

PO-CH/NL/0506

PART B

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1989 BUDGET PUBLIC
SERVICE PENSIONS

7-3-89

~~XXXXXXXXXX~~

THIS FOLDER HAS BEEN
REGISTERED ON THE
REGISTRY SYSTEM



FROM: R C M SATCHWELL
DATE: 22 February 1989

MR KUCZYS - IR

CC

PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Mr Scholar
Mr Culpin
Mr MacPherson
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Isaac - IR
PS/IR

PENSION LIMITS

The Financial Secretary has seen your minute of 21 February, the substance of which he discussed with you and others yesterday. As he mentioned to you then, he agrees with the Chancellor's view that the "Tyrie/MacPherson wheeze" should be stopped by requiring employees actually to leave an employer's service in order to benefit from the new and simpler rule for early leavers/retirers.

R. C. M. S.

R C M SATCHWELL
Private Secretary



FROM: J M G TAYLOR
DATE: 23 February 1989

Prof

PS/FINANCIAL SECRETARY

cc PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Dame A Mueller
Mr Scholar
Mr Culpin
Mr Harris
Mr Riley
Mr Dixon
Mr Gilhooly
Mr McIntyre
Mr Macpherson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Isaac - IR
Mr Kuczys - IR
Mr Hinton - IR
PS/IR

PERSONAL PENSIONS

The Chancellor has seen the Financial Secretary's note of 21 February.

2. He agrees with the Financial Secretary's conclusion that Option B offers the best set of percentage limits for the amount of contributions someone may make to a personal pension, but keeping the existing 17.5 per cent limit for those under 35. He also agrees that we have a parallel earnings limit for personal pensions of £60,000; and that we leave the existing retirement annuity rules unchanged.

JMG

J M G TAYLOR

Ch. 'X' over - do you want to do this (I don't really see why; unlike judges they will not require primary legislation).

FROM: D W RAYSON
DATE: 23 FEBRUARY 1989

- 1. MR L HARRIS
- 2. CHANCELLOR

cc: Treasury

Chief Secretary
 Financial Secretary
 Paymaster General
 Sir P Middleton
 Sir T Burns
 Mr Anson
 Dame Anne Mueller
 Mr Wicks
 Mr Hardcastle
 Mr Byatt
 Mr Scholar
 Mr Culpin
 Mr Luce
 Mr Riley
 Mr P Sedgwick
 Mr Dixon
 Mr Gilhooly
 Mr Macpherson
 Miss J C Simpson
 Mrs Chaplin
 Mr Tyrie
 Mr Call

H
23/2

Inland Revenue

Sir A Battishill
 Mr Beighton
 Mr Isaac
 Mr Painter
 Mr G Bush
 Mr Corlett
 Mr Kuczys
 Mr Hinton

Customs and Excise

Mr Jefferson Smith

PENSIONS REFORM: MEETING WITH THE LORD CHANCELLOR

1. In his minute of 16 February, Mr Isaac pointed out that fast accrual can be retained by employers after decoupling, but that benefits above the normal Revenue limits would not attract any tax privilege. We had not quite taken on board that the effects of decoupling would extend to fast accrual.

2. This will open up new options for the Lord Chancellor's Department. They will be able to continue to offer whatever benefits are necessary to attract Judges but, where the benefits are not consistent with the tax rules, the excess will have to come from a separate non-privileged scheme.

3. A head-on approach to try and persuade Lord Mackay to change the fast accrual for judges is therefore no longer necessary. But retention of fast accrual would have to be through a separate and unprivileged top-up scheme.

4. I attach a revised speaking note for the Chancellor which has been agreed with Inland Revenue.

X | 5. The Chancellor may wish to consider speaking to the Health Secretary and the Defence Secretary about the impact of the cap on the other two main public service groups affected - the consultants and the military.



D W RAYSON

SPEAKING NOTE

BUDGET CHANGE: LUMP SUMS

1. Wish to inform you in good time about proposed change in this year's budget, affecting judges among many others. There are two linked changes. First, an anomaly, whereby tax relief limits have come to determine what pensions can be paid, will be removed. This means that there will be more flexibility in relation to the pensions and lump sums you can offer Judges. Second, a cash limit will be placed on tax-privileged contributions and benefits, based on earnings of £60,000 a year.

2. Taken together, these changes need not affect the overall level of benefits for Judges. But there are two areas in which the judicial scheme will be out of line with the normal tax rules which apply to all other people. These are:-

- the 15-year fast accrual rules for the higher judiciary (as compared with 20 years under tax privileged schemes);
- the need for a £60,000 earnings cap.

But, as I have said, changing the judicial scheme to make it compatible with other schemes need not affect Judges' benefits. Benefits for earnings over £60,000, or to bridge the gap between 15 and 20 year accrual, may continue as now, but through a separate top-up scheme which will not attract tax relief.

3. Relevance of this to majority of public service schemes, including judicial scheme, is that lump sums derived from the slice of income above £60,000 will be taxed on receipt. Change will apply only to those joining a scheme after Budget day; it will not affect existing scheme members.

4. As an example of the earnings cap, a new judge appointed after Budget Day on a salary of £80,000 will receive benefits from two schemes. When he retires, the lump sum from the main judicial scheme will be tax free, as now. But the lump sum from the top-up scheme will be taxed. If he serves for a full period and gets maximum lump sum benefits, £60,000 would be tax free and £20,000 would be subject to tax (of £8,000). (For convenience, the example is in today's money, since the arrangements will be index-linked.)

5. Finance Act can override private sector scheme rules, but not the rules of most statutory public service schemes. Despite the tax rules not biting directly on the benefits from statutory schemes, it is customary to reflect those rules in the separate legislation governing these schemes because it is clearly right that Government should not be seen to treat its employees more favourably.

6. The Judicial Pensions Act 1981 probably needs amending to give effect to these Budget changes, which is why I need to consult you now. Would like to give a firm commitment during Budget debate that you will legislate as soon as possible to bring judges scheme into line with the private sector and the rest of the public services.

7. Although only new judicial appointments made after Budget day will be affected, some 160 judges will be affected ultimately. (See Annex A for details.) Change will bite on about 50,000 people in private sector. The other main public service group affected is some 900 NHS consultants, although some senior people in the armed forces and in central and local government will also be caught.

CHANGES TO THE MAIN SCHEME

8. Inland Revenue will require all privileged main pension schemes for newly appointed people to be "relevant". In future, all schemes will be required to have the £60,000 earnings cap on benefits. They will also have a minimum period of 20 years for accruing maximum benefits, in line with Finance Act 1987. Thus, judges' scheme will need changing by legislation.

TOP UP SCHEME

9. Your department will wish to consider urgently whether, and if so, how to deal with these changes. One way would be to start a top-up pension scheme for newly appointed judges earning more than £60,000. You will need to consider what to do about the fast accrual change, as well as how the top-up scheme will be financed. We expect other employers in the public and private sectors to consider these options. In practice, this means

(a) changing the main scheme's provisions, so that it is "relevant" (ie legitimate) in Inland Revenue terms; and

(b) ensuring that any excess lump sum is part of a top-up scheme, and therefore taxed when received.

The Judicial Pensions Bill or County Courts Bill could include the necessary amendment in the next session.

CONCLUSION

10. Wanted to let you know as soon as possible, so that you could be aware of the effects of the changes on newly appointed judges, including the point about fast accrual. You will wish to include a suitable amendment in a Bill as soon as possible reflecting the budget changes, and to consider setting up an appropriate top-up scheme.



		Current Salary £ <i>wef</i> <i>(1.10.88)</i>	Number in post	Pay bill £m (excl ERNICs & superannuation)
JUDICIARY				
Lord Chief Justice	Grp1	85,250	1	0.09
Lords of Appeal	Grp2) 78,750	13	1.02
Master of the Rolls				
Lord President of the Court of Session				
Lord Chief Justice (Northern Ireland)				
Lord Justice Clerk	Grp3) 75,750	39	2.95
Lord Justice of Appeal				
Lord Justices of Appeal (Northern Ireland)				
President of Family Division				
Vice Chancellor				
Inner House Judges of the Court of Session				
High Court Judges	Grp4) 68,500	103	7.06
Judges of the Court of Session				
Puisne Judges (Northern Ireland)				
London Official Referees	Grp4a	59,700	6	0.35
Chairman, Scottish Land Court and President, Lands Tribunal (Scotland) Official Referees	Grp5) 50,900	24	1.22
Vice Chancellor of the County Palatine of Lancaster				
Senior Circuit Judges				
Recorder of Liverpool				
Recorder of Manchester				
Recorder of Belfast				
Chief Social Security Commissioners (England), Wales and Scotland and Northern Ireland				
Presidents, Industrial Tribunals (England and Wales, Scotland and Northern Ireland)				
Judge Advocate General				
President Social Security Appeal Tribunals and Medical Appeal Tribunals (England, Wales, and Scotland)				
County Court Judges (Northern Ireland)				
Chairman, Criminal Injuries Compensation Board				
Presidents, Lands Tribunal (England and Wales and Northern Ireland)				



MINUTES OF A MEETING HELD IN THE CHANCELLOR'S ROOM
HM TREASURY AT 12 O'CLOCK NOON ON 24 FEBRUARY 1989

Present

Chancellor
Financial Secretary
Sir P Middleton
Sir T Burns
Dame A Mueller
Mr Anson
Mr L J Harris
Mrs Chaplin

Sir A Battishill - IR
Mr Isaac - IR

.....
PUBLIC SERVICE PENSIONS

Papers: Sir Peter Middleton's note of 16 February;
Mr L J Harris' note of 15 February.

The Chancellor, opening the discussion, said that the issues raised in the papers were undoubtedly very tricky. Two particular questions needed to be resolved: the approach to be taken towards public service pensions under the new regime; and what should be said about the implications of the new regime for public service pensions.

2. Sir Peter Middleton said that the proposals involved not only a tax change but also a structural change. We needed therefore to consider - as would all other employers - how to apply the changes to our own workforce. The changes would affect both recruitment to senior posts, and more general recruitment to entry grades. After 40 years, and assuming reasonable real growth in earnings, the scheme would affect virtually all employees at principal level and above. We needed to decide whether the pensions to be



provided to public service employees would be better, the same, or worse than those provided to the private sector under the new arrangements. A possible approach would be to seek the Top Salaries Review Body's advice. The TSRB was proposing to conduct a fundamental review of remuneration and could take this into account. The TSRB might also, specifically, be invited to consider how the proposals should apply to judges. Technical problems in relation to the implementation of the new scheme in the public service would also need to be addressed, since specific measures would need to be taken to give effect to the new proposals in statutory and prerogative schemes. It might therefore be necessary to consult with other Departments before Budget Day. In any event, the implications of the changes could have an impact on the Civil Service's ability to recruit staff.

3. In discussion, the following points were made:

- (i) Ministers' objectives, behind the Budget proposals, were to limit the taxpayers' contribution to pension provision and hence reduce the extent to which pensions as a form of investment were tax driven;
- (ii) one way of dealing with the technical problem of making regulations for other public service schemes might be to agree that the changes would only take effect at some point after Budget Day (eg Royal Assent), in order to allow drafting to be undertaken in good order. Retrospective implementation might be a possibility, though this might also not be practicable under the Order-making powers;
- (iii) it was not clear whether the prospective pension provision was a major motivational factor in the decisions of potential recruits to join the Civil Service



instead of other employers. On the other hand, a clear statement of intention would need to be given to potential employees if they were not to be unnecessarily discouraged;

- (iv) there was a clear advantage in leaving it to the TSRB to advise on how best to apply the new provisions in the public sector. It would not be appropriate, however, for the public sector to lead the way; instead, account should be taken of how private sector employers were dealing with the new rules. This pointed to the TSRB considering the position and providing advice after, say, a year's experience of the new rules. Earlier consideration might, however, be given to the specific application of the proposals to the judges' scheme, because of the particular characteristics of that scheme. The TSRB could be invited to consider provisions for judges alongside a more general consideration of judges' remuneration;
- (v) one effect of the new rules would be that employees with reserved rights would work alongside others to whom the new rules applied. Some form of compensation would be found for the latter group, either via enhanced pay, or through some additional (non-privileged) pension provision. There would be likely to be some upward pressure on pay costs. But this would apply equally in the public and the private sectors. The additional flexibility which had recently been introduced into Civil Service pay would help here;
- (vi) the new rules would have different implications for different types of public sector employee. Specific appointments to senior posts could be dealt with on an



ad hoc basis, as now. General rules would need to be devised for career staff joining at, say, administration trainee or executive officer level. Judges were in a special category, and an early solution should be found there;

- (vii) there would be advantage in avoiding over-prescription when asking the TSRB to advise on the pension provisions for the majority of Civil Servants. There might be advantage, for example, in devising a scheme involving a larger employer contribution to personal pensions.

4. The Chancellor, summing up, said it was agreed that the public sector should not lead the private sector in its response to the new rules. In deciding how to apply the new scheme to the public sector, private sector experience should need to be taken into account. This meant that reference to the TSRB of the arrangements for the majority of public servants should be held over until next year. In the meantime, it should be made clear that the new rules would not be applied in a way which would disadvantage the public sector. Judges' pensions - and the constellation of issues relating to them - should be referred immediately to the TSRB. This was agreed.

5. The Chancellor said that further consideration would need to be given to the technical aspects of applying the rules to public service schemes. The schemes affected included, apart from the PCSPS, the NHS Scheme, the Judiciary Scheme, the Armed Forces Scheme, the Local Government Scheme, and the Metropolitan Police Scheme. He invited Mr Isaac to provide further advice on the implications. This should include advice on the start date for application of the new schemes. He invited Mr Harris to examine the particular implications for the PCSPS. He would speak to the Lord Chancellor at an early date (now fixed for 28 February). He



would also inform other interested colleagues of the proposals, but explain that details would remain to be resolved after Budget Day.

J M G TAYLOR
Private Secretary

27 February 1989

Distribution

Those present

Chief Secretary
Paymaster General
Economic Secretary
Mr Tyrie

PERSONAL AND BUDGET CONFIDENTIAL

FROM: A G TYRIE
DATE: 24 February 1989
cc: Mrs Chaplin

CHANCELLOR

PENSIONS REFORM: MEETING WITH THE LORD CHANCELLOR

Following the discussion at Prayers I have just read Mr Rayson's note of 23 February. I think you can sugar coat the presentation to the Lord Chancellor.

2. The tricky bit. I don't think you can say, as the suggested speaking note does in paragraph 2, that these changes "need not effect judges' benefits". That's a bit disingenuous. A top-up scheme would ensure that their gross benefits were not affected but their post tax benefits clearly would be.

3. This certainly poses an acute problem. On reflection, I don't even like my own suggestion of telling him that the TSRB would, if necessary, raise salary levels to a level required to ensure adequate recruitment. If you did that Sir Peter and co would demand the same for their boys.

4. I can only suggest that you tell the Lord Chancellor something like: "As the new rules settle down, both in the public and the private sector, if it becomes clear that recruitment problems have increased for judges, we would have to consider paying them more". So you show a general preparedness to consider increases in pay, falling short of a decision to ask the TSRB to take the changes into account.

5. Some sugar-coating. You can point out that it's not all downside for the judges:

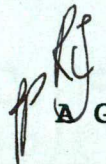
- The pensions package would enable judges to have a top-up scheme (albeit an unprivileged one) which is forbidden under existing rules.
- Most judges will already have set up PPPs or Section 226 schemes. Although they can no longer add to them

(assuming you close the Tyrie/Macpherson wheeze) the personal pension entitlement would enable them to breach the lump sum ceiling. So judges would be in a relatively "privileged" position.

- You could, if necessary, make it pretty clear that you would be prepared to take the public expenditure consequences of a money purchase/salary top-up on the chin.

6. I realise that none of those points are clinchers but they are points!

7. All in all, it is extremely annoying that you find yourself having to peddle all this to the Lord Chancellor at the same time as dealing with the anomaly on the fifteen year fast accrual rules.


A G TYRIE

P.S. I gather that the knock-on effects for clinicians, policemen and local government were raised at the pensions meeting this morning. Unlike judges these people don't, I think, drop their existing pension arrangements as they are promoted, so the transitional arrangements apply. Only those who are about to join, and reach the cap say twenty years hence, would be affected.

Officials may be right in saying that we have to change the law for these people, but I can't see why today's clinicians will have cause to hop up and down. As you said this morning, the judges are the tricky problem.



CHANCELLOR OF THE EXCHEQUER'S OFFICE: MEETING

SUBJECT	Public Sector Pensions.
DATE	Friday 24 February
TIME	12.00 Noon.
VENUE	Chancellor's Room, Treasury/No. 11/Conference Room/House of Commons
PAPERS	Harris → Ch 15/2. PEM → Ch 16/2.
THOSE ATTENDING	CST. FST. Sir P Middleton. Sir T Burns. Mr Anson Dame Ann Mueller Mr Harris Mrs Chaplin Sir Anthony Battishell Mr Isaac → Mr ACS Alan PMG.



CHANCELLOR OF THE EXCHEQUER'S OFFICE: MEETING

SUBJECT	Public Sector Pensions.
DATE	21 February.
TIME	11.45 am.
VENUE	Chancellor's Room, Treasury/No.11/Conference Room/House of Commons
PAPERS	Harris → Ch 15/2. PDM → Ch 16/2.
THOSE ATTENDING	CST. FST. PMG Sir P Middleton Sir T Burns, Mr Anon Dame A Mueller Mr Harris. Mrs Chaplin Mr Isaac. CC Mr AC S Khan. Sir A Battiswell.

FROM: M A BOLTON
DATE: 24 FEBRUARY 1989

- 1. MR MCINTYRE
- 2. CHANCELLOR

We hope to get confirmation from DSS on Tuesday that implementation in October will be feasible.

- cc Chief Secretary
- Financial Secretary
- Paymaster General
- Economic Secretary
- Sir P Middleton
- Mr Anson
- Mr Byatt
- Mr Scholar
- Mr Culpin
- Mr Sedgwick
- Mrs Lomax
- Miss Peirson
- Mr Matthews
- Mr Mowl
- Mr Gilhooly
- Mr Speedy
- Mrs Chaplin
- Mr Tyrie
- Mr Call
- Mr I Stewart (IR)
- PS/IR

That's all this (X) also allows for (employers?) NIC returns? No.

J.M. Good 24/2!

COST OF ABOLITION OF THE RETIREMENT PENSION EARNINGS RULE

Mr Speedy and I have met with officials from DSS and IR to discuss the method of calculating the cost of abolishing the earnings rule from 1 October 1989. The figures obtained were as follows (assuming that the option to defer is retained):

1989-90	Gross Public Expenditure	125
£m	PSDR	100
1990-91	Gross Public Expenditure	260
£m	PSDR*	190

X *allows for small benefit savings as well as tax revenue

2. The gross public expenditure cost of abolition is simply the cost of providing pensions for those who no longer defer them. The assumption, based on information obtained in a 1977 Retirement Survey, is that 20% of working pensioners would continue to defer, if this option were still available. The latest estimate of the current number of deferrers is 135,000, including 35,000 wives who

would depend on their husband's contribution record for a pension. The full cost (1989-90 prices) of providing them with a retirement pension would be £250m. There would be a small saving on Housing Benefit, in the region of -£5m.

3. The PSDR cost takes into consideration the extra tax revenue from increased pension expenditure. This would give savings of -£65m.

4. The estimate of the public expenditure and PSDR costs in 1989-90 assume that the change is implemented in October 1989, and that the 80 per cent who choose to claim their pension rather than deferring do so from 1 October. Because of the time lag in tax receipts, increased tax revenue in 1989-90 would be somewhat less than half the full-year calculation. This explains why the net cost in 1989-90 (£100 million) is slightly over half the net cost in 1990-91.

5. Because there was no good evidence by which the effect of possible behavioural changes could be estimated, it was decided not to include them in the calculation. Broadly speaking, they would have a negligible effect in the short term, while in the medium term there might be a beneficial increase in the labour supply.

6. While the cost of abolishing the earnings rule would remain approximately at the levels set out in para 1 over the next PES period, it is worth remembering that in the longer term it would decline as the need to pay increments on deferred pensions was reduced. Thus the public expenditure cost of abolition over the next 20 years has been estimated as follows (1989-90 prices):

1990-91	£250m
1995-96	£180m
2000-01	£120m
2005-06	£60m
2010-11	£20m

There are two effects at play here: firstly, the number of new pensioners receiving increments will fall rapidly over the first five years after the abolition of the earnings rule, and secondly there will be a longer-term decline as those who have already retired with an increment-enhanced pension die.

7. To sum up, our best estimate of the public expenditure increase in 1989-90 is £125 million (the Housing Benefit savings - half of £5 million - are perhaps too small to score for this purpose). For 1990-91, the estimate is £255 million, taking into account the £5 million HB savings. The cost to the PSDR would be £100 million and £190 million.

Michael Bolton

M A BOLTON



Inland Revenue

The Board Room
Somerset House
London WC2R 1LB

*Many thanks.
I shall welcome
POM's advice ASAP.*

FROM: A J G ISAAC
24 February 1989

CHANCELLOR OF THE EXCHEQUER

PENSIONS REFORM: PUBLIC SERVICE

1. As you asked earlier today, we have been thinking further about the start date for the pension reforms, and their application to the public service. Subsequently, I have had a further word with Mr Harris.

THE 1987 PRECEDENT

2. The 1987 changes took effect from Budget Day. However, the precedent is not perhaps wholly compelling. In particular, the 1987 changes were mandatory, while this year's changes will be partly mandatory, but in part will give employers new options to choose from. Paradoxically (as this morning's discussion illustrated) this may mean that employers need more time to consider the implications and adjust.

cc Chief Secretary
Financial Secretary
Sir P Middleton
Sir T Burns
Dame Anne Mueller
Mr Anson
Mr L Harris

Sir A Battishill
Mr Isaac
Mr Corlett
Mr Kuczys
Mr Hinton
Mr Lusk
PS/IR

A LATER STARTING DATE?

3. The arguments for a later starting date are perhaps:
 - It gives employers time to decide their response to the new regime (and handle contracts of employment already in the pipeline).
 - By the same token, it gives employers time to see the small print in the Finance Bill (published around 13 April) before having firmly to commit themselves.
 - It gives time for the public sector schemes - other than of course the judges - to make the necessary changes by Statutory or Prerogative Instrument, and to apply the same rules from the same date as private sector employers.
4. The Annex, prepared by Mr Gilbert, lists a number of public sector schemes, on the basis of a quick trawl through our papers here.
5. The arguments against a later start are perhaps:
 - There could be a certain amount of hassle, as people make sure that contracts of employment are completed, and new employees enrolled into pension schemes, before the curtain comes down. As you yourself said at this morning's meeting, it would be wrong to exaggerate the potential risk of disturbance in the labour market. Obviously, if an employer is proposing to take on a new employee, he will have an incentive to get things tied up before the appointed day. But he will be unlikely to take on someone prematurely, or carelessly, merely for the sake of a tax advantage that may not accrue for up to 40 years. Having said that, however, I imagine that you would not want to see transitional provisions

casting anything approaching so long a shadow as last year's mortgage reforms.

- There could be a particular problem of "forestalling" with existing employees - in particular controlling directors - who have not yet formally set up a pension scheme or who might be moved by the Budget announcement to set up a better one before the tax benefits are curtailed. It is easy to imagine the pensions industry mounting a campaign on the theme of "buy now, while stocks last". By contributing as little as a pound or two, a controlling director could buy reserved rights to the existing tax privileges, lasting to the end of his career. As we see it, this could be pretty disruptive (and, incidentally could result in some tens of thousands of new controlling director pension schemes suddenly flooding into the Superannuation Funds Office for approval).

A POSSIBLE APPROACH

6. On the basis of the further work we have done here since this morning (and we shall all want to reflect a little further) we see some attraction in a two-pronged approach.

7. First, the new rules would apply from Budget Day to new schemes set up on or after Budget Day. This looks to us, on the face of it, a reasonable approach (or, to put it the other way, we think that the onus of proof could reasonably lie on anyone who sought to argue that there was some title to pre-Budget relief under a scheme that was not set up until on or after Budget Day).

8. For new members of existing pension schemes (obviously, the vast majority of cases) the new rules might apply from a (later) appointed day. The justifications for this would be very much those in the first two indents of paragraph 3 above.

9. The best choice for an "appointed day" is very much a matter of judgment.

- One possibility might be 6 April. This is a temptingly "natural" date, and would allow about 3 weeks from Budget Day for employers and public sector schemes to get their act together. Mr Harris's first guess (if I have understood him correctly) is that public sector schemes might find that date unmanageable, and it could be pretty tight for private sector employers with contracts in the pipeline. It would also leave no scope for employers to consider the small print in the Finance Bill.
- At the other extreme, an alternative "natural" date might be Royal Assent (or possibly a little earlier, 30 June). We do not see this as unthinkable, but it seems to us longer than strictly necessary, and it could cast an uncomfortably long shadow on the labour market.
- In between, there are possible dates such as 1 May, or 1 June. Either of these should give both private sector employers and public sector pension schemes a breathing space to consider the small print of the Finance Bill, and push through the necessary immediate changes. But it would not involve an unduly prolonged interregnum (under any approach there must be a period of some uncertainty, until the Finance Bill becomes law). Mr Harris tells me that (on past form) some public sector schemes - though not the Civil Service schemes - may normally expect to take 3 months or more to change their rules; and you may need to ask Ministerial colleagues to exert some pressure if the non-Treasury schemes are to meet any reasonable timetable.

10. On balance, our inclination so far is to see attraction in a package applying the new rules

- to new schemes, from Budget Day
- to new members of existing schemes, from 1 May or perhaps 1 June 1989 (subject very much to your judgment of the balance of advantage here and the advice of Treasury (Superannuation Division) on how far the other public sector schemes can move).

CLO.

A J G ISAAC

1. SCHEMES COVERED BY OVERRIDE

All schemes approved before a date to be specified in the Finance Bill will be covered by the statutory override of scheme rules and so will not need to amend their rules to give effect to the earnings cap.

2. PUBLIC SERVICE SCHEMES

The Local Government Superannuation Fund is exceptional. Although it is a statutory scheme it is also tax approved, and thus will be covered by the override. Most other statutory public service schemes do not have to seek tax approval under the Taxes Act 1988, and so, the Local Government scheme apart, will not be covered by the override, and will have to amend their rules to reflect the £60,000 cap on earnings. The main schemes affected are:

Principal Civil Service Pension Scheme;
HM Forces;
Judicial Pension Scheme;
National Health Service;
Police;
Firemen;
Church of England;
Teachers;
UK Atomic Energy Authority.

There are also a number of smaller schemes which will be affected which operate by analogy with the Civil Service Scheme.



FROM: J M G TAYLOR

DATE: 27 February 1989

by 3/3

MR BOLTON

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Byatt
Mr Scholar
Mr Culpin
Mr Sedgwick
Mrs Lomax
Miss Peirson
Mr McIntyre
Mr Matthews
Mr Mowl
Mr Gilhooly
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

Mr I Stewart - IR
PS/IR

COST OF ABOLITION OF THE RETIREMENT PENSION EARNINGS RULE

The Chancellor was grateful for your note of 24 February.

2. He notes that the 1990/91 PSDR figure in the Table allows for small benefit savings as well as tax revenue. He has asked whether this also allows for (employers') NIC revenue. I should be grateful for advice.

A handwritten signature in dark ink, appearing to be 'J M G TAYLOR'.

J M G TAYLOR

FROM: M A BOLTON
DATE: 27 FEBRUARY 1989

- 1. MR MCINTYRE
- 2. CHANCELLOR

Jm
28/2

- cc Chief Secretary
- Financial Secretary
- Paymaster General
- Economic Secretary
- Sir P Middleton
- Mr Anson
- Mr Byatt
- Mr Scholar
- Mr Culpin
- Mr Sedgwick
- Mrs Lomax
- Miss Peirson
- Mr Matthews
- Mr Mowl
- Mr Gilhooly
- Mr Speedy
- Mrs Chaplin
- Mr Tyrie
- Mr Call

Thank. This will cause for (lower off-sets) same to the relevant section of the budget.

Mr I Stewart - IR
PS/IR

COST OF ABOLITION OF THE RETIREMENT PENSION EARNINGS RULE

You wanted to know whether the 1990-91 PSDR figure given in my submission of 24 February allows for employers' NIC revenue.

2. On the assumptions used in calculating the figures, there would be no change in employers' NICs. We have assumed that, when the earnings rule is abolished, 80 per cent of those currently deferring receipt of their pension will choose to receive it. This will not affect the amount of employers' NICs due on their earned income. Changes in revenue from employers' NICs could only come about through behavioural changes (more pensioners choosing to work, those currently working choosing to work different hours, etc) and, as I suggested in my earlier submission, we and DSS think these effects are too uncertain to quantify.

Michael Bolton

M A BOLTON



FROM: J M G TAYLOR

DATE: 27 February 1989

bf. 2/3

MR ISAAC - Inland Revenue

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Sir T Burns
Dame A Mueller
Mr Anson
Mr L HarrisSir A Battishill - IR
Mr Isaac - IR
Mr Corlett - IR
Mr Kuczys - IR
PS/IR

PENSIONS REFORM: PUBLIC SERVICE

The Chancellor was most grateful for your note of 24 February.

2. He would welcome Sir Peter Middleton's advice, as soon as possible.

A handwritten signature in dark ink, appearing to be 'J M G Taylor'.

J M G TAYLOR



FROM: J M G TAYLOR
DATE: 28 February 1989

PMF

NOTE FOR THE RECORD

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Dame A Mueller
Mr Scholar
Mr Culpin
Mr Luce
Mr L Harris
Mr Dixon
Mr Gilhooly
Mr Macpherson
Mr Rayson
Miss Simpson
Mrs Chaplin
Mr Tyrie
Mr Call

Sir A Battishill - IR
Mr Isaac - IR
Mr Corlett - IR
Mr Kuczys - IR
Mr Hinton - IR

PENSIONS REFORM: MEETING WITH THE LORD CHANCELLOR

The Chancellor had a bilateral meeting this evening with Lord Mackay.

2. The Chancellor began by outlining the changes made to pensions in the 1987 Budget. One of these changes had been to set the minimum period of years for a fast accrual pension scheme at 20. The general convention was that when there was a change in the tax treatment of private sector schemes through the Finance Act, statutory schemes would make parallel changes. This was because it was clearly wrong to affect public and private sector schemes in different ways. However, this particular change was not introduced for the judicial scheme. As a result, senior



judges still enjoyed tax relief on 15 year fast accrual schemes. It would be right to take action now to bring the judicial scheme into line with the rest.

3. Continuing, the Chancellor said this had come to light because of the further changes he was planning to make in this year's Budget. He described those changes, and explained the rationale behind them. The changes meant that a cash cap would need to be imposed on the amount of pension (and lump sum) which would attract tax relief. He had decided to set this limit, in terms of the related salary, at £60,000.

4. The Chancellor said that he wanted to alert Lord Mackay now to the proposed changes. The judicial scheme would require primary legislation to bring it into line. The changes would then more immediately affect judges than any other part of the public service, because of the relatively high level of remuneration at which judges were appointed. Like the 1987 changes, they would not be retrospective - they would only affect new entrance to pension schemes. In that sense it would be helpful to Lord Mackay in his efforts to encourage career progression amongst judges. The liberalisation involved would also allow Lord Mackay to continue to offer 15 year fast accrual to judges, but without tax relief. In the sense that this fast relief would otherwise be withdrawn, that could also be presented as a benefit. There might, also, be some scope for changing the rates of accrual under the judges scheme in order to get the best value out of the available remaining tax relief.

5. The Chancellor said that he did not think that the new proposals would alter the position of those who had already accrued large pension rights under separate schemes before becoming judges. He was, in fact, proposing to increase the percentage of income which the self employed could invest in a



pension scheme. A cap would be imposed on a self employed pension. But there would be no cumulation of benefits.

6. Lord Mackay said that no one could object to the tax treatment of pensions applying equally to the public and private sectors. He would probably need to offer more pay to potential judges in order to attract them. There might also be some difficulties in the interim period before the new arrangements (and the details of e.g. top-up schemes) were bedded down. But he was content to take forward the necessary legislation. He would prefer not to remit the question of how to accommodate judges' pensions to the new rules to the TSRB; it would be desirable to sort it out bilaterally. Consideration would need to be given to the details of any top up schemes.

7. Lord Mackay said that he was responsible for the judiciary in England, Wales, and Northern Ireland. The Chancellor would, however, have to speak separately to Mr Rifkind about the Scottish judiciary. He would hope that they would be treated exactly the same way.

8. Lord Mackay, at the Chancellor's invitation, said that he would nominate one official to liaise with the Treasury and Revenue.

A handwritten signature in dark ink, appearing to be 'J M G TAYLOR'.

J M G TAYLOR



FROM: J M G TAYLOR
DATE: 28 February 1989

MR L HARRIS

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Sir P Middleton
Mr Anson
Dame A Mueller
Mr Scholar
Mr Culpin
Mrs Chaplin
Mr Tyrie
Mr Call

Sir A Battishill - IR
Mr Isaac - IR
Mr Kuczys - IR

PENSIONS: CHANGES TO TAX TREATMENT OF PUBLIC SERVICE SCHEMES

During today's bilateral with the Lord Chancellor (recorded separately) there was some discussion of the need to legislate separately (apart from the Finance Act) in order to make changes in tax provisions effective for public service pension schemes.

2. The Chancellor has asked that consideration be given to how it might be made possible to implement these changes in the future by way of the Finance Act alone. I should be grateful for advice, in due course.

A handwritten signature in black ink, appearing to be 'J M G Taylor'.

J M G TAYLOR



FROM: J M G TAYLOR
DATE: 28 February 1989

NOTE FOR THE RECORD

cc Chief Secretary
Financial Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Dame A Mueller
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Mr Culpin
Mr Luce
Mr L Harris
Mr Dixon
Mr Gilhooly
Mr Macpherson
Mr Rayson
Miss Simpson
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Mr Call

Sir A Battishill - IR
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Mr Hinton - IR

PENSIONS REFORM: MEETING WITH THE LORD CHANCELLOR

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A handwritten signature in dark ink, appearing to be 'J M G TAYLOR'.

J M G TAYLOR



Ch.

Lord Chancellor's responsibilities

The view of Tsg. officials is that although Ld. Mackay is not formally responsible for judges in Scot. + N. Ireland, the Courts Bill could be used as a vehicle to cover pension changes for all judges. However, they cannot confirm this without talking to the Ld. Chamberlain's Department, which of course they cannot do at this stage.

It might be an idea for you to ask Ld. Mackay whether he thinks you should separately speak to Mr King + the Lord Advocate (or perhaps whether he will do so himself). It might also

/over

be a good idea for him to name
say two officials with whom one people
could discuss.

JF
.. 28/2

P.S. Do you want me to sit in,
or will you see Lt. Mackey
alone?

JF
.. 28/2
Do not sit in.
M.



Phyp

Treasury Chambers, Parliament Street, SW1P 3AG
01-270 3000

1 March 1989

Paul Stockton Esq
Private Secretary to the
Lord Chancellor
Lord Chancellor's Department
House of Lords
LONDON
SW1

Dear Paul

CHANCELLOR'S MEETING WITH THE LORD CHANCELLOR

...

I attach an internal note of yesterday's meeting. I should be most grateful if you could treat this copy as strictly personal.

Yours sincerely
J M G Taylor

J M G TAYLOR
Private Secretary

MP



FROM: J M G TAYLOR

DATE: 1 March 1989

Spare

MR BOLTON

- cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Mr Byatt
Mr Scholar
Mr Culpin
Mr Sedgwick
Mr McIntyre
Mrs Lomax
Miss Peirson
Mr Matthews
Mr Mowl
Miss Wallace
Mr Gilhooly
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call
- Mr I Stewart IR
PS/IR

COST OF ABOLITION OF THE RETIREMENT PENSION EARNINGS RULE

The Chancellor was grateful for your note of 27 February.

2. He has commented that this will call for some amendment (not difficult) to the relevant section of the draft Budget speech.

A handwritten signature in dark ink, appearing to be 'J M G Taylor'.

J M G TAYLOR



FROM: J M G TAYLOR

DATE: 1 March 1989

MR BOLTON

- cc PS/Chief Secretary
- PS/Financial Secretary
- PS/Paymaster General
- PS/Economic Secretary
- Sir P Middleton
- Mr Anson
- Mr Byatt
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- Mr Culpin
- Mr Sedgwick
- Mr McIntyre
- Mrs Lomax
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- Miss Wallace
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J M G TAYLOR



Inland Revenue

BUDGET CONFIDENTIAL

Savings and
Investment Division
Somerset House

*This note has been seen
in draft by FP, and
reflects their comments*

FROM: J D HINTON
DATE: 1 MARCH 1989

1. MR KUCZYS ✓
2. FINANCIAL SECRETARY ✓

*JK
1/3*

PERSONAL PENSIONS: PERSONALISED FUNDS

1. In his note of 25 January to the Chancellor, Mr Culpin suggested that it should be made possible for people in personal pension schemes to have much more control over how their contributions are invested. The thought was that a move in this direction would enlarge freedom of choice, and help expand both individual responsibility and wider share ownership.

2. In his response of 26 January, Mr Taylor recorded the Chancellor's view that:

cc **Chancellor of the Exchequer**
Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Mr Anson
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Matthews
Mr MacPherson
Mrs Chaplin
Mr Tyrie
Mr Call

Sir A Battishill
Mr Isaac
Mr Painter
Mr Bush
Mr Corlett
Mr Lusk
Mr Kuczys
Mr Hinton
Mr Cooke
Mr Gilbert
PS/IR

"He thinks it is well worth pushing whether we can do anything more to allow people to run their own pension schemes. He would be grateful if you could take this forward."

3. The purpose of this note is to report on developments.

Background

4. Before personal pensions were introduced there was very little choice available to people with individual pension arrangements. They were limited to retirement annuity contracts available only from insurance companies and certain friendly societies. The investment choice under those contracts was generally restricted to 'with profits' or 'unit linked' policies - although some contracts did allow people to switch between different funds. A very few allowed greater individual say in investment - but at a price, and only for high earners.

5. Personal pensions, which have been available since last July, widened the investment choice. People are no longer limited to the traditional providers but can now also choose schemes run by banks, building societies and unit trust groups. But in practice, with the exception of unit trusts, these new choices have been more apparent than real because banks and building societies can at present only offer deposit based pensions (not a sensible long-term "investment").

Providers of personalised funds

6. We were approached in Autumn 1987 by the Committee of London and Scottish Bankers for approval for bank subsidiary companies to be allowed to offer discretionary fund management schemes. The banks wanted to market schemes under which the funds would be invested (at the fund manager's discretion) within a broad investment strategy directed by the client. In principle, this was

unobjectionable. Indeed, we were content (subject to the safeguards mentioned later in this note) to go further and allow the client to choose the specific investment.

7. Agreement to this approach would have involved allowing bank subsidiary companies to set up personal pension schemes - which can be done by Treasury Order. This power has already been exercised to allow pension companies owned by building societies to provide personal pensions.

8. But, at the time, the DTI (at official level) were not keen on widening the range of personal pension providers in this narrow way. Their view was that, for level playing field reasons, if banks were to be allowed to operate "personalised" funds, the same facility should be available to all FIMBRA and IMRO members. This was not something we could agree to - because of the unacceptable supervisory costs that we would face in policing a multitude of, probably, very small schemes.

9. Nonetheless, we have never accepted the DTI view about the effect of allowing in bank subsidiaries. We have always seen the issues as being involved with the range of personal pension investment choice - rather than with who can offer personal pensions. For administrative reasons, we need to restrict the latter to a manageable range of institutions. But - as with personal equity plans - their role need be little more than that of intermediary. There is no tax reason why the personal pension scheme member should not instruct the institution as to how his money is invested.

10. So, following the Chancellor's note, we have again pressed the DTI on this subject. Although they continue to express reservations, they do recognise the pressures that exist and will not obstruct the change we had proposed. This effectively gives the green light to an announcement in the Budget.

The investment choice

11. With this first hurdle overcome, the next issue is what parameters should be set to the investment choice. In contrast to occupational schemes, and particularly small self-administered schemes for controlling directors, we adopt a very much 'hands off' approach towards the administration of personal pensions. The Superannuation Funds Office would just not have sufficient staff resources to police personalised funds if they were to operate in the same way as small self-administered schemes.

12. There will therefore need to be certain safeguards to prevent exploitation of the tax reliefs. In particular we believe that it will be necessary to:

- i. ban loanbacks and self-investment;
- ii. ban transactions with the scheme member or other connected persons;
- iii. ban some other investments which could offer personal advantages, such as holiday homes, yachts, luxury cars etc.

This is all familiar stuff from our consideration of controlling director schemes.

13. But this leads on to the question of what personalised funds should be allowed to invest in. It will be desirable to give some clear guidelines - perhaps in the Budget Day press release. Otherwise we can expect to come under pressure at the margins as people test how far we are prepared to go.

14. To be consistent with the twin objectives of

- a. making people more responsible for their investment and widening share ownership, and

- b. the need to protect the tax reliefs from exploitation,

we recommend keeping the investment choice to:

- quoted UK stocks and shares (including shares on the Unlisted Securities Market);
- quoted overseas stocks and shares;
- unit trusts;
- insurance company managed funds;
- deposit accounts.

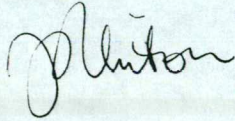
Legislation

15. No primary legislation will be required to give effect to this policy. The extension to bank subsidiaries can be done under existing legislation through a Treasury Order. And the investment controls could be implemented through our discretionary approval powers. The way would then be open for building society subsidiaries, if they wished, to offer the same facility.

Summary

16. The DTI are no longer barring the way to greater investment flexibility in personal pensions. We will write after the Budget to the representative bodies of the various personal pension providers. The only group interested, so far, in personalised funds is the Committee of London and Scottish Banks. We will write individually to tell them we propose to amend the range of authorised providers to allow bank subsidiary companies to offer discretionary fund management schemes.

17. We would, meanwhile, be pleased to know whether you are content for us to proceed on this basis and, in particular, for the range of investment choice to be as described at paragraph 14.

A handwritten signature in cursive script, appearing to read "J D Hinton".

J D HINTON

BUDGET CONFIDENTIAL

From: SIR PETER MIDDLETON

Date: 1 March 1989

CHANCELLOR

cc

- Chief Secretary
- Financial Secretary
- Paymaster General
- Sir T Burns
- Mr Anson
- Dame A Mueller
- Mr Wicks
- Mr Hardcastle
- Mr Byatt
- Mr Scholar
- Mr Culpin
- Mr L Harris
- Mr Luce
- Mr Riley
- Mr Sedgwick
- Mr J Dixon
- Mr Gilhooly
- Mr Macpherson
- Mr Rayson
- Miss Simpson
- Mrs Chaplin
- Mr Tyrie
- Mr Call

- Inland Revenue
- Sir A Battishill
- Mr Beighton
- Mr Isaac
- Mr Painter
- Mr G Bush
- Mr Corlett
- Mr Kuczys
- Mr Hinton

- Customs and Excise
- Mr Jefferson Smith

Thanks. Let us go for Mr's 2-prong approach, with 1 June as a second prong. Incentive, not a wage, not for simple & better to fight in FA so that it overcomes situation. Section 500 (set x n Mr Rayson's note) as is budget already approved scheme (set y n Mr Rayson's note)?

PENSIONS

One is always a little uneasy about delays in implementation. The most amazing ingenuity can be applied to absorb tax relief. But I do think that Mr Isaac's suggested device will keep forestalling activity to a minimum.

2. I therefore suggest that we should go for a short delay. As ... the note below makes clear, our pensions experts would feel safer with the Royal Assent. But I would prefer on general grounds a shorter delay. If you are prepared to push your colleagues to release legal resources to give priority to this above other things, and put up with a certain amount of complaint about lack of prior consultation on implementation, I think you could go for 1 June. 1 May is too soon.

3. You were in any case minded to let the Ministers most affected know on a personal basis of your intentions.

A handwritten signature in blue ink, appearing to be 'P E Middleton', written in a cursive style.

P E MIDDLETON

FROM: D W RAYSON
 DATE: 28 FEBRUARY 1989

- Handwritten: 28.2.89*
1. MR L J HARRIS
 2. SIR P MIDDLETON
 3. CHANCELLOR
- Handwritten: 28/2.*

cc: Treasury

Chief Secretary
 Financial Secretary
 Paymaster General
 Sir T Burns
 Mr Anson
 Dame Anne Mueller
 Mr Wicks
 Mr Hardcastle
 Mr Byatt
 Mr Scholar
 Mr Culpin
 Mr Luce
 Mr Riley
 Mr P Sedgwick
 Mr Dixon
 Mr Gilhooly
 Mr Macpherson
 Miss J C Simpson
 Mrs Chaplin
 Mr Tyrie
 Mr Call

Inland Revenue

Sir A Battishill
 Mr Beighton
 Mr Isaac
 Mr Painter
 Mr G Bush
 Mr Corlett
 Mr Kuczys
 Mr Hinton

Customs and Excise

Mr Jefferson Smith

APPLYING THE PENSIONS CAP IN PUBLIC SERVICE SCHEMES

1. You asked about the logistics of amending all the public service pension schemes and how much breathing space might be reasonable after the budget for the public service schemes to apply the cap. Mr Issac's note of 24 February covers much of the ground.

Statutory Basis

2. Only the judges scheme requires primary legislation to reflect the budget changes. The terms of the other main public service schemes are in Statutory or Prerogative Instruments.

Changes could take effect for new members of the schemes once new Instruments were made. But, in most cases, the Instruments cannot introduce detrimental changes retro-actively unless the individuals concerned consent (which is unlikely!). Thus, unless the Finance Act overrides Statutory scheme rules, which could well go beyond the normal scope of a Finance Bill, amended Statutory or Prerogative Instruments will need to be in place before the cap is applied.

Revising Scheme Rules

3. Apart from the Civil Service pension scheme, which is the Treasury's responsibility, the initiative for amending most of the other main public service scheme rules rests with other Ministers. There is, however, no Ministerial direction in the UKAEA or Church of England schemes. Scheme rules are complex and departmental legal advisers will need time to draft watertight amending regulations, but we ourselves do not foresee particular difficulties in applying the cap to existing schemes from July, or even June. However, departments cannot anticipate the Budget statement and, unless you authorise us to consult Departments in advance, we cannot be certain about the difficulties they may have or of the availability of their lawyers to draft scheme amendments.

4. The Civil Service scheme is governed by administrative rules. Drafting amendments to apply the cap looks straightforward and is being put in hand.

Procedure

5. There is no procedural problem for the Civil Service. Changes in the rules are made by Order which is laid before Parliament but which is subject to neither affirmative nor negative resolution procedure and can, if necessary, come into effect immediately.

BUDGET CONFIDENTIAL

6. The NHS, teachers, police and fire service schemes are governed by Statutory Instrument, subject to negative resolution. In normal circumstances, once amendments have been drafted by departmental lawyers, time is needed for Instruments to be printed, signed by the appropriate Minister and two Lords Commissioners and laid before the House for 21 days before coming into effect. The procedure could be short cut.

7. For the Armed Forces, the pension arrangements are by Order in Council (Navy), Royal Warrant (Army), and Queens Regulations (RAF). An amendment to the Order in Council would need to await a suitable Privy Council meeting (normally held monthly, we understand). The Palace would need notice for amendments of the Royal Warrant or Queens Regulations. We are told that it would be prudent not to short cut the procedure for the Prerogative Instruments.

8. For Judges, the Courts Bill would be the vehicle for change. Subject to the Lord Chancellor's advice, it might be possible to make the change retrospective if he was prepared to announce in advance that it would be effective from an earlier date.

9. The Energy Secretary would need to ensure that the UKAEA submitted amended scheme rules for his approval and Treasury consent.

10. In the Church of England, the Archbishops of Canterbury and York have stipends of around £30,000 pa. But the clergy's maximum pensions and lump sums are expressed as flat rates, apparently unrelated directly to salary. From April, the Archbishops' maximum pensions and lump sums will be just over £11,000 and £15,000. The Church's pension arrangements are governed by the Church of England (Pensions) Measure 1988, made by the General Synod. It seems the amendments could only be made in a further Measure by the Synod. However, since benefits are flat rates within normal Revenue limits and are not directly related to salary, and since it is unfunded, the scheme would not appear to be affected by the application of the cap (which might, over time, bite at lower real salary levels). No scheme amendment therefore seems necessary.

11. There should be no problem for the smaller schemes run by non-departmental public bodies which operate by analogy with one of the main schemes. Changes will apply automatically at the same time as changes in the parent scheme.

12. The rules of the Local Government approved schemes will be overridden by the Finance Act, and are therefore in the same position as those for private sector schemes.

Scotland and N. Ireland

13. In some cases (NHS, teachers, police, fire and judges), there are separate arrangements for England and Wales, Scotland and N. Ireland. For NHS, teachers, police and fire, regulations for Scotland and N. Ireland follow those of England and Wales. For judges, we understand that Courts Bill should be able to apply the cap to judges in Scotland and N. Ireland, but we cannot be sure of this without consulting the Lord Chancellor's Department on the specific point.

Consultation

14. There is a statutory requirement for formal consultation with employing authorities and staff interests in most of the public services about changes to pension schemes. This could be done quickly: it should amount to no more than informing them of the change, rather than negotiating its terms or discussing its merits.

Board Members

15. Chairmen and members appointed by Ministers to nationalised industry and other public boards after Budget day would effectively be in "new" statutory schemes which would not be caught by the Finance Act. But their terms of appointment are within Ministers' control, so there should be no difficulty about applying the cap to arrangements made after Budget day. The demand will be for compensatory topping-up schemes with grossing up, but arrangements can be agreed ad hoc in the light of private sector practice and sponsoring Ministers' recommendations.

General Considerations

16. Mr Isaac's two pronged approach safeguards against undue manipulation and should avoid transitional problems for the public services. There is no scope for abuse in the public services: even Board Members' arrangements are in the control of Ministers. It is, of course, highly desirable for the public services to be in step with the timing of change for the private sector.

17. For the private sector, the cap is applied automatically because the Finance Act overrides scheme rules. Private sector employers therefore have no action to take immediately. The public services are different because scheme amendments are needed. An orderly approach to scheme amendments is highly desirable to ensure that they are properly conceived and to avoid undue shortcutting of the Statutory and Prerogative Instrument procedures. We know that pressures on some Departments' lawyers have meant long delays in implementing changes in scheme rules in the past (eg to bring them into line with the 1985 and 1986 Social Security Acts). And Departments may be expected to point out that their other work (eg on privatisation, education and health reforms) is already stretching their lawyers.

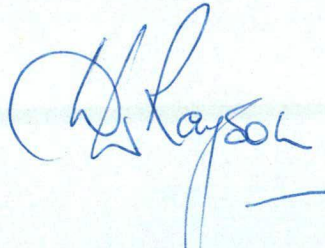
Conclusion

18. An implementation date of 6 April (one of Mr Isaac's two "natural" dates) would be impracticable. 1 May is likely to impose a burden on Departments which colleagues may resent. 1 June is a safer option, but Royal Assent (Mr Isaac's other "natural" date) may be the best compromise between the need to act without undue delay and the procedural and drafting difficulties likely to be involved.

Top-up Schemes

19. Separate amendments will be needed in due course to introduce top-up schemes, once decisions have been taken on them in the light of emerging private sector practices. Procedurally, these

will follow the same pattern as the "capping" amendments, but to avoid separate primary legislation in the case of the judges, you may wish to suggest to the Lord Chancellor that he should explore the possibility of taking enabling powers in the Courts Bill to make the changes by Statutory Instrument.



D W RAYSON
Superannuation Division



FROM: J M G TAYLOR

DATE: 2 March 1989

MR L J HARRIS

cc Mr Rayson
Mr Michie
Mr Kuczys IR

PENSIONS

The Lord Chancellor's department have nominated the following two officials to deal with the implications of the Budget proposals for the judiciary:

Mrs Nicky Oppenheimer (Grade 5) - Tel 2108649

Mr Tony Wilkinson (HEO) - Tel 2108642

A handwritten signature in black ink, appearing to be "J M G TAYLOR".

J M G TAYLOR

FROM: M A BOLTON
DATE: 2 MARCH 1989

- 1. MR MCINTYRE
- 2. CHANCELLOR

JM
2/3

- cc Chief Secretary
- Financial Secretary
- Paymaster General
- Economic Secretary
- Sir P Middleton
- Mr Anson
- Sir T Burns
- Mr Byatt
- Mr Scholar
- Mr Culpin
- Mr Riley
- Mr Sedgwick
- Mrs Lomax
- Miss Peirson
- Mr Matthews
- Mr Mowl
- Mr Gilhooly
- Miss Simpson
- Mr Speedy
- Mrs Chaplin
- Mr Tyrie
- Mr Call

- Mr Kuczys (IR)
- Mr I Stewart (IR)
- PS/IR

Ami

ABOLITION OF RETIREMENT PENSIONERS EARNINGS RULE: IMPLEMENTATION

Mr McIntyre and I met with DSS officials to discuss the mechanics of abolishing the earnings rule. No new issues have arisen which require Treasury Ministers' involvement. This report is for information only.

2. DSS confirmed that the earnings rule could be abolished from the start of October. They could then process all claims by the end of the financial year. They would undertake to process as many as possible by Christmas, and in any case would backdate claims to the start of October.

3. The procedure for implementing the abolition of the earnings rule would start around 1 August*, when the DSS Newcastle office would send out information to all those currently deferring receipt of their pension. Most individual claims would be dealt with at local office level, with the Newcastle office responsible

* i.e. when the Bill has been enacted.

for the remainder. DSS gave rough figures for the extra staff requirements (350 staff units for 6 months) and administrative cost (£5 million in 1989-90 only) of the implementation, but these will need to be revised in view of the new caseload figure.

Consequentialia

4. Our attention was drawn to several anomalies which would arise as a result of the abolition of the earnings rule, and which would require amendments to current social security legislation. The main problem involves those contracted out of SERPS. At present, the Government is required to pay this group their nominal SERPS entitlement minus the guaranteed minimum pension they receive from their occupational schemes. If the law were left unchanged, those choosing to work beyond pension age but not in receipt of the guaranteed minimum pension would be entitled to receive SERPS in full; manifestly unfair, as they have opted out of the state scheme. DSS therefore propose to include a provision in the Bill to avoid contracted out people being paid SERPS in these circumstances.

5. In addition, some changes in current regulations on overlapping benefits would be necessary, for example to prevent people from claiming both retirement pension and unemployment benefit/sickness benefit. Again, DSS would make the necessary changes in the Bill currently before Parliament.

Michael Bolton

M A BOLTON



Inland Revenue

Savings and
Investment Division
Somerset HouseFROM: A W KUCZYS
2 MARCH 1989

Ch: I had already minuted out (behind), when you asked today (held behind) whether the FA 1988 will be the vehicle for change this year, as it is for the LA schemes. This note is a response to my first minute, but I think it also deals with the more immediate question. I fear it is a bit late. 2/3

PENSIONS: CHANGES TO TAX TREATMENT OF PUBLIC SERVICE SCHEMES

1. Mr Taylor's note of 28 February asks you for advice, in due course, on how it might be possible to make future changes in tax provisions effective for public service pension schemes through the Finance Act, rather than through separate legislation.

The problem

2. On the face of it, it is very odd that we apparently cannot do what the Chancellor suggests. The reason is that we will not, in the Finance Act, be changing the tax treatment of pension schemes! That treatment will remain, as now:

- tax relief for employer's and employee's contributions (if applicable)

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Sir P Middleton
Mr Anson
Dame A Mueller
Mr Scholar
Mr Culpin
Mrs Chaplin
Mr Tyrie
Mr Call

Sir A Battishill
Mr Isaac
Mr Corlett
Mr Cleave
Mr Kuczys
Mr Hinton
PS/IR

- freedom from any benefit in kind charge on employees
- tax-free build up of funds (if applicable)
- tax-free lump sum.

3. This treatment applies to:

- a. private sector schemes, and the local authorities' scheme, which are approved by the Board of Inland Revenue; and
- b. public sector schemes set up under statute.

It does not apply to any other schemes - eg the new unapproved "top-up" schemes.

4. The key is approval. The Taxes Act gives the Board the power to approve schemes for tax purposes. What the Chancellor will be doing in the Budget is changing the rules for tax approval. He will not be changing the tax consequences of approval (which would, arguably, be a Green Paper matter).

5. We could, following the Budget, withdraw approval from all existing schemes whose rules would permit them to pay a pension above the new cap to a member joining after Budget Day, and then invite them all to revise their rules and re-apply for approval. But that would be an administrative nightmare for pension schemes and for us.

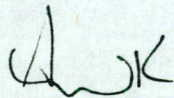
6. Instead, in 1987 Parliamentary Counsel provided for scheme rules to be over-ridden by the Finance Act (with schemes having the option - which none took - of keeping their rules unchanged, but losing tax approval). Since this was the most convenient way of implementing changes in the requirements for tax approval, and since the power to approve a scheme is given to the Board in the Taxes Act, Counsel agreed that the Finance Bill was an appropriate vehicle.

7. But this will not work for statutory schemes. They get the same tax treatment; but it is automatic, not contingent on Inland Revenue approval. The Board has no power to approve them, or withdraw approval. So changing the rules of the schemes is a matter for their own legislation, not the Finance Bill.

Further work

8. I will pursue this question again with Parliamentary Counsel, to explore whether a way round can be found. But, if the Chancellor agrees, I propose not to do so until current pressures on Counsel, in completing the drafting of the Finance Bill, have subsided - in other words, not for a month or so. We will have to follow the 1987 precedent for this year's Budget changes.

9. Meanwhile, as you pointed out in an earlier note, there is one change we should press for. That is, it would be most helpful if the Lord Chancellor's Department could give themselves a power, in their forthcoming Bill, to make future changes in the rules of the judges' scheme by secondary legislation, thus bringing the judges into line with all other public service schemes.



A W KUCZYS



FROM: J M G TAYLOR

DATE: 2 March 1989

MR L J HARRIS

cc Mr Rayson
Mr Michie
Mr Kuczys IR

PENSIONS

The Lord Chancellor's department have nominated the following two officials to deal with the implications of the Budget proposals for the judiciary:

Mrs Nicky Oppenheimer (Grade 5) - Tel 2108649

Mr Tony Wilkinson (HEO) - Tel 2108642

A handwritten signature in black ink, appearing to be 'JMG'.

J M G TAYLOR



FROM: J M G TAYLOR

DATE: 2 March 1989

PS/SIR P MIDDLETON

cc Chief Secretary
 Financial Secretary
 Paymaster General
 Sir T Burns
 Mr Anson
 Dame A Mueller
 Mr Wicks
 Mr Hardcastle
 Mr Byatt
 Mr Scholar
 Mr Culpin
 Mr L Harris
 Mr Luce
 Mr Riley
 Mr Sedgwick
 Mr J Dixon
 Mr Gilhooly
 Mr Macpherson
 Mr Rayson
 Miss Simpson
 Mrs Chaplin
 Mr Tyrie
 Mr Call

Sir A Battishill - iR
 Mr Beighton - IR
 Mr Isaac - iR
 Mr Painter - IR
 Mr Bush - IR
 Mr Corlett - IR
 Mr Kuczys - IR
 Mr Hinton

Mr Jefferson Smith - C&E

PENSIONS

The Chancellor was grateful for Sir Peter Middleton's note of 1 March.

2. He has concluded in favour of Mr Isaac's two pronged approach ie. the new rules would apply from Budget day to new schemes set up on or after Budget day; and for new members of existing pension schemes the new rules would apply from a later appointed day. He has decided in favour of 1 June as the second, appointed, day.

✓
 [MJK responded obligingly
 to this in his note of
 2/3 to L2 Harris -
 NFA]



3. He has noted the implication in paragraph 2 of Mr Rayson's note of 28 February that the need for amended Statutory or Prerogative Instruments might be dispensed with if the Finance Act overrode Statutory scheme rules. He acknowledges that this could well go beyond the normal scope of a Finance Bill, but he notes that (paragraph 12 of Mr Rayson's note) the rules of the Local Government approved schemes will be overridden by it. He suggests that, if possible, it would be simpler and better to draft the Bill so that it overrode Statutory public sector scheme rules, and he would be grateful for urgent advice.

A handwritten signature in black ink, appearing to be 'JMG'.

J M G TAYLOR



FROM: J M G TAYLOR
DATE: 3 March 1989

MR KUCZYS

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Dame A Mueller
Mr Anson
Mr Wicks
Mr Scholar
Mr Culpin
Mr L Harris

Sir A Battishill - IR
Mr Isaac - IR
Mr Corlett - IR
Mr Bush - IR
Mr Kuczys - IR
Mr Hinton
PS/IR

PENSIONS: LETTER FROM THE GOVERNOR

The Chancellor was grateful for your note of 2 March.

2. He has commented that the general position is satisfactory. However, the judges pose a real problem. Your paragraph 7 explains that it is unlikely that they would get much better than normal (40 year) accrual under their final scheme. The Chancellor understands why this is so. But it will be quite impossible, on this basis, to get high earning barristers to become judges unless judges' salaries are to be considerably increased - which would pose all sorts of TSRB-type problems.

3. He would be grateful if you could perhaps find some way of cracking this nut.

A handwritten signature in dark ink, appearing to be 'JMG'.

J M G TAYLOR



RS

FROM: R C M SATCHWELL

DATE: 3 March 1989

MR HINTON - IR

cc

PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Mr Scholar
Mr Culpin
Mr Gilhooly
Mr Matthews
Mr Macpherson
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Kuczys - IR
PS/IR

PERSONAL PENSIONS: PERSONALISED FUNDS

The Financial Secretary was grateful for your minute of 1 March. He is content for you to proceed along the lines set out in para 16 of your minute; and agrees with your recommended restrictions on the range of investment choice.

R.C.M.S.

R C M SATCHWELL
Private Secretary

BUDGET CONFIDENTIAL

FROM: L J HARRIS

DATE: 3 MARCH 1989

MR J M G TAYLOR

cc PS/Chief Secretary
 PS/Financial Secretary
 PS/Paymaster General
 Sir P Middleton
 Mr Anson
 Dame A Mueller
 Mr Scholar
 Mr Culpin
 Mrs Chaplin
 Mr Tyrie
 Mr Call

CL/ Disappointing -
 Content to proceed
 per para 3, in the circs?

Sir A Battishill - IR
 Mr Isaac - IR
 Mr Kuczys - IR

PENSIONS: CHANGES TO TAX TREATMENT OF PUBLIC SERVICE SCHEMES

Your minute of 28 February recorded the Chancellor's request that consideration should be given to ways of implementing changes in the tax treatment of public service pension schemes in the future by means of the Finance Act alone. Your further note of 2 March to Mr Sargent conveyed the Chancellor's suggestion that it would be preferable for this year's Finance Bill to be drafted, if possible, so as to override the rules of both the statutory and the public sector schemes.

2. You will by now have seen Mr Kuczys' note of 2 March explaining the peculiar technical difficulty that public service schemes do not receive approval from the Revenue. Their rules are made by or under separate legislation, and any changes would normally have to be made by the same route. As your note of 2 March recognises, attempting to make changes to the structure of the statutory schemes through the Finance Bill would go well beyond its normal scope. This is an area where the main expertise lies with the Revenue, Parliamentary Counsel, and the House authorities, but I understand that Counsel sees considerable difficulties about using the Bill in the way proposed. This is a pity, because from our point of view it would be much cleaner and simpler to be able to make the changes in a single piece of legislation than to have to engineer amendments to a wide range of

schemes over which we have only indirect control, but I am afraid that for the moment we have to go along with Mr Kuczys' analysis.

3. The Revenue will be advising separately on whether anything can be done at this late stage to change this year's Bill, but it looks very much as though there is no quick or easy way round the problem. Subject to the Revenue's further advice, I suggest that we follow the 1987 precedent this time round, and then arrange for the general issue to be taken forward with Parliamentary Counsel and the Treasury Solicitor, and then, once a possible approach has been worked out, for me to arrange a discussion with other interested departments in our interdepartmental pensions group.

4. Meanwhile, we are in touch with the Lord Chancellor's officials on the amendments which will be needed to the Judicial Pensions Act to implement the changes, and we will discuss the possibility of taking powers to make future changes to the judges scheme by way of secondary legislation in that context.

C Genwardi

PP L J HARRIS



FROM: J M G TAYLOR
DATE: 3 March 1989

MR KUCZYS

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Sir T Burns
Dame A Mueller
Mr Anson
Mr Wicks
Mr Scholar
Mr Culpin
Mr L Harris

Sir A Battishill - IR
Mr Isaac - IR
Mr Corlett - IR
Mr Bush - IR
Mr Kuczys - IR
Mr Hinton
PS/IR

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3. He would be grateful if you could perhaps find some way of cracking this nut.

A handwritten signature in dark ink, appearing to be 'J M G Taylor'.

J M G TAYLOR



FROM: J M G TAYLOR

DATE: 3 March 1989

A handwritten signature in dark ink, appearing to be 'JMG'.

MR BOLTON

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Mr Anson
Sir T Burns
Mr Byatt
Mr Scholar
Mr Culpin
Mr Riley
Mr Sedgwick
Mrs Lomax
Miss Peirson
Mr Matthews
Mr Mowl
Mr Gilhooly
Mr McIntyre
Miss Simpson
Mr Speedy
Mrs Chaplin
Mr Tyrie
Mr Call

Mr Kuczys - IR
Mr I Stewart - IR
PS/IR

ABOLITION OF RETIREMENT PENSIONERS EARNINGS RULE: IMPLEMENTATION

The Chancellor was grateful for your note of 2 March.

A handwritten signature in dark ink, appearing to be 'JMG'.

J M G TAYLOR



Inland Revenue

Savings and Investment Division
Somerset House

FROM: A W KUCZYS

3 MARCH 1989

- 1. MR CORLETT *AWK 3/3*
- 2. FINANCIAL SECRETARY

PENSIONS: OUTSTANDING POINTS

1. This note sweeps up four points still outstanding on the pensions package in the Budget:

- start dates
- minor changes
- tax regime for top-up schemes
- freestanding AVCs.

We should be grateful for confirmation that you are content with the outcome on each item.

cc Chancellor of the Exchequer
 Chief Secretary
 Paymaster General
 Economic Secretary
 Sir P Middleton
 Sir T Burns
 Dame A Mueller
 Mr Scholar
 Mr Culpin
 Mr L Harris
 Mr McIntyre
 Mr Dixon
 Mr Gilhooley
 Mr Macpherson
 Mrs Chaplin
 Mr Tyrie

Sir A Battishill
 Mr Isaac
 Mr Corlett
 Mr Bush
 Mr Lusk
 Mr Kuczys
 Mr Hinton
 Mr Cooke
 PS/IR

Ch & clear
 A v helpful note. I have not included the (voluminous!) back pages, but can let you have any you want on Monday

AA

*Inland. And
 Smith v. H. G. Smith
 solution. The AVC
 simplification
 done with
 IR minis
 a section
 in the
 Budget
 speech*

A. START DATES

Papers: Mr Isaac, 24 February "Pensions Reform: Public Service"
Mr Kuczys, 27 February "Pensions: letter from the Governor"
Mr Rayson, 28 February "Applying the pensions cap in public service schemes"
Sir P Middleton, 1 March "Pensions"

2. For occupational pension schemes we originally proposed that the main changes - the £60,000 cap and the simplifications in our rules - should apply to new schemes and new members of existing schemes from Budget Day. This followed the 1987 precedent.

3. Following Mr Isaac's and Sir P Middleton's notes, the Chancellor has now decided (Mr Taylor's note of 2 March) that the start dates should be:

- for new schemes, Budget Day
- for new members of existing schemes, 1 June.

We have instructed Parliamentary Counsel accordingly.

4. For personal pensions the new contribution limits will apply to contributions paid from 6 April. The freedom to take charge of your own investments in a personal pension requires us:

- a. to issue detailed guidance on what investments are permitted (see Mr Hinton's note of 1 March); and
- b. to make (Treasury) Regulations permitting bank subsidiaries to offer "personalised funds" (in addition to the deposit based personal pensions they can already offer).

In practice this is likely to be sometime in May.

5. Other changes, including the freedom to set up a top-up scheme, and the new tax charge on "excess" AVCs (see below), will operate from Royal Assent to the Finance Act.

B. MINOR CHANGES

Papers: Mr Gilbert, 9 January
Mr Taylor, 13 January
Mr Satchwell, 19 February

6. You agreed that we should (a) change the way the personal pensions lump sum is calculated; and, if there was sufficient Finance Bill space:

(b) extend provisional approval of personal pension schemes indefinitely; and

(c) deal with a technical anomaly affecting pre-1970 closed schemes.

7. We can now report back that Parliamentary Counsel has dealt with (a) and (b). However, (c) proved less straightforward than we had thought, when it came to drafting. In view of the other pressures on Counsel this year, therefore, we have not pursued (c). We can always come back to it another year.

C. TAX TREATMENT OF TOP-UP SCHEMES

Papers: Mr Kuczys, 9 February "Tax Regime for non-approved (top-up) pensions"

Record of the 4th Overview meeting (13 February).

8. At the Overview meeting on 13 February, it was agreed that

a. in the case of funded schemes, the employer should get a deduction and the employee should pay tax at the time contributions are paid; but

b. in unfunded arrangements, the employer should get a deduction and the employee should pay tax when benefits are paid.

Legislation is necessary to secure b., whereas a. will generally follow from existing tax rules.

9. It was recognised, however, that it might be possible for an employer to make a reserve against future liabilities which was specific enough for him to obtain a deduction at that point; and yet not specific to named employees, so that their tax liability could not be quantified - or imposed. This would represent a degree of "front-end" relief, which in turn would involve complicated anti-avoidance provisions.

10. It was left to you to consider the extent to which we should rely on existing case law or should introduce new statutory provisions; and we undertook to do further work on this. Our conclusion is that a further statutory provision is needed, but that it can be quite simple. It will say that no Schedule D deduction will be due except to the extent that a Schedule E charge arises. (We have lifted this idea from the legislation in preparation for putting Schedule E on a "receipts" basis, where some similar questions arise).

11. We have asked Parliamentary Counsel to include this additional provision in the legislation. It will avoid the need for the fallback suggested by Mr Isaac, under which the employer would pay a generalised Schedule E charge on behalf of his employees. I should be grateful to know if you are content with this outcome.

12. In addition, you were asked to look into the NIC position of top-up pensions. I am grateful for Mr Macpherson's help on this point. The position is:

a. Funded schemes: no employer's NICs on employer contributions; but if the employer pays more salary

for some years

(and the employee contributes) then there will be extra NICs to pay. (We can ignore employee's NICs, since top-up pensions will only arise for those well above the UEL.)

b. Unfunded schemes: so long as the employee has genuinely retired, there will be no employer (or employee) NICs on pensions paid.

13. The NIC treatment of top-up schemes will thus be less onerous than the tax treatment. And, for funded schemes, there will be an NIC advantage for non-contributory schemes (whereas in tax terms it will make no difference whether the employee or the employer pays the contributions). In view of the conclusion at the Overview meeting that there was a case for maintaining some NIC advantage, we assume that you will be content to leave this NIC result as it is.

D. FREESTANDING AVCs

Papers: Mr Hinton, 5 December.
Mr Taylor, 9 December and 16 December.
Mr Kuczys, 12 December.

14. It is a long time since we last discussed this subject with you, so it might be worth recounting the story so far.

15. The problems with freestanding AVCs are:

a. If the total benefits at retirement, from the main occupational scheme and AVCs combined, exceed Revenue limits, then main scheme benefits have to be cut back. From the employee's point of view, the additional contributions have gone to waste; and the employer is put in an awkward position.

b. We therefore have very stringent requirements for checks to be carried out before AVCs are paid at all, to try and ensure that this result never arises. Since

most employees are in no danger of exceeding Revenue limits, the work - most of which falls on employers' schemes - is often unnecessary.

c. Employers have not minded when the resulting AVCs are paid to an "in-house" scheme. But they complain loudly at having to do all the work just so that AVCs can be paid to a freestanding "competitor". So they delay, or make hefty charges, or even refuse outright to co-operate. That in turn leads to complaints from freestanding providers, and from aggrieved employees.

16. Ministers agreed late last year that the way to cut through all this was:

1. To make the consequences of building up excess funds less drastic: instead of going to waste, the excess funds would be returned, less a suitable tax charge. This would make possible:
2. Much less stringent requirements at the point where AVCs are paid - and in particular less of a burden on employers.

17. Our original proposal was that the tax charge on returned funds should be a flat 40 per cent. But you and other Ministers were unhappy with this. On the one hand it would be rather severe for a basic rate taxpayer. On the other hand it would provide no disincentive to a higher rate payer piling funds in (with tax relief) to get the benefit of tax-free build up.

18. You therefore agreed that the tax charge on returned funds should be the member's marginal rate plus X, where X (perhaps at 10 per cent) would be a proxy for recouping the tax relief on build up.

19. We now need to report back to you, both on the tax charge, and on the easing of our requirements at the point where AVCs are paid.

The Tax Charge

20. We recommend that X should be 10 per cent. So the total tax charge should be 35 per cent for a basic rate taxpayer, and 50 per cent for a higher rate taxpayer. But, as a matter of mechanics, we propose to achieve this in the following way.

21. First, there will be a tax charge on the AVC scheme administrator of 35 per cent of the amount refunded. Second, the refund will be treated in the member's hands as having borne tax at the basic rate. So, if he is a basic rate payer, there will be nothing further to pay. But if he is a higher rate taxpayer, he will have to pay the extra 15 per cent through his tax assessment.

22. This approach has two advantages:

- W. J. Hinton*
- a. tax offices will only need to get involved in the case of higher rate taxpayers; and
 - b. it preserves the position that there is no tax rate above 40 per cent.

Annex A, by Mr Hinton, provides an example of how it works.

23. The legislation to introduce the new tax charge needs to be in the Finance Bill, and will take effect from Royal Assent. We have already instructed Counsel provisionally. We should be grateful to know if you are content with the approach we have adopted.

Simplification of Procedures

24. With this tax charge in place, we believe it is possible to have a very radical simplification indeed of the procedures at present required before AVCs (especially freestanding ones) can be paid. We have worked up a set of proposals under which:

- In about 90 per cent of cases, the freestanding AVC provider will obtain the information he needs from the employee, without any need for the employer to be involved at all. This will apply to contributions of up to £2,400 a year, or £200 a month. (The average additional contribution is around £1,000 a year). The £2,400 figure will need to be reviewed from time to time.
- Where an employee wants to pay more than £2,400 a year, a greater level of checking will be required - but still much less than under the present rules. The employee will be able to obtain the information required from his employer's scheme under the DSS Regulations which give him the right to such information. The AVC provider, not the employer, will do the calculations on the basis of this information.

25. Annex B, by Mr Cooke, sets this out in more detail. The existing DSS Regulations will need strengthening in one respect. We have discussed this with DSS, who do not see any difficulty: there will be an opportunity to amend their Regulations around July. Even without that, however, no employer will be able to prevent an employee paying up to £2,400 a year in AVCs.

26. Overall, this new approach will have a major impact on the administrative burden on employers' schemes, particularly in relation to freestanding AVCs. We will have

- cut completely the need for employer involvement in 90 per cent of cases when AVCs are first paid;

- in the remaining cases, cut the work involved to a minimum, and transferred the task of calculating "headroom" from the employer to the provider who wants to sell his freestanding AVC scheme;
- cut out all checks between starting (or increasing) contributions, and retiring (or leaving employment).

27. The employer's scheme will still have to pull all the threads together at retirement, to check that total benefits are not excessive. If they are, he will need to ask the employee which AVC funds he wants returned, and instruct the AVC scheme to make the refund, less the tax charge. There may be complaints about this aspect, but we do not see any alternative procedure. It is still very much better than the present position.

28. In any case, this will be very much the exception. With an effective exit charge 10 per cent above marginal rate, no-one is likely to aim deliberately for excessive funds. In the case of freestanding AVCs, "best advice" and "know your customer" should mean providers take reasonable steps to ensure that clients do not end up facing a tax charge. They are likely to do some checks of their own, even where the Inland Revenue does not require any. Similarly, with in-scheme AVCs, it will be in the scheme administrator's interests, and part of the responsibility of scheme trustees, to ensure that employees do not pay too much.

29. When we discussed freestanding AVCs in December, you said you would like some independent confirmation that the procedural changes we came up with went far enough. We have been able to discuss our proposals within Government with Mr Loades (GAD) for an actuary's view; and with Treasury Superannuation Division for an employer's perspective. I think both agree that our approach would make a very real difference. Superannuation Division's initial reaction was that we might have gone too far, and tilted the balance of


advantage away from in-scheme to freestanding AVCs. We do not accept that that is the case, but this is clearly a reaction from employers for which we will need to be prepared, and have the counter-arguments ready.

30. These procedural changes are not, in any case, for the Finance Bill, but will require amendments to the Revenue's rules for approving AVC schemes. So there will be an opportunity to discuss them with pension providers and employers immediately after the Budget, and if necessary to adapt the approach in the light of discussion. We should be grateful for your agreement to proceed in this way.

CONCLUSION

31. Although this note has been rather long, much of it is for information. It asks you:

- a. to note the revised start-dates for the various aspects of the pensions package;
- b. to note the progress made on minor changes;
- c. to confirm that you are content with the outcome of our further work on the tax regime for top-up schemes;
- d. to note the NIC treatment of top-up schemes;
- e. to confirm that you are content with the form of the tax charge on refunded excess AVCs; and
- f. to agree that we should consult on the procedural changes for AVCs immediately after the Budget.



A W KUCZYS

FREE-STANDING AVCs: THE TAX CHARGE

The Financial Secretary agreed (at a meeting on 9 December) that excess contributions should be returned to the member less a tax charge. The rate at which that charge should be set was, however, left until later.

Clearly the tax charge and the administrative rules for monitoring free-standing AVCs cannot be divorced from each other. If the charge is set very low, significant controls on contributions will remain necessary to ensure that the emerging benefits are not likely to be excessive. Free-standing AVCs might otherwise be turned into a form of tax sheltered general savings. There would be some risk that movements in tax rates might go against them - but with a low exit charge this risk might be perceived as worthwhile.

On the other hand, if the recovery charge was set too high employees might be reluctant to invest without being sure that there was no risk of a surplus arising. Although Revenue controls on contributions might then arguably be unnecessary. This could be counterproductive if it meant that people were scared away by a very tough recovery charge.

It is therefore necessary to try and find a reasonable balance between the need to protect the very generous tax reliefs and the desire for a simple and straightforward administrative system. As explained in the submission of 5 December the level of the tax charge depends on how long and at what rate the tax-free build-up has been taking place, and whether the refund is regarded as consisting of contributions paid many years ago (which will have enjoyed a significant benefit from tax-free build-up) or those 8002.

paid in the last year or so (where there will have been very little benefit). The first assumption could merit a tax charge (in addition to marginal rates) of up to 15 per cent; the latter one, perhaps, nil.

Our view is that a charge of about 10 per cent would probably be about right. It neither seems too penal nor would it allow a higher rate taxpayer a one way bet into a new tax shelter. More importantly, a 10 per cent charge will be sufficient to introduce a substantial simplification of the administrative procedures for free-standing AVCs. We therefore recommend accordingly.

As to the mechanics of the tax charge, the best approach will be to make the pension scheme administrator responsible for deducting, and accounting for, the basic rate and the special 10 per cent rate tax charge on the refund. They already do something similar in relation to refunds of ordinary contributions and pension fund surpluses. For simplicity this will entail setting the charge at a flat 35 per cent (to recoup tax relief given on contributions and investment build-up) as this would fit most conveniently with the existing assessing and collection machinery.

For basic rate taxpayers this will be the end of the story, but higher rate taxpayers would face a further liability as the following example shows:

Surplus AVCs	=	£1000
Scheme administrator deducts		
35 per cent	=	£ <u>350</u>
Amount payable to member	=	£ 650

The £650 received by the member is treated as his income which has suffered basic rate tax, so

Net received	=	£ 650
basic rate addition		
(assuming 25 per cent)	=	£ <u>217</u>
gross amount	=	£ 867

If the member is a basic rate taxpayer, there is no further liability. But if he is not liable to tax he cannot claim repayment.

If the member is a higher rate taxpayer he will be chargeable at higher rates on the grossed-up amount, i.e.

gross amount	=	£ 867
higher rate tax due at		
15 per cent	=	£ <u>130</u>

FSAVC SCHEME PROCEDURES: SIMPLIFICATION

1. This note sets out the proposed simplified procedures made possible by Ministers' decision to legislate for the repayment of surplus FSAVC funds subject to an exit charge.

2. The intention is to remove from the main occupational pension scheme administrator the responsibility for carrying out checks on the "headroom" for paying further contributions. This responsibility, in a simplified and much less onerous form, will in future fall on the FSAVC scheme provider who is in the business of providing a service for his clients. The main scheme administrator will however retain the responsibility for operating the final check on benefits to identify surplus AVC funds so that they can be repaid. A more detailed step by step description of the new procedures is set out in the rest of this annex.

Taking out AVCs

3. When the scheme member wishes to invest in a FSAVC he approaches the provider. The provider must first establish from the member that he is indeed a member of an occupational pension scheme and that he is not currently paying contributions to another FSAVC scheme.

4. The second step is to determine whether and to what extent the member is contributing to the main scheme. Reference to a current

payslip will normally enable the provider to determine whether (and to what extent) there is capacity to pay further contributions within the statutory 15 per cent limit on contributions. If the member has a particular level of contribution in mind which is within this capacity and is no more than £2,400 per annum (£200 per month) the contribution can be accepted without any further check.

5. This contrasts with the current position where the member must first approach the main scheme administrator to obtain a certificate. That certificate can only be given without actuarial calculations being made if:

- a. the main scheme benefits do not exceed $\frac{1}{60}$ th of final remuneration for each year of service; and either
- b. the member can complete 20 or less years of pensionable service to normal retirement age; or
- c. the member's remuneration does not exceed £15,000 and the proposed AVC is 5 per cent or less of remuneration.

6. The figure of £2,400 represents the nearest round figure with a round monthly equivalent to 10 per cent of the level of

remuneration at which a single person becomes liable to higher rate tax. It is also about 2½ times the broad order of magnitude of individual annual contributions currently being made to FSAVC schemes. We believe, that this figure will exempt about 90 per cent of proposed initial contributions from any further test. (The rationale for the link to higher rate taxpayers is that we believe that only they could afford to gamble sufficient excessive contributions to take advantage of any (however small) difference between upfront relief and the exit charge. Even if the whole of the £2,400 annual contributions were "excessive" the loss to the Exchequer would be trivial.)

7. While the Revenue do not require any further tests in these circumstances, it is arguable that the best advice and know your client requirement of the Financial Services Act might do so.

8. Where the proposed contributions exceeds £2,400 pa or the member wants to know the maximum he can pay, it becomes necessary for the member to approach the main scheme administrator to obtain sufficient information to enable the FSAVC provider to calculate the headroom for further contributions. We propose to publish details of the necessary information in the form of a proforma questionnaire. In general the provision of the type of information needed will not be onerous for the administrator and he would only need to give it to one person. We are in contact with DSS officials to

explore whether their Disclosure Regulations could be more closely tailored to give the member a statutory right to the relevant information.

9. Currently the main scheme administrator is asked to provide a separate headroom certificate to each FSAVC provider the member approaches. This information will in future be given to the member who can then produce it to as many providers as he wishes.

10. On receipt of the information the provider will carry out the necessary check on headroom. We intend with the help of the Government Actuary's Department to publish guidance to simplify into an arithmetical formula what is a complex professional calculation. Ideally this will be in the form of a flow chart to guide the provider through the variations necessary for different types of scheme. It will be based on actuarial assumptions which might need to be updated from time to time. If the main scheme is a simplified defined contributions scheme it is only necessary to ensure that the sum of the employer's and employee's contributions (including any national insurance rebate and incentive) do not exceed $17\frac{1}{2}$ per cent of remuneration.

11. Having determined either that no headroom check is required or that there is sufficient headroom for a contribution to be made it is possible for the arrangement to proceed. At this stage the member must sign an undertaking to notify the provider if he

changes employment, if he leaves the scheme or if there is any increase in the benefits from or his contributions to the main scheme. We propose to ask scheme administrators when notifying members of any increases of benefits or contributions to draw their attention to the fact that this may have consequences for any FSAVC scheme contributions. Also at this time the provider must notify the main scheme that the member is paying FSAVC scheme contributions.

Subsequent checks

12. It is proposed to eliminate all the pre-retirement checks currently required at 3 yearly intervals starting 10 years before normal retirement age. After inception the only further checks necessary will be triggered by increases of the rate of contribution to the FSAVC scheme where the revised contribution exceeds:

- a. £2,400 pa for the first time; or
- b. an amount or a fraction of current earnings justified by a previous headroom check and is more than 10 per cent over the previous rate of contribution.

Clearly, however, any revised rate of contributions must come within the overall 15 per cent limit.

At retirement or leaving

13. At the earliest of retirement or leaving pensionable service (either leaving the employment or just withdrawing from the scheme) the main scheme administrator must carry out the final check to determine whether and to what extent there are surplus AVC funds. He will need to contact each provider which has sent him a notification (see paragraph 6 above) in respect of the member. Each provider will provide him with a valuation (in terms of an immediate or deferred pension, as appropriate, increasing annually by the lesser of 5 per cent pa or the proportionate increase in the retail prices index) of the FSAVC scheme benefits. The administrator then carries out the normal checks required under the rules of the scheme to ensure that benefits are not excessive. If they are within limits he should write to each provider to confirm that the full benefits may be paid. If not he must instruct providers as to how much surplus is to be repaid. Where there is more than one provider and not all AVC benefits are surplus he should consult the member as to which providers (including, if appropriate, the main scheme) are to pay benefits and which repay excess.

14. It is only the main scheme administrator who is capable of carrying out this final check. He will have been given notification of all the relevant sources of benefit and, apart from the necessary contacts with each provider, this system does not add to his administrative burden.

15. Once any surplus has been repaid the balance of benefits payable (whether immediately on retirement or deferred where pensionable service has terminated) may be paid either as a level pension or a lesser pension increasing annually at a specific percentage but not exceeding the proportionate increase in the retail prices index.



FROM: J M G TAYLOR
DATE: 6 March 1989

see can I see
X ASAP
h.

PS/FINANCIAL SECRETARY

cc Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Dame A Mueller
Mr Scholar
Mr Culpin
Mr L Harris
Mr McIntyre
Mr Dixon
Mr Gilhooly
Mr Macpherson
Mrs Chaplin
Mr Tyrie

MP

Miss Wallace

Sir A Battishill - IR
Mr Isaac - IR
Mr Corlett - IR
Mr Kuczys - IR
PS/IR

PENSIONS: OUTSTANDING POINTS

X The Chancellor has seen Mr Kuczys' note of 3 March.

2. He thought this very helpful and clear, and that some of the solutions were most ingenious. He has commented that the AVC simplification looks as if it merits a sentence in the Budget speech.

JMT

J M G TAYLOR

BUDGET CONFIDENTIAL

fst.jf/Robert/6.3.1



MR KUCZYS - IR

FROM: R C M SATCHWELL
DATE: 6 March 1989

cc PS/Chancellor
PS/Chief Secretary
PS/Paymaster General
PS/Economic Secretary
Sir P Middleton
Dame A Mueller
Sir T Burns
Mr Scholar
Mr Culpin
Mr Harris
Mr Dixon
Mr Gilhooly
Mr McIntyre
Mr MacPherson
Mrs Chaplin

Mr Corlett - IR
PS/IR

PENSIONS: OUTSTANDING POINTS

The Financial Secretary was most grateful for your minute of 3 March. He notes the things in para 31 you asked him to note; confirms he is content with the outcome of your further work on the tax regime for top-up pensions and with the form of the tax charge on refunded excess AVCs; and agrees that you should consult on the procedural changes for AVCs immediately after the Budget.

R.C.M.S.

R C M SATCHWELL
Private Secretary

FROM: L J HARRIS

DATE: 6 MARCH 1989

MR J M G TAYLOR

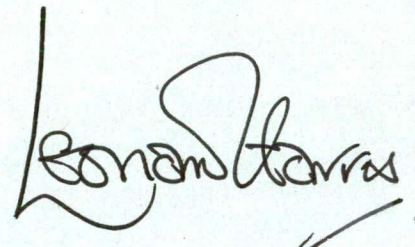
cc PS/Chief Secretary
 PS/Financial Secretary
 PS/Paymaster General
 Sir P Middleton
 Mr Anson
 Dame Anne Mueller
 Mr Scholar
 Mr Culpin
 Mrs Chaplin
 Mr Tyrie
 Mr Call
 Mr Dixon

Ch. / OK?
OK -
7/3

Sir A Battishill - IR
 Mr Isaac - IR
 Mr Kuczys - IR

PENSIONS: CHANGES TO PRINCIPLE CIVIL SERVICE PENSION SCHEME

At an earlier overview meeting, I said that the changes necessary to implement the Chancellor's pension proposals as far as the Civil Service is concerned could, if necessary, be made by means of a scheme amendment to be laid before the House and come into effect on Budget Day. In that case, the consultation with the Civil Service unions required by the Superannuation Act 1972 would have taken the token but adequate form of sending them a copy of the amendment just before it was laid. Now that the Chancellor has decided that the Budget changes generally should apply to new members of existing schemes from 1 June, it would be gracious to give the unions a little more time to react, even though there is not much they can do beyond expressing ritual displeasure. If the Chancellor is content, therefore, we shall give the Council of Civil Service Unions on Budget Day formal notification of the Treasury's intention to amend the PCSPS in line with the Budget Statement, take delivery of their response, and aim to lay the amendments early in May, to take effect from 1 June.



L J HARRIS



FROM: J M G TAYLOR
DATE: 6 March 1989

MR L J HARRIS

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Sir P Middleton
Mr Anson
Dame A Mueller
Mr Scholar
Mr Culpin
Mrs Chaplin
Mr Tyrie
Mr Call

Sir A Battishill - IR
Mr Isaac - IR
Mr Kuczys - IR

PENSIONS: CHANGES TO TAX TREATMENT OF PUBLIC SERVICE SCHEMES

The Chancellor has seen your note of 3 March, and is content to proceed along the lines you propose: to follow the 1987 precedent this time round; then arrange for the general issue to be taken forward with Parliamentary Counsel and the Treasury Solicitor; then for you to discuss with other interested departments in your interdepartmental pensions group.

A handwritten signature in dark ink, appearing to be 'J M G TAYLOR'.

J M G TAYLOR



FROM: J M G TAYLOR
DATE: 6 March 1989

MR L J HARRIS

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Sir P Middleton
Mr Anson
Dame A Mueller
Mr Scholar
Mr Culpin
Mrs Chaplin
Mr Tyrie
Mr Call

Sir A Battishill - IR
Mr Isaac - IR
Mr Kuczys - IR

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J M G TAYLOR



FROM: J M G TAYLOR
DATE: 6 March 1989

PS/FINANCIAL SECRETARY

cc Chief Secretary
Paymaster General
Economic Secretary
Sir P Middleton
Sir T Burns
Dame A Mueller
Mr Scholar
Mr Culpin
Mr L Harris
Mr McIntyre
Mr Dixon
Mr Gilhooly
Mr Macpherson
Mrs Chaplin
Mr Tyrie

Miss Wallace

Sir A Battishill - IR
Mr Isaac - IR
Mr Corlett - IR
Mr Kuczys - IR
PS/IR

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J M G TAYLOR



FROM: J M G TAYLOR
DATE: 6 March 1989

MR RAYSON

cc Chief Secretary
Financial Secretary
Paymaster General
Sir P Middleton
Sir T Burns
Mr Anson
Dame A Mueller
Mr Wicks
Mr Hardcastle
Mr Byatt
Mr Scholar
Mr Culpin
Mr Luce
Mr Riley
Mr Sedgwick
Mr Dixon
Mr Gilhooly
Mr Macpherson
Miss Simpson
Mrs Chaplin
Mr Tyrie
Mr Call
Mr Sheridan
Mr L J Harris

Sir A Battishill - IR
Mr Beighton - IR
Mr Isaac - IR
Mr Painter - IR
Mr Bush - IR
Mr Corlett - IR
Mr Kuczys - IR
Mr Hinton - IR

Mr Jefferson Smith - C&E

PENSIONS CAP: MPs AND OFFICE HOLDERS

The Chancellor was grateful for your note of 2 March.

2. He has commented that the forthcoming Bill will need either explicitly to include revision for the *cap*, or to include a



regulation making power, which could then be used for this purpose. He would be grateful for advice on these two options, in due course.

A handwritten signature in black ink, appearing to be "J M G TAYLOR".

J M G TAYLOR



FROM: J M G TAYLOR
DATE: 6 March 1989

A handwritten signature in dark ink, appearing to be 'JMG'.

MR L J HARRIS

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Sir P Middleton
Mr Anson
Dame A Mueller
Mr Scholar
Mr Culpin
Mrs Chaplin
Mr Tyrie
Mr Call

Sir A Battishill - IR
Mr Isaac - IR
Mr Kuczys - IR

PENSIONS: CHANGES TO TAX TREATMENT OF PUBLIC SERVICE SCHEMES

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A handwritten signature in dark ink, appearing to be 'JMG'.

J M G TAYLOR



FROM: J M G TAYLOR

DATE: 7 March 1989

MR L J HARRIS

[Handwritten signature]

cc PS/Chief Secretary
PS/Financial Secretary
PS/Paymaster General
Sir P Middleton
Mr Anson
Dame A Mueller
Mr Scholar
Mr Culpin
Mrs Chaplin
Mr Tyrie
Mr Call
Mr DixonSir A Battishill IR
Mr Isaac IR
Mr Kuczys IR**PENSIONS: CHANGES TO PRINCIPAL CIVIL SERVICE PENSION SCHEME**

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[Handwritten signature]

J M G TAYLOR