Strengthening the incentive to save: a consultation on pensions tax relief – September 2015

Introduction

The Associated Society of Locomotive Engineers and Firemen (ASLEF) is the UK's largest train driver's union representing approximately 20,000 members in train operating companies and freight companies as well as London Underground and light rail systems.

ASLEF has major concerns over any potential changes to tax relief for pensions. There is no doubt that pensions are often complicated considerations for workers. The way they work, are financed and what you get out at the end, as well as the wide variety of products available, makes pensions an area of working life that is often neglected. However much of this complication is inevitable with such long term savings and insurance products.

ASLEF does not believe that the current method of tax relief is the cause of confusion around pensions or that it is complicated. Explaining to people that contributions (within limits) and investment returns are free from tax is simple, and a strong incentive to save. Taxation on receipt of pensions is also easy to comprehend as individuals are used to be taxed on income.

ASLEF fears that any of the changes proposed could have a catastrophic effect on current pension schemes, especially those which are defined benefit. We therefore oppose any attempts to end the current EET regime.

The central stated aim of this consultation is to create more of an incentive for people to save for their retirement. ASLEF of course supports this aim. But people are not put off saving for retirement because of the complexity of the tax relief. More often than not, they are unable to afford to put money aside for retirement due to the increased cost of living and stagnation of wages. Saving for a pension you may not receive for 50 years will not be a priority for a young worker who has debt to pay off, and is struggling to pay rent, pay to heat their home or even to feed themselves. By ensuring workers have a real living wage and more money left over at the end of the month, you will incentivise pension saving.

<u>Questions</u>

To what extent does the complexity of the current system undermine the incentive for individuals to save into a pension?

ASLEF, far from believing that complexity of the current system causes confusion, believes that it is perhaps the simplest element of pensions to explain. Tax relief as an incentive to save is always going to be a dry subject and one that people do not always fully investigate. But surely there can be no simpler way of giving tax relief than telling people that all contributions to your pension are free from tax, investment returns are free from tax and the income you draw out at the end is taxed in the same way as your earnings throughout your working life.

Pensions are complex. However ASLEF do not believe it is possible to simplify the tax regime. The union therefore believes complexity does not undermine the incentive to save.

Do respondents believe that a simpler system is likely to result in greater engagement with pension saving? If so, how could the system be simplified to *strengthen the incentive for individuals to save into a pension?*

ASLEF is not sure that there could be a simpler form of tax relief than the current system offers.

As previously mentioned, ASLEF does not believe that changing the tax regime will increase engagement with pension saving. Firstly, the tax relief currently on offer is an incentive to save. It is often just communicated poorly.

One employer ASLEF has recognition with automatically sends the difference in take home pay a member would receive if they opted out of their defined benefit pension, if they express a desire to do so. This way they can see that it will not mean that their contributions are now available for them to spend due to the tax relief. This clearly demonstrates to members of pension schemes, the value of tax free contributions. The company tells us when given this information, the vast majority of members stay in schemes. The problem is therefore not complexity, but lack of information.

Surely there can be no greater incentive to save than by telling people that, if they put their cash into a pension, its will be worth 20% or 40% more than if they put it in their pockets.

Would an alternative system allow individuals to take greater personal responsibility for saving an adequate amount for retirement, particularly in the context of the shift to defined contribution pensions?

As mentioned above, the current system offers a very good incentive to take personal responsibility for pensions saving. However it is often communicated poorly. But while ASLEF agrees that individuals should take personal responsibility, the union also considers pensions as a three way responsibility. Pensions are deferred wages. The employee takes responsibility for them by contributing. But so does the employer, as part of staff remuneration and to ensure they are a responsible employer who seeks to look after staff in a holistic way. The state also has a role through tax relief. This is important in both ensuring that citizens are able to have comfortable retirement, but also in ensuring that pensioners will not face poverty and in turn need to rely on the welfare state.

Therefore whilst personal responsibility is important, so is the responsibility of employers and the state. The tax relief offered ensures the latter.

Would an alternative system allow individuals to plan better for how they use their savings in retirement?

ASLEF does not believe that this would be the case. This biggest obstacle in knowing how to use savings in retirement is the performance of the market in the years leading up to expected retirement. This is why the decline of defined benefit schemes has been such a problem. ASLEF fails to see what elements of the tax relief system currently in place currently stops people being able to plan. Taxation on receipt is identical (other than NI contributions, therefore arguably simpler) to the receipt of salary.

Should the government consider differential treatment for defined benefit and defined contribution pensions? If so, how should each be treated?

ASLEF believes that any change to the tax relief offered on pension savings would be catastrophic for defined benefit schemes and could well be the final nail in the coffin for those which remain open. Contribution rates are set on the basis that they receive tax relief and will continue to do so until pensions go into payment. Should this relief stop, suddenly pension scheme will find themselves in huge deficits, as the actuarial assumptions are based on this stream of money.

Additionally, future service contributions would have to increase dramatically to make up for this shortfall. If the cost of the scheme becomes prohibitive, many members will drop out of it all together. This will especially be the case for the low paid. This will mean that the incentive for good quality retirement provision could actually be negatively impacted.

ASLEF does not believe there is case for changing the current tax regime for either defined contribution or defined benefit pensions for the reasons stated above and would call upon the government to keep the current system. However, if changes are to be pushed through, they must offer the same level of tax relief as the current regime, and defined benefit schemes should be able to continue with the current system. Otherwise, rather than ensuring good provision for retirement, the government will be closing many good quality pensions to thousands of workers. If the government pursues such changes, it would be necessary to have a separate regime for defined benefit schemes.

This becomes clearer when one considers that certain industries that have been privatised, including the railway, have legislation that protects pensions for workers. Many workers, who were employed at the time of privatisation, have their pension protected by the 1993 Railways Act. Whilst they are employed on the railway, they must accrue a pension that is no worse than when the industry was publically owned. Getting rid tax relief on contributions, as previously stated, would make paying for this impossible and could lead to legislative problems.

This is also the case for AVCs. The railway pension scheme has an AVC option called BRASS. The offer of tax relief is a cornerstone of this. The could have major implications to AVCs and the protected nature of them if the tax relief changes.

One of the reasons ASLEF opposes the suggested change to TEE (and the already enforced changes which came under the “Pensions Freedom” legislation) , is the potential for pensions to stop being savings and insurance products that ensure a certain standard of living from retirement till death, and instead become a way avoiding tax for the well off and well informed.

To some extent this has always been the case. SIPs, for example, give individuals the chance to use their pension as an investment vehicle with tax advantages, as long as they are able to wait until their minimum retirement age to reap the benefits. Changing the tax regime to TEE, could exacerbate this. Individuals could simply put investments in SIPs, and not have any tax bill through capital gains, or when drawing income. Whilst ASLEF acknowledges there are annual and lifetime allowances, this does appear to offer wealthy investors a method of avoiding tax (more than is currently the case) on their investments, rather than genuine options to save for retirement.

What administrative barriers exist to reforming the system of pensions tax, particularly in the context of automatic enrolment? How could these best be overcome?

Auto-enrolment should be welcomed, though ASLEF still believes that the level of contributions required are too low to build a decent pension. Despite this, the measures have led to far more people having pensions. It should therefore be remembered that the auto-enrolment system was introduced with EET in mind. It would be a shame to do anything that could jeopardise this growth in pensions saving.

How should employer pension contributions be treated under any reform of pensions tax relief?

As previously mentioned, workplace pensions are a three way responsibility between employee, employer and the state. It is right the employers are also encouraged to contribute to employee pensions with National Insurance relief.

How can the government make sure that any reform of pensions tax relief is sustainable for the future?

The government must always remember the purpose of tax relief. Taxation and tax relief is often used to influence behaviour. Of course there is a cost in offering tax exemption. However, when considering the cost of this to the taxpayer, one must also consider the long term price of removing these breaks.

As the consultation points out, pensions play a major role in financing long-term investment and in the gilts market. Both of these are clearly important for economic growth and government finances. Short term saving to pension tax relief could have a major long term negative effect on government revenue if the gilt market and economic growth are negatively affected by less pension savings.

Additionally, any reduction in government support for private and workplace pensions is likely to mean a reduction in incentive to save, and therefore a reduction in pension provision. This will mean more and more pensioners relying on the state in retirement and an increase in pensioner poverty. Again this has a long term negative effect on government revenue, as well as being morally wrong.

ASLEF therefore rejects any attempt to reduce the short term cost of pension relief. Not only will it undermine public finances in the long term, but it will also be at a great cost to society.

Conclusion

Defined benefit schemes have been closing at a rapid pace. Often this has not been due to a lack of affordability, but bad decision making and government policy. For example, companies having to publish deficits on their FRS102, which gives a false impression of their financial health. Allowing employers to take long contributions holidays during periods of surplus, rather than ensuring they build a buffer to account for tougher times. Also, more recently, the decision to end the state second pension and thus end the NI rebate from opting out. ASLEF fears that any changes to EET would be the final nail in the coffin. This would mean that many people who currently have the good pension provision that government claims to want for all, could lose it.

Many companies have used the death of DB schemes to change provision to DC schemes. This transfers risk to the employee rather than the employer. But whilst doing this, they have also taken the opportunity to significantly reduce their contributions. This is another issue which must be resolved. 3% contributions under auto-enrolment are simply insufficient in helping staff save enough for retirement.

For many workers paying into defined contribution pensions, the extra 20% they get through tax relief is one of the decisive reasons they pay in. Offering any relief much further down the line may be a far less effective incentive.

From ASLEF's experience, the only thing that stops tax relief being more effective is poor communication. The government should focus on this, rather than adding further complications by changing the current tax regime.

What this consultation overlooks is the fact that the biggest obstacle to pension savings we face in the UK is the cost of living. Over many years, wages have failed to increase at the same pace as prices, and in particular housing costs. Our economy has increasingly become a low pay one. The stark reality is that if people are having to choose between paying bills, heating their homes and even if they can afford to eat, they are never going to consider how much to put in a pension.

It is only by dealing with low pay, that people will feel able to save for retirement. Any changes to the current tax regime are therefore simply tinkering around the edges of the issue, and in many cases could have very dangerous effects on workers in Britain. This must not be allowed to happen.

Mick Whelan
General Secretary
ASLEF
77 St John Street
London
EC1M 4NN