Spotlight on Pensions
PRESENTS
Le Grand View

FEBRUARY 2021

Taxes in hard times – finding the balance

The UK has entered a challenging new financial era. The COVID-19 pandemic has already hit GDP hard, and forecasters predict a further reduction due to Brexit – despite the conclusion of an eleventh-hour trade deal with the EU. Meanwhile, the country continues to rack up debt to pay for pandemic remediation measures.

The personal finances of many have suffered, with further pain to come. Unemployment numbers have increased, with further rises inevitable when the furlough scheme and other temporary business-supporting measures cease. A cliff-edge awaits at the date those measures end. Meanwhile, the longer that restrictions continue – with or without Government support measures – the greater the number of businesses that will close their doors permanently.

A focus on the unemployment figures alone understates the extent of the pain being inflicted across the nation's workforce. Many of the self-employed, or those who work in the gig economy are experiencing severe difficulties, with no access to the Government's COVID financial support schemes.

As well as being a serious issue for the individuals affected, the wider impact on the economy from a contraction of the nation's wealth-generation capabilities, and the immediate reduction in the tax base, together exacerbate the challenge facing HM Treasury in trying to balance the nation's books. Difficult decisions lie ahead.

Uneven burden

Pain is not evenly spread though. A number of people who have been able to continue working, often from home, have increased their household wealth through savings on work-related expenditure such as travel and takeaway coffees and sandwiches, and through reduced discretionary expenditure imposed by lockdowns, such as on entertainment and eating out.

This has sharpened pre-existing social and financial inequalities across the country – something the Government has pledged to address with policies including avoiding any return to austerity policies such as were adopted following the banking crisis. This promise is credited with being responsible for their parliamentary majority at the last election, so we should expect to see the emergence of policies aimed at trying to "level up" living standards.

However, in an economy wounded by the pandemic and with growth over the next few years at least hampered by post-Brexit complications, the task becomes more difficult. In a strong and growing economy where new wealth is being created, there is more scope to divert some of it to the poorer in society. If the economy is stagnant – or contracting – redistribution of wealth over timeframes consistent with electoral cycles presents a much greater challenge.

It is more likely that in such an environment the response will involve at least some active redistribution of personal wealth. Focus will inevitably turn to the tax system as a potential tool.

Wealth tax

Step forward the Wealth Tax Commission, which was established in the Spring of 2020. It published a report in December, recommending a tax on privately-held wealth which could be used to meet most of the costs of COVID-mitigation expenditure.

The principles behind the proposal are that it should be a one-off tax levied on each individual and based upon a valuation of the individual's total wealth calculated on a given date. The total value above an agreed threshold would be subject to a tax payment at a set percentage.

Controversially, the assets used to calculate an individual's wealth would include their house, which would bring a large number of people of otherwise modest means into the catchment group. Also included would be the value of private pension funds. The inclusion of both of these illiquid items, was justified on the "horizontal equity" argument. In the Commission's words "individuals of similar means should not be taxed differently because (for example) one owns a house while the other holds cash while they wait to buy a house, or one has their savings in a pension while the other has reinvested their savings in their business".

Although from an academic perspective that position makes sense, there are strong moral objections in the Real World to using assets needed to provide basic living requirements to calculate a tax on "wealth".

The proposal requires that, where possible, the tax would be payable as one lump sum straight away – which would make sense given the urgency with which funds need to be raised for the Exchequer. However, there would be provisions to extend or even defer collection in cases where individuals are "asset rich and cash poor", where liquidity constraints would cause them financial hardship if required to pay the tax immediately. For such individuals, the Commission had pension assets firmly in its sights as a means of paying the tax. It stated that "wealth tax due in respect of pension wealth should be payable out of the pension lump sum on retirement, for those not yet at state pension age. This wealth cannot be accessed in working life, so deferral and automatic withholding should be allowed".

Bad messaging

The targeting of private pensions in this way sends the wrong message to savers. It undermines the success of retirement saving through automatic enrolment, rightly celebrated by the Government. It has taken a long time to get across the message of the need to lock away money to provide for retirement to supplement a meagre state pension.

A key part of that message is that the state takes the issue so seriously that it is prepared both effectively to force people to do so and to give tax relief to help. For the state to then say that in order to meet a short-term fiscal deficit it is acceptable for it to dip into those personal long-term savings, would cut the ground from beneath the hard-won argument that individuals should save in pension schemes and that those savings are safeguarded.

It would also create a dangerous precedent. Whatever "guarantees" are given that it is a one-off, exceptional measure for an exceptional time, once it has been used the chances of a future Government declaring another "exceptional time" increase.

Easy target

The Chancellor has reportedly rejected the proposals. Nevertheless, he does have a large black hole in the nation's finances to address and is under pressure to start indicating how he will do so, possibly in the forthcoming Budget on 3 March. Outside of the Treasury the idea of a wealth tax in some form enjoys considerable support, as highlighted in the Commission's report. There are also other voices suggesting that pensions should make a contribution to the fiscal black hole. The longer the pandemic crisis lasts – and the greater the bill for remedial measures grows – the greater will be the temptation to seek a quick boost to the Treasury's coffers.

As an easily-identifiable large pool of assets, pension schemes provide a tempting target. Indeed, the Commission noted when discussing the challenges involved in valuing assets for taxation purposes that the value of pension scheme assets is "...readily available, and could be straightforwardly reported".

Recent proposals to encourage schemes to invest in social projects indicate a growing interest in state intervention over how pension fund monies are utilised. Whilst pension funds should be good citizens and sensitive to the world in which they live, they still have a primary direct obligation to the beneficiaries for whom they were created to serve. Where the two principles can both be met simultaneously, then doing so is good practice. However, removing value from accrued funds held for the purpose of paying individuals' pensions is not.

Taking all these factors together, the risk to the security of pension scheme assets is real. The Chancellor should take the opportunity on 3 March to state categorically that pension pots are beyond the scope of any possible wealth taxes.

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Reviewing pensions tax relief

For some time the Treasury has more generally been considering options to reform pensions tax relief, to address various anomalies and inconsistencies. The complexities involved in a major change are likely to be a factor in the absence of a decision to date. However, the issue is unlikely to be allowed to drift much longer. In the current fiscal environment, opinions that were already being expressed to the effect that existing arrangements are too generous, are likely to carry greater weight, increasing the probability that a reform exercise will include measures to reduce the pensions tax relief bill.

Hopefully, the principle of providing tax relief for pensions saving is sacrosanct and so any review will focus on details. The current system undoubtedly has anomalies that need addressing. Given current social and financial inequalities in the UK, there is also a moral argument that tax relief on contributions should be at a flat rate for all, which would be consistent with the Government's "levelling up" agenda. By the same token, the existence of the lifetime allowance looks anomalous. If tax relief is restricted through contributions, there is no need for a further limit that penalises successful investment.

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A question of equity

Pension schemes live in the Real World and must be sympathetic to the financial constraints that apply there. However, the other side of the bargain is that the importance and purpose of pension schemes should be recognised, and that the sanctity of assets already put aside in good faith for that purpose should be respected.

The state already exercises strict control over citizens' pension costs to the UK economy, through restrictions on the generosity of the state pension. The other side of that bargain is that citizens are encouraged and helped to supplement their state pension through making private provision. A fundamental part of that bargain is the principle that monies lawfully and legitimately put aside by individuals in good faith should be protected from subsequent depletions – even if the objective is to help a broader social need.

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