor of between 15 and 20 there is a potential for groups of staff that are not perceived to be 'high earners' to be caught up in this new tax regime. For example, should the AA be set at £30,000 and the valuation factor set at 20 then a Watch Manager within a Fire and Rescue Service, on a modest salary of £34,961 pa will potentially be required to pay tax on his/her pension benefits. Appendix A provides a worked example of the impact to a Watch Manager.

For Devon and Somerset Fire and Rescue Authority, it is estimated that based on the worst case scenario, approximately 100 fire officers (14% of wholetime staff) could be impacted, which we would suggest are not all the groups of staff being targeted by these changes.

It is the view of this Authority that the changes to the AA and valuation factor should be set at levels which do not impact on those 'middle earners' e.g. Watch Manager.

The Authority supports the preferred proposal to exempt deferred members from the AA test, on the basis of ease of administration and transparency. As stated in the discussion document, to exempt deferred members, and maintain fairness to those active members would require a revaluation methodology of the previous year's benefits to be included in the new regime, however this would inevitably place additional administrative burdens on pension administrators who will now be required to make additional calculations each year.

In relation to changes in the lifetime allowance (LTA) whilst it is difficult to assess what an appropriate level should be, we do believe that it should be closely aligned to the AA methodology in order to provide transparency. In terms of fairness it is important that any changes provide protection against existing pension benefit accruals, as it is likely that those high earners will wish to make individual choices based on professional tax advice as to the most tax efficient way of providing future pension provision.

Managing impacts on individuals

We are concerned, as an employing authority, of the potential for the new regime to provide a financial disincentive for individuals to take up promotion opportunities, as a result of a 'spike' in pension benefits in the year of promotion, resulting in a serious breach of the AA test. We do feel therefore that it is important for the taxation regime to provide some form of smoothing mechanism to enable these 'spikes' to be spread over a number of years. Without this form of protection it would be left to the employer to be as innovative as a possible to introduce a financial reward package alongside the promotion to avoid the AA breach, probably at a slower rate, which would run the risk of career aspirational staff leaving the organization for a different employer or sector.

Delivery and Compliance

As is stated in the discussion document, it is inevitable that the significant reduction in the AA will mean that a larger number of individuals will now become liable for taxation based on their pension benefits. Whilst it is difficult for this Authority, as an employer, to comment on the additional administration this will incur, in terms of providing the necessary calculations and information, we are concerned that because of the potential complexities of how any final system is to be operated, there is the risk that many individuals will not be aware of any breach of the AA until after the reporting period, by which time the tax liability has been incurred. With this in mind we do believe that it is important for the new system to be as simple and transparent as possible, to ensure as much as possible that individuals are aware of the potential tax implications from their increased pension benefits. This will almost certainly require some form of annual statement being issued to every individual in the scheme, to advise of their pension benefits increase and a test against the AA. This of course will place significant additional administration on the pension providers to provide this information. It may also be helpful to not only provide an assessment of the AA test for the reporting year, but also for the next three years, in order that an individual is aware, well in advance of the potential to breach the AA test, and to make informed decisions about future pension provision.

To assist transparency and administration, it would make sense for the new regime to be clear about which groups of staff will be impacted. For instance, could the scheme not exempt basic rate tax payers, which would remove large numbers of staff within our organisation from the regime, therefore significantly reducing the numbers of assessments that would need to be made.

Watch Manager with 25 year's Service
Assumed 2 % pay rise

1/4/2010	31/3/2011	Annual Allowance Test
20 years/60 x £34,961 = £11,564 + 5 years x 2/60 x £34,961 = £5,827 Total Pensionable Benefit = £17,391	20 years/60 x £35,660 = £11,887 + 6 years x 2/60 x £35,660 = £7,132 Total Pensionable Benefit = £19,019	GROWTH IN PENSION = £1,538
Factor		
20	£30,760	EXCESS OVER £30,000 ANNUAL ALLOWANCE = £760

APPENDIX B TO REPORT HRMDC/10/15

From: Jane Sherlock
Sent: 27 August 2010 18:26
To: ':'pensionstax@hmtreasury.gsi.gov.uk''
Cc: Sally Scott; Steven Pope; Michelle Smitham; .Service Management Board
Subject: FW: Response to Discussion Document Restriction of pensions tax relief

Dear Sir/Madam.

Earlier this afternoon, Devon and Somerset Fire and Rescue Service submitted a brief response relating to the discussion document issued recently relating to proposals to change to pension tax relief arrangements. I would be grateful if you would consider the contents of this email as an extension to that original submission.

As Director of People and Organisational Development, I am concerned not only as to the financial impact upon individuals but also a more holistic concern regarding organisational impact in terms of attraction, recruitment and retention, of highly skilled employees as well as the real risk and potential of a national industrial dispute, should the proposals be implemented. We have highlighted this in our response submission, but I think it is fair to say, that until several examples were worked through (attached in our appendices), it was not obvious how far reaching these proposals could be in terms of those staff groups affected.

To this end I would very much like to see a copy of the Equality Impact Assessment undertaken, to ascertain how these proposals were assessed in relation to the impact on groups of staff, and whether or not it shows that some groups of staff are disproportionately affected. As you are aware under The Race Relations (amendments) Act, public bodies not only have a duty to undertake an Equality Impact Assessment, but a duty to publish the results. I have been unable to locate, from your website, such a document and would be pleased if you could direct me as to where I may find it, or indeed furnish me a copy by return.

Like all public organizations we are trying to assess the impact of potential fiscal restraints and the impact on our employee relations. Pensions issues are a significant risk on our corporate risk register, in terms of industrial action and business continuity, and our operational capability and capacity should we see a reluctance to strive for promotion or a sudden spike in attrition rates.

I am happy to discuss these issues further.

Kind regards

Jane Sherlock
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Devon and Somerset Fire and Rescue Service
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