100 HYMANS ROBERTSON

Sixty second summary

Autumn Budget 2021: pensions

There was little that was pensions-related in the Autumn Budget.[1] The biggest news may be the Treasury's plans to address the anomalous treatment of low earners under the 'relief at source' and 'net pay arrangements' systems for contribution tax relief. The Government will also bring forward proposals for changes to the automatic enrolment charge cap, '*to better accommodate well-designed performance fees and enable investments into the UK's most productive assets, while continuing to protect savers.*'

The pensions press was uncharacteristically muted in the lead up to the Autumn Budget, as though pundits could not summon the energy for the usual frenzied speculation about radical tax reform, allowance cuts, or an end to tax-free lump sums. Chancellor of the Exchequer Sunak was scolded by the Deputy Speaker for the number of measures that were announced to the news media ahead of his statement to Parliament, so it may simply be a case of people assuming that everything worthy of note had already been aired.

The 'net pay anomaly'

There are two main methods by which pension scheme members obtain tax relief on their contributions: relief at source (RAS), and net pay arrangements (NPA). Under RAS, contributions are deducted from post-tax earnings, and pension scheme administrators claim from Her Majesty's Revenue and Customs (HMRC) an amount equal to basic-rate tax on those contributions on their members' behalf (higher- and additional-rate taxpayers can obtain any balancing relief that is due via their tax returns). The crux of the aforementioned anomaly is that the basic-rate claim is made *even for non-taxpayers*.

This valuable perk of the RAS system (tax 'relief' when no tax was paid) is not available to similarly low-earning members of NPA schemes, a fact that gained new notoriety with the advent of automatic enrolment, as millions more of the lower-paid were defaulted into pensions saving. The Government made a manifesto promise, on the way into the December 2019 general election, to explore resolutions to the problem, and duly made a 'call for evidence' in August 2020.

The outcome of this exercise was announced as part of the Autumn Budget. HMRC will make changes to its IT systems enabling it to identify low earners who contribute via NPA, and to start paying them top-up payments during the 2025/26 tax year, in respect of their contributions in 2024/25. The Government is also planning to invest in modernization of HMRC's admin systems, to make the operation of pensions tax relief more efficient.

[1] <www.gov.uk/government/publications/autumn-budget-and-spending-review-2021-documents>.

Productive finance & the DC charge cap

The Government would like to make it easier for money purchase schemes to invest in less-liquid assets, such as infrastructure. It has already, earlier this year, made some changes to the charge-capping rules, so as to better accommodate performance fees.[2] In his Budget speech and 'red book' document the Chancellor indicated that in a consultation exercise slated to begin '*before the end of the year*' the Government will advance further changes to the charge cap, '*to enable pension savers to benefit from better growth in their long-term investments*.'

Ameliorating the tax consequences of the *McCloud* remedies

The Court of Appeal, in a December 2018 ruling known as the '*McCloud*' judgment, confirmed that transitional provisions made during the 2014/15 reforms to the main public-service pension schemes were unlawfully discriminatory. The unfunded arrangements made for teachers, police officers, firefighters, NHS staff, etc. had (in broad terms) allowed older members to remain in their legacy, final salary schemes, whilst younger members were placed into new career-average revalued earnings (CARE) schemes for future service. The funded arrangements for local government employees took a different approach, moving everyone into the CARE schemes immediately, irrespective of age, but with underpins protecting older members who would have done better under the final salary rules.

The Government's response to *McCloud* is to provide members of the unfunded schemes with a 'deferred choice underpin', allowing them to choose, at retirement, which benefits are better for them, based on personal circumstances and preferences. The Local Government Pension Scheme (LGPS) solution involves revising the underpins so that they do not discriminate against younger members. Both approaches have tax implications.

Alongside the Budget, HMRC published a policy paper, *Taxation of Public Service Pension Reform Remedy*, introducing legislation intended to ensure that the pensions tax framework applies as intended to the '*McCloud*' remedies.[3] The *Finance Bill 2021-22* will permit modification of the pension tax rules to put members in the position they would have been in had they always had the benefits ultimately received so that, for example,

- any compensation payments that are due are exempt from tax charges;
- lifetime allowance protection is appropriately calculated;
- any (retrospective) annual allowance charges are no higher than they would been had members accrued their chosen benefits during the relevant tax years; and
- pensions and lump sums are not treated as unauthorized member payments.

The long wait for a solution to the net-pay anomaly will disappoint many, but may be less surprising to those familiar with the chequered history of changes to HMRC's IT systems. It appears that the planned 'bonuses' will be paid directly to low earners, rather than (as with basic-rate RAS claims) into their pension pots, so will not help with the problem of under-saving unless additional steps are taken. The scepticism that will no doubt be aroused when low-earning members of NPA schemes—even those with defined benefits—are invited to claim this 'free money' might partly explain the Treasury's low estimate of the costs, which seem to assume that only ~24 per cent of those entitled will take up the offer.

Some of the historical barriers to illiquid investments are easing, and we have seen great examples already of DC schemes accessing these assets to improve outcomes for their members. Now is the time to explore this exciting development for those with the governance capacity to do so. Although costs and charges are likely to be higher than in most existing DC funds, we believe that in this instance it is possible for DC savers to pay more and get more.

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[2] The *Occupational Pension Schemes (Administration, Investment, Charges and Governance) (Amendment) Regulations 2021* (SI 2021 No. 1070).
[3] <www.gov.uk/government/publications/taxation-of-public-service-pension-reform-remedy/taxation-of-public-service-pension-reform-remedy>.

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