# Death, taxes and childbirth

Personal tax

01 November 2019

*Bill Dodwell* considers the Office of Tax Simplification’s report on Taxation and Life Events

“Death, taxes and childbirth! There’s never any convenient time for any of them.” So starts the latest report from the Office of Tax Simplification (OTS) on Taxation and Life Events, recalling Scarlett O’Hara in Gone with the Wind. This report looks at occasions within an individual’s life where tax may prove particularly complicated – and makes recommendations for simplification. It’s thought that this is the first time a report has looked at a range of possible tax issues through life.

The report concentrates on income tax and NI, the two more complicated taxes that affect most adults in the UK. HMRC data reveals that about 47 million people have taxable income, but that 16 million have income below the personal allowance, leaving about 31 million who pay income tax. Of course, even more people buy goods and services where the price includes VAT – but almost all the complications there apply to businesses, not to private individuals. The OTS has recently looked at inheritance tax and there may be opportunities in the future to examine stamp duty land tax and capital gains tax.

## The High Income Child Benefit Charge

The first event considered in the report is childbirth. Having a child isn't a tax issue at all but for many parents the High Income Child Benefit Charge, introduced in January 2013, added complexity to claiming one of the UK's two major universal benefits: child benefit. The government policy was that better-off parents shouldn't receive the benefit, but the mechanism chosen wasn't a means test on awarding the benefit in the first place, but a tax charge to recapture it. The charge applies if one of a couple has income of at least £50,000 pa, which brings a second complexity in the form of the benefits definition of a partner. Recapturing the benefit through a tax charge meant that HMRC estimated up to 500,000 people would need to register for self assessment and complete an annual income tax return simply to report and pay the charge. In an effort to reduce this number, the option of not receiving the benefit was made available. Those who didn't receive the benefit didn't pay the charge.

What wasn't made sufficiently clear when the charge was launched was that the child benefit claim carried with it two other important benefits: firstly, the claimant could obtain NI credits which count towards the state pension; and secondly, HMRC's administration was triggered to issue a NI number automatically to the child on reaching 16. The trick to get these benefits – but not to have to register for self assessment – was to register for child benefit and then opt not to receive it. Not registering at all also cuts out the tax charge but crucially doesn't give a non-working claimant NI credits, or the child an automatic NI number.

The practical problem was that until May 2019, the application form given to new parents didn't make these options sufficiently clear. The result is that there are likely to be hundreds of thousands of children who won't receive their NI number automatically and a smaller number of parents who won't receive NI credits whilst looking after children.

There isn't an easy remedy here, given that HMRC will need a claim form to administer child benefit. It would be good if a different data source could be found for HMRC to use – but that would perhaps involve the Registrar of Births giving information to HMRC – and addresses change over the 16 years before a child needs a NI number.

## Pensions

The topic of pensions is full of complexity. Pensions themselves are inherently complicated and full of jargon. They've also changed significantly over the last 10 to

20 years as employers have made changes to reduce the cost of providing pensions for their employees – and as auto-enrolment has brought many more people into pension saving.

The OTS highlights three particular areas of tax complexity. The first is relevant to employees who earn at or less than the personal allowance. Many have opted to save for a pension under auto-enrolment, no doubt encouraged by employer contributions alongside their employee contributions. The issue is that the method chosen by the employer to administer PAYE and pension contributions affects the cost to the individual of saving. Should the employer choose the ‘relief at source’ approach, the pension saving will be enhanced by a refund to the scheme of basic rate income tax – even though the individual hasn’t actually paid any tax. It’s the same approach as for stakeholder pensions, where a third party (typically a relative or spouse) can make net contributions of up to £2,880 pa into a pension scheme, which recovers basic rate tax. If, however, the employer chooses the ‘net pay’ approach, there is no basic rate refund of tax and the individual needs to contribute more to reach the same level of fund. Data published by the OTS reveals that the issue affects 2.4 million people in 2016/ 17. Some 1.3 million receive the basic rate refund in their pension saving; 1.1 million do not. Again, this isn’t an easy problem to fix. Economic secretary John Glen told the Work and Pensions Committee that the annual cost would be £100m, plus administrative costs of £10m. Given that the issue affects the lowest paid, it must be hoped that goodwill would allow a solution to be found to ensure that all employees receive a similar level of support from the exchequer.

The second major issue concerns the way in which the overall exchequer cost of pensions is managed. When the current pension system of tax relief was introduced in 2006, the limits were remarkably generous. There was a limit of £225,000 on the annual increase in value of the pension (the contribution for defined contribution schemes) and a lifetime limit on the size of the fund of £1.5m. Both these limits increased over the next few years – to £250,000 and £1.8m. Contributions, or funds, over these limits faced a heavy tax charge intended to recover the benefits of saving in a tax-exempt fund.

Reducing the annual allowance to £40,000 pa and then tapering it down to £10,000 for those earning over £210,000 has undoubtedly contained the exchequer cost. The problem for higher earners in defined benefit schemes is twofold: firstly, it is almost impossible to forecast during a tax year what level of tax charge could arise; and secondly, there are some cases where the tax charge and related financing costs exceed the related increased pension. The issue of consultants and doctors in the NHS has brought the matter to public attention. Consultants could receive additional earnings for extra work, which triggered a bigger potential pension. That bigger pension exceeded the annual allowance and so a tax charge became due. If the charge was paid by the pension fund at the request of the consultant, the loan and finance cost could outweigh the extra pension. This isn't the case for everyone; typically, the closer an individual is to retirement, the less likely that the extra pay could leave them worse off. Examples need to be worked out individually and usually after the end of the tax year.

The tax issue isn't just related to the taper of the annual allowance from £40,000 to £10,000, although the taper exacerbates the problem and definitely makes it very hard to understand. One possible solution would be for employers to change their contracts such that greater amounts would be paid as earnings, rather than providing for a greater pension accrual.

High earners contributing to defined contribution schemes have a different problem. They can relatively easily understand what level of contribution doesn't exceed the annual allowance (subject to the taper problem) but they can't forecast how their fund will grow and so when it would be sensible to stop contributing.

The recommendation from the OTS is that: 'The government should continue to review the annual allowance and lifetime allowances and how, in combination, they deliver against their policy objectives, taking account of the distortions (such as those affecting the National Health Service) they sometimes produce.'

The final area concerns the money purchase annual allowance (MPAA). This rule provides for an annual limit on pension contributions of £4,000 pa, where an individual has drawn down money from a pension fund. The objective is to prevent 'round-tripping'; i.e. getting two lots of tax relief on the same contribution. If you start from the position that pension saving is only intended to provide for retirement, then the MPAA is understandable. However, if pension freedom championed by George Osborne is supposed to allow savers access to their money, perhaps a different solution would be more appropriate. It's possible to withdraw money from an ISA and recontribute it without breeching the ISA contribution limit; perhaps something similar could be considered for those urgently needing cash, but who then wish to replace the money on their pension fund. Unfortunately, we don't have any data from HMRC on the numbers accessing pensions and then recontributing; more data might help us understand whether this is a big enough issue to warrant developing a new solution.

## PAYE issues

The report considers a range of PAYE issues, including how employees claim tax relief for business expenses borne personally. There are about 5 million employees claiming tax relief, of which the bulk relates to the small allowances for providing tools, or cleaning uniforms and other protective clothing. Too often, so-called high volume repayments agents enter the market to 'help' individuals get tax relief. Often their costs swallow up much of the value and there is evidence that in some cases the agents make incorrect claims, leaving the individual to repay HMRC when eventually detected. Finding a better way to help people in this area could be worth a separate study.

The report also looks at the operation of PAYE by non-commercial employers (typically employing a carer or other domestic staff); issues on starting work; or having multiple employments or pensions.

## Education

The report ends with a short look at tax education. There's no doubt that education – especially when delivered as the individual is coming up to a particular event – can help reduce or even remove complexity. For example, someone retiring from their employment will typically give their employer notice. If an employer could provide a useful HMRC online briefing to help retiring people understand how their tax will change on retirement, it could help reduce some of the confusion and potential errors faced by some retired people.

The report was an initiative by the OTS, instead of being commissioned by the chancellor. Nonetheless, it is hoped that the government and HMRC will respond to the areas highlighted.