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19 January 2015

*Dear Tommy,*

#### **PENSIONS SCHEMES BILL COMMITTEE**

I am writing to you in relation to various matters raised during the Lords Committee of the Pension Schemes Bill on Monday 12 January 2015.

#### **Salary Sacrifice**

Lord McKenzie mentioned Clause 54 of the Pensions Schemes Bill, which prevents the tax exemption for the advice safeguard being used in conjunction with salary sacrifice arrangements, and asked whether a similar measure could have been used in the Taxation of Pensions Act in order to prevent pension contributions being made through salary sacrifice.

Clause 54 of the Pensions Schemes Bill provides that, where an employer pays for the advice required by one of their employees on transferring from a defined benefit to a defined contribution scheme, this will not be taxed as a benefit in kind. The Government believes that it is right to prevent this tax exemption applying where this advice is paid for through a salary sacrifice arrangement in order to ensure that the employer pays for the advice where the transfer is being made as part of an employer-instigated transfer exercise.

The Government wants to encourage further pension saving, particularly in the context of the early success of automatic enrolment. Many employers make contributions on behalf of their employees, and the Government is aware that this is sometimes done through salary sacrifice. Many of these arrangements will be motivated by a genuine desire to save more money for retirement, rather than to gain unintended tax advantages, and the Government does not wish to introduce rules which are potentially detrimental to legitimate pension saving.

The Rt Hon the Lord McAvoy  
House of Lords

Having consulted extensively, the Government believes that the £10,000 annual allowance is the appropriate approach to allow people the flexibility to withdraw or contribute to their pension as they choose, whilst also ensuring the individuals do not exploit the flexibilities for unintended tax advantages.

The Government will be closely monitoring behaviour under the new system and will work closely with industry to ensure the system remains fair and proportionate.

### **Forecast Revisions**

Lord Bradley was keen to confirm that the revisions to the forecast which I set out during the debate took account of the increased cost of salary sacrifice arrangements as a result of the pension flexibility reforms, and I am pleased to reassure you that this is the case.

The Government explored this issue in greater detail between Budget and Autumn Statement. As a result of this work, a costing was produced and scrutinised by the Office for Budget Responsibility. In line with standard practice, these are accounted for as changes to the underlying forecast, and are therefore not published as a separate costing.

I set these figures out during the debate, but I will reproduce them here also. The revisions to the forecast to account for salary sacrifice, which take account of further discussions and considerations since the Budget, are £35 million in 2015-16, £30 million in 2016-17, and £25 million in each of the following three years.

These figures were also included in the letter sent by the Financial Secretary to the Treasury to the former Taxation of Pensions Bill Committee.

### **Behavioural assumptions**

During the debate at Committee, Lord McKenzie rightly pointed out that the assessment of how people will behave in the new system is fundamental to the figures the Government published at Budget for the impact of pensions flexibility on the Exchequer. This is recognised in the policy costings note for the policy which was published alongside the Budget. This explains in greater detail how the figures have been calculated.

The note bears out the Noble Lord's point, noting that there is no 'static', or pre-behavioural, cost to the measure, and goes on to describe how the Government has estimated the number of people who will access their pension flexibly. These assumptions have been subject to scrutiny by the OBR.

The relevant section, which I hope will answer a number of the Noble Lord's questions, states:

“The proportion of pension pot holders who choose to make early withdrawals is forecast by estimating whether an individual would have a preference for present income over later income.

This preference is estimated using information on individuals’ current financial positions using data from the Wealth and Assets Survey. It is affected by their indebtedness and the returns available on investments outside the implied returns of annuities. Other factors which may influence take-up include individuals’ preference for liquidity and their tendency to stick to default options, which affect take-up in opposite directions. It is estimated that around 30% of people in defined contribution schemes will decide to drawdown their pension at a faster rate than via an annuity” (*Budget 2014 Policy Costings, p11*). The full document can be found at: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/295067/PU1638\\_policy\\_costings\\_bud\\_2014\\_with\\_correction\\_slip.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/295067/PU1638_policy_costings_bud_2014_with_correction_slip.pdf)

Further information on the number of people the Government expects to access their money is also provided in the Tax Information and Impact Note, which states that the Government expects around 130,000 individuals a year to access their pension flexibly. The full document can be found at: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/385065/TIIN\\_8130\\_2140.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/385065/TIIN_8130_2140.pdf)

As discussed during the debate, the costing of tax policies often takes account of how individuals will behave in response to it. The assumptions that underpin this behavioural assessment and the methodologies used to arrive at them are of course certified by the independent OBR. As stated in the debate, the Treasury considers that in certain circumstances, usually regarding tax-planning and avoidance, making these detailed behavioural assumptions public can have the potential to affect the behaviour they relate to, and can as such be potentially detrimental to policy-making.

I would like to reassure Noble Lords that the Government will be closely monitoring the behaviour of individuals when the new system comes into force, through tax data and the significant amounts of data on tax receipts and liabilities that HMRC publishes annually.

### **Consultation concerning the safeguarded treatment of pensions which offer such forms of benefit as a Guaranteed Annuity Rate**

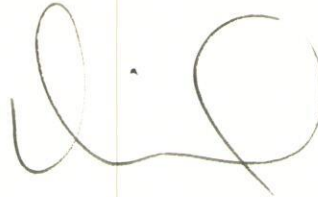
I promised to write setting out what consultation had been done in the development of amendments 45, 46, 49, 50 and 103 concerning the safeguarded treatment of pensions which offer such forms of benefit as a Guaranteed Annuity Rate. These amendments were brought forward after officials noted that since taking an UFPLS was not legally a conversion or transfer, this action would not be covered by the advice safeguard as currently drafted. This change was made to ensure sufficient coverage of the advice requirement.

The decision to safeguard pensions that offer such forms of guarantee was reached jointly by DWP and HMT as part of the policy development process in the context of the new flexibilities, to ensure that members who would be forgoing a valuable feature of their pension savings did so from an informed position. This process has seen a 12 week consultation run by the Treasury that concluded in July with the publication of the Government response. Since that time DWP has co-ordinated a structured engagement with industry through the Budget Flexibilities Industry Working Group, which has met regularly since September 2015 to discuss the implementation of the flexibilities, and contains representatives from all major industry stakeholders.

I hope you find this letter helpful. I have copied it to all Peers who spoke during Committee and have placed a copy in the Library.

All good wishes,

Yours,

A handwritten signature in black ink, appearing to be 'L. Newby', written in a cursive style.

LORD NEWBY