

Office of  
Tax Simplification

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**Review of pensioners' taxation:  
Interim report**

March 2012



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# Contents

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|   | Page |
|---|------|
| Foreword  | 3    |
| Executive summary   | 5    |
| Chapter 1 Introduction  | 7    |
| Chapter 2 Methodology of the pensioner tax review                       | 11   |
| Chapter 3 Areas of complexity   | 13   |
| Chapter 4 Priority areas for further review and consideration of reform | 53   |
| Annex A Pensions and pensions tax reliefs: some historical notes        | 67   |
| Annex B International comparisons                                       | 71   |
| Annex C List of common HMRC forms for pensioners                        | 79   |
| Annex D The pensioner population in the UK                              | 83   |
| Annex E The evidence gathering process                                  | 87   |



# Foreword

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There is no such thing as a typical pensioner. They may be single or married; above or below sixty five; in work or taking their leisure; with or without a pension; with or without savings or investments.

It's against this backdrop that successive 20<sup>th</sup> and 21<sup>st</sup> century Chancellors have had to try and devise a way of taxing this diverse group of individuals, whose needs change with the advancement of their years. Over time the age of a pensioner, their marital status and even modest savings provision have had their influence on the development of the tax regime which is now applied to this group of people.

The result is a patchwork of allowances and rules which many in their later years find very confusing, especially if during their working lives they have had the benefit of their personal tax affairs effectively being on "autopilot" through the use of the pay as you earn (PAYE) system.

For some, the arrival of a combination of their state pension and a limited income from their savings and investments can mean for the first time that they need to complete a self assessment tax return, just when they thought that life was getting easier.

It was against this background that we were delighted when the Chancellor accepted our recommendation that the Office of Tax Simplification (OTS) be tasked with producing a report about how life could be made easier for the 5 million pensioners currently affected by the tax system.

During the last 6 months we have worked closely with a broad range of organisations - the media, (both print and broadcast), our excellent Consultative Committee and individual pensioner taxpayers - to complete part one of our work: namely to identify where the biggest problems currently lie. To that end we were particularly grateful to Tax Help for Older People whose casework files greatly added to our understanding of the real world problems that this group of taxpayers are facing.

For those with knowledge of this area of taxation our key findings should come as no surprise. It is the operation of the age allowance, the tax status of the state pension and the way the system deals with certain types of savings income that causes the greatest confusion. However, as you read this report you will also see that we have unearthed some more obscure problems, which also require attention.

In the second part of our work in this area we will address the challenge of how this section of our tax code can be made simpler for those pensioners who pay tax. To this end your thoughts and observations on our proposals to date would be very much appreciated. We will look at each area of "complexity" with a view to proposing either a simplification of the tax code or an improvement in the way HMRC's administration works as far as the taxpayer is concerned.

Once our work is completed, it will provide Ministers with an opportunity to reflect on whether they are satisfied that improving the current system is the most appropriate way forward or whether they should look at how this area of tax law operates, as a whole, in a world where pensioner numbers are increasing and life expectancy is rising.

None of this report could have been written without the efforts of our small team of experts. In particular I would like to thank Kelly Sizer, who has led the project whilst on part time secondment from the Low Incomes Tax Reform Group. She was particularly helped from within OTS by Tunde Ojetola and Richard Thomas, whose practical HMRC experience provided an invaluable source of information and advice for the project.

Although the "half time" whistle has blown on our work in this area I can assure you that our team are anxious to get back on the pitch so that they can begin work on providing practical solutions that will really make tax simpler for the rising number of pensioner taxpayers.

A handwritten signature in black ink that reads "Michael Jack". The signature is written in a cursive style with a horizontal line above the name.

Rt Hon Michael Jack  
Chairman



# Executive summary

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The Office of Tax Simplification (OTS) is pleased to present this interim report on pensioner taxation.

As we explain in the introduction, we have broadly identified the ‘pensioner’ population as those aged 60 or over for the purposes of our review, unless otherwise stated. Pensioners are, however, a far from homogeneous group in terms of age, circumstances and capability to deal with tax matters.

We stress that our immediate objective, before Budget 2012, was to identify and explore the areas of complexity. Therefore, whilst a wide range of options for reform – some potentially contentious – have been raised, discussed and noted, we have not yet formulated recommendations for substantial or radical change.

Some of the issues we discuss affect a wider range of taxpayers than just pensioners, but are those that may pose particular difficulties for pensioners. Other issues affect just pensioners, and indeed differences between the treatment of pensioners and other taxpayers are a major source of complexity.

We thought it necessary to understand the historical context for having those differences – such as higher age allowances – and to give some thought to whether the same rationale is valid today. We have also carried out some initial research into tax systems overseas to see how other jurisdictions treat pensioners, which will be useful in informing the second stage of our review.

Our work also has to be set in the context of demographic and broader policy changes. People may be working longer, perhaps at the same time deferring taking their pensions (whether state or private). Compulsory retirement ages are disappearing, auto-enrolment is being introduced, the state pension age is increasing and the basic personal tax allowance is increasing gradually towards £10,000, which effectively diminishes the value of age-related allowances.

Furthermore, tax policy change is ongoing, with consultations on modernising the personal tax systems and improving transparency, developments with PAYE Real Time Information (RTI) and merging the operation of income tax and national insurance all being especially relevant.

However, as some of those changes are longer term ideals (for example taxpayers having their own online HMRC account as envisaged in the transparency consultation), the OTS does hope to identify some changes which could be made much sooner to improve pensioners’ dealings with the tax system.

We have outlined the areas of complexity in detail in Chapter 3 of this report. For ease of reference, we have provided a summary table at the beginning of Chapter 4 which shows:

- which areas we have identified as being of high, medium or low priority for the second stage of our review;
- areas in which we have noted that HM Treasury, HM Revenue and Customs (HMRC), and/or the Department for Work and Pensions (DWP) are already carrying out work; and
- any immediate suggestions we have for improvement, based upon our findings to date.

Chapter 4 then explains in a little more detail our thoughts on prioritisation of each area of complexity.

By the completion of the second stage of our review, we hope to be in a position to make detailed recommendations. To help inform that second stage, we would welcome contributions from readers on any aspect of this report. We particularly encourage submission of any suggestions as to what might be done to ease the complexities we have identified in this first stage.

You can email the review team at [OTS-pensions@ots.gsi.gov.uk](mailto:OTS-pensions@ots.gsi.gov.uk)

# 1

## Introduction

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### Aim of the review of pensioner taxation

**1.1** In July 2010, the Chancellor of the Exchequer announced the creation of the Office of Tax Simplification (OTS). Following its initial reviews, the OTS wrote to the Exchequer Secretary to HM Treasury, David Gauke MP, on 14 June 2011 setting out possible areas of future work<sup>1</sup>. We received the Minister's response on 5 July 2011, which invited us to work on two of our proposals: pensioner taxation and employee share schemes.<sup>2</sup>

**1.2** In the area of pensioner taxation, the Minister agreed to our suggestion of producing an interim report before Budget 2012 identifying and examining the areas of the tax system which cause the greatest complexity for pensioners, and looking at how the problems vary across the pensioner population. He asked that we put forward proposals for simplification in a final report later in the year.

**1.3** In this interim report, whilst we have sought to identify whether there are any immediate changes which could offer simplification, we are mindful of the need to conduct a thorough review and produce properly formulated proposals. Accordingly, in a number of areas we have identified possible solutions but these should not be read as recommendations at this stage: rather, they are areas to explore further. We would welcome comments from interested parties on the various suggestions.

**1.4** There are longstanding issues in the area of pensioner taxation. We have found it instructive to trace back the history of taxation as it affects pensioners in the UK and how, for example, special rates of personal allowances for older people have come to exist. Annex A of the report outlines our historical research. This highlights that the system we see today is the product of a complex series of past events and policy decisions. It is clear that, if starting now with a blank canvas to design a tax system for pensioners, a very different picture would be likely to emerge. Indeed, a fundamental question is whether different tax rules for pensioners are necessary at all. Differing rules will almost always risk increases in complexity.

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<sup>1</sup> [http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/ots\\_letter\\_michaeljack\\_to\\_davidgauke\\_14062011.pdf](http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/ots_letter_michaeljack_to_davidgauke_14062011.pdf)

<sup>2</sup> [http://www.hm-treasury.gov.uk/d/ots\\_letter\\_050711.pdf](http://www.hm-treasury.gov.uk/d/ots_letter_050711.pdf)

## Terms of reference

1.5 The full terms of reference for the pensioner tax review were published on the OTS website in the autumn of 2011<sup>3</sup>, and they are:

### **Box 1.A: Pensioners' tax review – terms of reference**

The taxation of pensioners is often seen as overly complex, with many pensioners subject to PAYE before retirement, but self assessment afterwards, when they may have several small sources of income that may or may not need tax deducted.

The Government has therefore commissioned the Office of Tax Simplification to conduct a review of the system of pensioner taxation and make recommendations to the Chancellor on how to simplify the tax system and ease tax administration for pensioners.

The Office will provide an initial report to the Chancellor by Budget 2012 that:

- examines evidence and identifies the areas of the tax system that cause the most complexity and uncertainty for pensioners;
- identifies how these issues vary within the pensioner population; and
- explores what changes could achieve simplification and what the wider implications of these might be.

In particular the review should:

- draw on evidence provided by pensioners, tax professionals, the pensions industry and representative bodies; as well as analysis of taxpayer data and academic research; and
- consider all HMRC taxes and compliance responsibilities that impact on pensioners, including the administrative burdens imposed – however, inheritance tax and tax relief for pension contributions are not within the scope of this review.

If the review of evidence presents a case for change then the Office will go on to produce a final report later in 2012 with specific recommendations. Both the interim report and final recommendations should have regard to:

- the Government's work on merging the operation of Income Tax and NICs;
- other work within Government, such as the coalition commitment to increase the personal allowance and the flat rate state pension, as well as related reports by the National Audit Office and the Public Accounts Committee;
- the wider economic and policy implications of any proposals – including impact on individual pensioners, fairness between different taxpayers, wider Government policy and tax receipts;
- the risk of non-compliance and avoidance opportunities; and
- the Spending Review resource constraints on HMRC.

The Office's work will be informed by consultation with interested parties, including forming and working with a Consultative Committee

<sup>3</sup> [http://www.hm-treasury.gov.uk/d/ots\\_pensioner\\_taxation\\_tor.pdf](http://www.hm-treasury.gov.uk/d/ots_pensioner_taxation_tor.pdf)

**1.6** It is important to note from the above that tax relief on pension savings and inheritance tax matters were specifically excluded from the scope of our review. However, we have touched on the tax implications of drawing funds from pensions, particularly for those with small pension savings.

**1.7** A Consultative Committee for the review was formed in September 2011, terms of reference for which were also published on the OTS website<sup>4</sup>. The names and organisations of members of the Committee are given at Annex E.

## Definition of a 'pensioner'

**1.8** The term 'pensioner' is a broad one. Retirement and working ages are increasingly blurred and there are wider changes in progress to be taken into account, for example changes to the state pension age, abolition of the default retirement age and demographic changes.

**1.9** For the purposes of data-gathering for the pensioner tax review, the OTS decided that we were looking at people aged 60 or over, who are either in receipt of 'pensions' (including the state pension) or are otherwise retired and living wholly or partly off investment income, which might be a return from savings, rent from property or other unearned income. In either case, they might also have some part-time earnings: we have been at pains to include the older worker in the scope of our review.

**1.10** However, we acknowledge that there are issues for younger pensioners, for example those retiring from the armed forces or police. Also, within the 60-and-over age range there is a wide variety of people with different issues, needs and levels of capability to understand and comply with tax obligations.

**1.11** Given this breadth of potential for our review, it is perhaps inevitable that our findings touch not only on issues that affect pensioners alone, but also areas which cause complexity for many others within the taxpaying population. Where relevant, this report acknowledges those broader impacts.

**1.12** In general, then, the term 'pensioner' used in this report should be read as applying to all the various constituencies above, except where specified to the contrary.

## What is meant by tax simplification?

**1.13** The past reports produced by the OTS have looked at what might be considered 'simplification'. As many of the areas of complexity for pensioners arise as a result of the special reliefs and allowances that are available to them, we have referred back to our review of tax reliefs for a reminder of simplification principles.

**1.14** Chapter 3 of our tax reliefs interim report<sup>5</sup> outlined those principles. Taking into account our research, in summary our reliefs review focused on:

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<sup>4</sup> [http://www.hm-treasury.gov.uk/d/ots\\_pt\\_ConsultativeCommittee.pdf](http://www.hm-treasury.gov.uk/d/ots_pt_ConsultativeCommittee.pdf)

<sup>5</sup> [http://www.hm-treasury.gov.uk/d/ots\\_review\\_tax\\_reliefs\\_interim\\_report.pdf](http://www.hm-treasury.gov.uk/d/ots_review_tax_reliefs_interim_report.pdf)

### Box 1.B: Simplification principles from the OTS review of tax reliefs

**The policy rationale:** A number of tax reliefs have been introduced over the years to fulfil a specific purpose, or to help a certain industry in need. We will examine whether there continues to be a policy rationale behind a relief and also whether the relief is the best way to deliver the aim.

**Evidence of taxpayer take up**, which may be a proxy for the perceived value of the relief. This is a function of understanding, complexity and whether the legislation is too tightly focused.

**The tax cost of the relief** is also a key factor which we take into account but it is not by any means the key driver.

**The administrative burden** for the taxpayer, adviser and HMRC; determining for each relief which aspects take up the most time and resource. This includes the legislation itself, the volume of changes, the procedures and documentation required for dealing with HMRC or other bodies, and the work HMRC has to undertake to monitor claims.

1.15 In the context of the pensioner review, it is also helpful to restate the features of good tax law and practice outlined by Graeme Cooper in 1993<sup>6</sup>:

### Box 1.C: Cooper's view of the key features of tax simplification

- Predictability – legislation and its scope should be easily and accurately understood by taxpayers and their advisers.
- Proportionality – the complexity of the solution should be no more than reasonably necessary to achieve the stated aim.
- Consistency – similar issues should be dealt with in the same way and without the need to make arbitrary distinctions.
- Compliance – it should be easy for taxpayers to comply without incurring excessive costs.
- Administration – it should be easy for a revenue authority to administer.
- Coordination – it should fit appropriately with other tax rules.
- Expression – it should be clearly expressed.

1.16 All of the above are of relevance to the pensioner review.

1.17 For example, in the context of different age allowances for older people, in order to consider simplification under the 'proportionality' heading above, we first need to know the aim of having such allowances. In turn, that would allow us to consider the issue of consistency by questioning whether the distinction is arbitrary in the modern context.

1.18 We have also carried out a range of work on how the tax system for pensioners is administered. For example, we have considered the range of tax-related forms a pensioner might be faced with (Annex C refers), how the tax distinctions between working age and pension age are coordinated across Government, how the special tax provisions for pensioners are expressed in guidance and what support is available when changes occur in their circumstances.

<sup>6</sup> G.S. Cooper "Themes and issues in tax simplification" Australian Tax Forum Vol 10 pp 417 - 460

# 2

## Methodology of the pensioner tax review

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**2.1** The first steps in our review were to identify those areas causing complexity. This we have done in Chapter 3 of this report, before going on to look at which of those areas should be prioritised for further review and reform (Chapter 4).

**2.2** As with other exercises that the OTS has carried out, we have laid great stress on evidence gathering, so that our recommendations are firmly evidence-based. We have tried to make sure the work we are doing is well-publicised in relevant areas and with appropriate bodies. We have engaged with advisers to pensioners both from the voluntary sector and the paid agent community at various meetings around the UK (see Annex E), discussed our review within Government and sifted through written contributions from individual pensioners<sup>1</sup>. Coupled with our own researches, we compiled a list of areas for review. Within each area, we identified specific issues, forms or administrative processes which contribute to complexity and we listed any ideas put forward for reform.

**2.3** In all of this work we have been greatly helped by our Committee members (see Annex E) who have also been of great assistance in helping us link to a range of external bodies.

**2.4** Some of the areas for review could be simplified by changes in policy and legislation, and some by improved administration. Within some areas, both the underlying policy and the administration cause problems.

**2.5** HMRC has kept us informed of changes that are already in progress which might help improve the administration of the tax system for pensioners. We have referred to HMRC's current work throughout the report, where relevant to the issue under discussion.

**2.6** In Chapter 3, we set out the areas of complexity, differentiating between those affecting pensioners only and others which have wider impact but nonetheless impact heavily on pensioners.

**2.7** After having gathered details of the complexities of pensioner taxation, the OTS sought to prioritise those areas to which precedence should be given in the second stage of our review. Those priorities are summarised and explained in Chapter 4, based on our findings.

**2.8** We have given a priority rating of high, medium or low to the various areas. Within each area, we first address matters requiring policy attention or changes in legislation, and then we look at administrative simplifications.

**2.9** We must stress this does not mean that the OTS is not prepared to consider those areas which we have concluded to be of lesser priority if we have the time, resources and support of Ministers to do so. Some of the low priority areas may easily evolve into a simple measure or recommendation, although more work would clearly make any recommendation more authoritative.

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<sup>1</sup> Many of these contributions have been generated following coverage of our work in the media. We are grateful for the constructive and positive way that many media outlets have highlighted our aims and the project generally.

**2.10** Some priority areas have become clear simply because they were a recurring theme from the various meetings we have held, or in written submissions to us.

**2.11** We also wanted to ensure that we had captured the views of our Consultative Committee on the areas they thought were high priority, given that its members were recruited for their depth and breadth of expertise in the field of pensioner taxation. Between 21 December 2011 and 6 January 2012, we conducted an online survey of our Committee members.

**2.12** The survey results, combined with the research we have undertaken and other evidence we have gathered have helped us to prioritise each area.

**2.13** Whatever the priorities the OTS has set out, we welcome comments from readers of this report on any aspect of the contents. We especially welcome views as to how we make progress on the areas covered, and comments on the ideas and suggestions listed in Chapters 3 and 4, which we have not yet formulated into final recommendations.

**2.14** Both Chapters 3 and 4 are divided into the following headings:

- A. Age-related allowances
- B. Married couple's allowance
- C. Sundry reliefs
- D. Blind person's allowance
- E. Savings taxation
- F. The state retirement pension and its interaction with certain other benefits
- G. Welfare benefits, other than the state retirement pension
- H. Accessing funds in small pension pots
- I. Overseas pensions paid to UK residents
- J. Collecting tax – PAYE
- K. Collecting tax – self assessment
- L. Support for bereaved pensioners
- M. National insurance contributions
- N. Other administrative issues
- O. Gift aid
- P. Care and support employers
- Q. Capital gains tax
- R. Foreign income, other than pensions – non-UK domiciled pensioners
- S. Pensioners retiring abroad



# 3

## Areas of complexity

3.1 The areas of complexity identified by the OTS are considered in turn in this Chapter. For the next stage of the review, we welcome views and comments on the findings, ideas and suggestions, none of which we have formulated into final recommendations.

### A. Age-related allowances

| <b>Box 3.A: Personal allowances</b>               |              |              |
|---|--------------|--------------|
| Personal allowances are currently set as follows: | 2011/12<br>£ | 2012/13<br>£ |
| Basic personal allowance                          | 7,475        | 8,105        |
| For those aged 65 to 74                           | 9,940        | 10,500       |
| For those aged 75 and over                        | 10,090       | 10,660       |

3.2 We refer here to the higher rates for those aged 65 and over as ‘age-related allowances’. Those allowances are withdrawn by £1 for every £2 of ‘adjusted net income’ over £24,000 for 2011/12, until they reach the basic personal allowance<sup>2</sup>.

3.3 The basic personal allowance is now subject to tapering, down to nil, for those with incomes exceeding £100,000, but the OTS has considered that matter outside the scope of this review, given that it affects all taxpayers and we have not heard of it causing any special complexity for pensioners. It is a possible issue for a wider review of personal allowances.

3.4 The complexities of the age-related allowances are numerous:

- not everyone is aware of them before they become a pensioner;
- the taper of the allowances is unfamiliar to pensioners caught within its ambit, as no similar mechanism will have operated to restrict the basic personal allowance during their working life. The tapering of personal allowances for those with incomes over £100,000 is unlikely to alter this familiarity issue for the majority of new pensioners, as it will only apply to a minority of higher earners;
- by removing £1 of allowance for every £2 of income over the threshold, the taper of the allowances creates a marginal tax rate of 30% for those within its bracket; the tax rate drops back to 20% thereafter until the taxpayer’s income reaches the higher rate threshold. For instance, an extra £200 of income over the threshold is taxed at 20%, i.e. tax of £40. It also removes £100 of age-related allowance, creating a further tax charge of £100 at 20%, i.e. £20. The total additional tax is therefore £60, which equates to a 30% effective rate;

<sup>1</sup> Section 58 of Income Tax Act 2007

<sup>2</sup> So for those aged 65 to 74 the difference between the age-related allowance and the ordinary personal allowance is £2,465. By doubling that (£4,930) and adding the result to £24,000 we find that a person aged 65 to 74 with an income of £28,930 or more gets no age-related allowance. For those aged 75 and over, this figure is £29,230.

- the calculation of taxable income for the purposes of calculating the taper is adjusted for various items such as gift aid payments and pension contributions, which makes its calculation complex;
- the taper interacts with tapering of the married couple's allowance (see section B of this Chapter, below), where that relief is also claimed, making the calculation even more tortuous for older taxpayers;
- the difference between the two levels of age allowance is now small, yet having two different rates contributes to complexity;
- the age allowance has to be claimed<sup>3</sup> and the HMRC's processes for so doing are not infallible, sometimes leading to the allowances going unclaimed for many years, with tax being overpaid as a result;
- the tapering of the allowances makes it almost impossible to collect accurate amounts of tax in-year, thus requiring an end of year adjustment. It is therefore HMRC's policy to keep in the self assessment system many taxpayers within the tapering band<sup>4</sup>; and
- the entitlement to additional allowances at age 65 and 75 respectively is out of step with the state pension age, and changes thereto.

**3.5** The OTS has explored the history of age-related allowances (see Annex A), so as to review the original policy rationale and how it fits into a modern context.

**3.6** From the data available to us, there are some 10.3 million people aged 65 and over in the UK<sup>5</sup>. This represents 16.63% of the total UK population, some 62.4 million at 1 January 2011. As might be expected with current demographic trends, both the number of people aged 65 and over, and the proportion of the total UK population they represent has been increasing, from 8.4 million (15%) in 1981, to 9 million (15.75%) in 1991 and 9.3 million (15.83%) in 2001.

**3.7** From HMRC data, in 2007/08 we believe there were some 4.79 million taxpayers claiming age-related allowances, 3.56 million receiving the full, untapered amount, 419,000 receiving a partially tapered amount and 807,000 whose age-related allowance was fully tapered. This leaves some 5.51 million aged 65 and over who are not receiving age-related tax allowances. This may be because they are not taxpayers and therefore not identified within HMRC's systems as claiming the age allowance, but there will almost certainly be some who are entitled to the allowances but who have not claimed them.

**3.8** The National Audit Office have previously raised the issue that age-related allowances may be under-claimed<sup>6</sup>, and the House of Commons Public Accounts Committee reinforced this by recommending that HMRC should attempt to assess how many such allowances go unclaimed<sup>7</sup>. HMRC could follow up this recommendation by seeing how using its systems to identify, and then make contact with, pensioners who may be entitled to age-related allowances but have not

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<sup>3</sup> This is a statutory requirement rather than an administrative one. See Sections 36(1) and 37(1) Income Tax Act 2007

<sup>4</sup> See HMRC Self Assessment Manual ref SAM100050

<sup>5</sup> <http://appsso.eurostat.ec.europa.eu/nui/submitViewTableAction.do>

<sup>6</sup> National Audit Office report, October 2009: "HM Revenue and Customs, Dealing with the tax obligations of older people" – see Executive Summary paragraph 14b.

[http://www.nao.org.uk/publications/0809/dealing\\_with\\_the\\_tax\\_obligatio.aspx](http://www.nao.org.uk/publications/0809/dealing_with_the_tax_obligatio.aspx)

<sup>7</sup> House of Commons Committee of Public Accounts, Eleventh report of session 2009/10 published 25 February 2010 – see Conclusions and recommendations point 3.

<http://www.publications.parliament.uk/pa/cm200910/cmselect/cmpubacc/141/141.pdf>

claimed them. This may be facilitated by the National Insurance and PAYE Service (NPS) database offering improved functionality, compared with the previous system.

**3.9** Furthermore, HMRC data for 2009/10 shows that 320,000 pensioners are in self assessment and have their age-related allowances tapered (282,000 with age-related personal allowance tapered and 38,000 with tapered married couple's allowance).

**3.10** Questions were put forward by those consulted in this first stage of our review as to the Government's intentions for age-related allowances when considered against the pledge in the Coalition Agreement to increase the basic personal allowance to £10,000<sup>8</sup>.

**3.11** It is interesting to note that, when age allowances were introduced in 1975/76, as a replacement for age exemption<sup>9</sup>, they were in themselves a simplification measure, the Chancellor, Denis Healey saying:

**Box 3.B:**

"I believe all Members of the House on both sides will know how much this concession will be welcomed by elderly people, who find the present system complicated and confusing."<sup>10</sup>

**3.12** Furthermore, their predecessor, age exemption, appears to have been introduced to reflect potentially higher costs of living of older people. Yet at the same time, it was acknowledged that younger people "have their responsibilities too" and it was therefore necessary to "hold a fair balance between the young and old".

**3.13** Older people can struggle to meet living costs. They are often on a fixed income once they have retired, or perhaps on a declining income in real terms where flat annuities have been purchased to maximise income on retirement.

**3.14** In reviewing age-related allowances, it is therefore arguable that we should consider whether the balance struck in the policy of years gone by remains valid today. A further consideration is whether the tax system is the right place to compensate, by proxy, for those costs faced by pensioners and whether that compensation is reaching its target audience.

**3.15** It is interesting to note that living costs do not necessarily remain stable during retirement. Much depends on the health and situation of the pensioner, care needs, whether they are single, married, within a civil partnership, or other stable relationship. For example, the Pensions Policy Institute published a report in 2009 in which they noted:

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<sup>8</sup> The Coalition: our programme for government, May 2010, Section 29

[http://www.cabinetoffice.gov.uk/sites/default/files/resources/coalition\\_programme\\_for\\_government.pdf](http://www.cabinetoffice.gov.uk/sites/default/files/resources/coalition_programme_for_government.pdf)

<sup>9</sup> As noted Annex A which gives some historical background

<sup>10</sup> [http://hansard.millbanksystems.com/commons/1974/nov/12/personal-taxation#S5CV0881P0\\_19741112\\_HOC\\_278](http://hansard.millbanksystems.com/commons/1974/nov/12/personal-taxation#S5CV0881P0_19741112_HOC_278)

**Box 3.C:**

“Pensioner spending can drop off as people become older and less mobile, after the age of 75, and then increase again in older age as people acquire health problems and need to spend more on housing, fuel, power and food. However as people reach age 95 and beyond, total spend tends to decrease as spending on items such as clothing, leisure and transport tends to drop off dramatically.”<sup>11</sup>

**3.16** The question is: should the tax system attempt to acknowledge these changing costs?

**3.17** There have been many suggested answers to that question over the course of our discussions in the initial stages of the review. As noted, none of these are formulated into recommendations at this stage. We list them here as points for consideration but we will go on to recommend later in the report that this is an area which requires further focus in the second stage of our review. Some of the ideas have cost implications for the Exchequer, or for claimants of the existing allowances, and so would need careful consideration.

**3.18** Some of the suggestions are administrative, others would require policy decisions. An eventual recommendation from the OTS could comprise a combination of these suggestions, or others which have yet to be proposed or considered.

**3.19** Taking into account the evidence we have obtained and from our research, possible reforms to age-related allowances are listed below:

- consider abolition of all age-related personal allowances, probably by allowing them to ‘wither on the vine’ as the main personal allowance is increased;
- gradually remove age-related allowances – for example by restricting entitlement to them to those born before a certain date, as has happened with the married couple’s allowance;
- give the higher age allowance to all by reference to age and regardless of income level (i.e. abolish the current taper) up to the income level where personal allowances are withdrawn generally.
- if the age allowance is to be withdrawn from those with higher incomes, do not taper it away. Instead, set a higher income threshold (perhaps aligned with the higher rate threshold for administrative ease) at which point the higher allowance is removed all at once, rather than a gradual taper. However, this has obvious marginal rate or ‘cliff edge’ consequences;
- when tapering the allowance, introduce a disregard for a certain amount of savings income so that HMRC can calculate the restriction on the allowance via automatic ‘P800’<sup>12</sup> end of year reconciliations, thus taking many pensioners out of self assessment. The tax cost of so doing, depending on the level of disregard, might be counteracted by administrative savings as a result of processing fewer self assessment tax returns. The level of such a disregard could be considered in the

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<sup>11</sup> Pensions Policy Institute report: Retirement income and assets: do pensioners have sufficient income to meet their needs?  
[https://www.pensionspolicyinstitute.org.uk/uploadeddocuments/2009/PPI\\_Retirement\\_Income\\_and\\_Assets\\_28\\_April\\_2009.pdf](https://www.pensionspolicyinstitute.org.uk/uploadeddocuments/2009/PPI_Retirement_Income_and_Assets_28_April_2009.pdf)

<sup>12</sup> See Annex C for a list of HMRC forms which pensioners may have to use

context of other levels which HMRC uses to decide whether or not a self assessment return should be issued;<sup>13</sup>

- consider whether there is merit in giving age-related allowances as a tax reduction instead of an allowance against income. This reduction could be given to all pensioners over a certain age regardless of income level, but only at a fixed rate, for example at the basic rate (currently 20%). Such an approach could even extend to negative tax – a credit – for non-taxpayers, possibly integrated with other benefits;
- simplify the basis on which the allowances are tapered. For example, the meaning of 'adjusted net income' for the purposes of assessing whether income is over the abatement threshold could be simplified;
- round all allowances to the nearest £50 or £100. For example, for the 2011/12 tax year, £9,950 and £10,100 would have been clearer figures than £9,940 and £10,090 for those aged respectively 65 to 74, and 75 and over;
- for those pensioners not in self assessment or making repayment claims on form R40, give the higher age allowance automatically in the year of becoming eligible for it, without the taxpayer having to make a claim, thus preventing under-claimed allowances. This would require a change in the law, as it currently states that the allowances must be claimed. It could also lead to underpayments in some cases and would need careful thought. The OTS acknowledges that HMRC is changing the way in which age-related allowances are claimed, by replacing the form P161 with a shortened claim form and allowing claims by a new email channel (see section J of this Chapter);
- have just a single age allowance for those aged 65 and over, i.e. remove the differential between age 65 to 74 and those over 75. For instance, the allowances in the 2011/12 tax year are £9,940 for those aged 65 to 74 and £10,090 for those aged 75 and over. The additional tax saving for those aged 75 and over at 20% is just £30 a year (under £0.58 a week);
- consider the age at which the age-related allowance is given: the entry point could be aligned with the state pension age after the equalisation of the women's state pension age with that of men, and the subsequent increase for both men and women; and
- review the age-related personal allowances and married couple's allowance together and consider making the age-related allowances transferable also between spouses and civil partners. At present, there is confusion for pensioners who try to equalise their income, for example by moving savings to the partner with the lower income. This arguably creates unfairness for those who cannot transfer assets to each other, i.e. those whose income is mainly comprised of pensions. Equally, however, introducing transferable personal allowances could create new, albeit different, complexities and may be expensive to the Exchequer and give rise to potential administrative burdens for both pensioners and HMRC.

**3.20** In all the above we would need to have regard to the possible impact on pension credit entitlement.

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<sup>13</sup> SAM100050 - <http://www.hmrc.gov.uk/manuals/sammanual/sam100050.htm>

## B. Married couple's allowance

| The married couple's allowance is currently set as follows <sup>14</sup> : | 2011/12  | Value at 10% | 2012/13  | Value at 10% |
|--|----------|--------------|----------|--------------|
|  | £        | £            | £        | £            |
| Minimum allowance, if full restriction applies                             | 2,800.00 | £280.00      | 2,960.00 | 296.00       |
| Full allowance   | 7,295.00 | £729.50      | 7,705.00 | 770.50       |

**3.21** The married couple's allowance is now available only to married and civil partner couples in which one partner was born before 6 April 1935. It is still possible to claim the allowance where qualifying couples marry or register a new civil partnership. Nevertheless, it is inevitable that the number of couples eligible for, and claiming, the allowance will dwindle over time. HMRC's latest available data, for the 2007/08 tax year, suggests that some 1.19 million couples claimed the married couple's allowance in that year. The OTS appreciates that this information is slightly out of date and consequently the numbers claiming the allowance currently is likely to have decreased.

**3.22** Up to and including the 2008/09 tax year, two different rates of married couple's allowance could be claimed – one for those aged up to 74 and another for those aged 75 and over (based upon the age of the elder spouse or civil partner). However, since 2009/10, all claimants of married couple's allowance must be in the higher bracket, because one of the couple must have been born before 6 April 1935 in order to be entitled to it. They would therefore have reached age 75 in the 2009/10 tax year and so qualify for the higher rate.

**3.23** Oddly, however, the law still provides for a lower rate of married couple's allowance of £7,185 (for 2011/12) for 'any other case' than where a man or his wife<sup>15</sup>, or an individual or their spouse or civil partner<sup>16</sup>, was aged 75 or over in the tax year. As this is now no longer possible, the law could be amended to give an immediate simplification.

**3.24** The married couple's allowance could of course be considered entirely separately to age-related allowance, but there have been suggestions that the allowances should be considered together.

**3.25** On a more detailed level, in the year of marriage or civil partnership registration, the married couple's allowance is only given for those tax months in which the couple's relationship was made official. By contrast, when a taxpayer reaches age 65 or 75, they receive the higher age-related personal allowance for the whole tax year, regardless of when in the tax year their birthday falls.

**3.26** The OTS has not been able to establish how many new claims to married couple's allowance are made each year for new marriages and civil partnerships. However, we were given an example by Tax Help for Older People in Scotland of where an older couple, widow and widower, had remarried at the ages of 75 and 77 respectively but had not realised they were eligible for the married couple's allowance. By the time they found help to claim the allowance, they were 85 and 87, and had lost the benefit of the earlier tax years altogether, as they were out of time to claim.

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<sup>14</sup> <http://www.hmrc.gov.uk/rates/it.htm>

<sup>15</sup> Section 45(3)(b) Income Tax Act 2007

<sup>16</sup> Section 46(3)(b) Income Tax Act 2007

**3.27** The married couple's allowance also operates differently from age-related personal allowances, in two ways:

- it is given at a 10% rate
- it is given as a reduction of the claimant's tax liability rather than as a deduction from income.

These mechanisms for giving relief makes the allowance almost impossible to explain in layman's terms, and causes substantial confusion when showing the allowance on PAYE codes (both for claimants and HMRC staff).

**3.28** There are other peculiarities within the rules. For instance, new rules were introduced from 5 December 2005 in order to recognise civil partnerships as well as married couples for the purposes of the allowance. From this, there remains a divide depending on whether a marriage took place before or from that date as to which of the couple the allowance is first allocated (i.e. for those married before 5 December 2005, it is the husband to whom it is allocated; but for marriages on or after 5 December 2005, it is allocated to the spouse with the higher income). Couples married before 5 December 2005 can elect for the later regime to apply which affects the tapering of the allowance.

**3.29** The married couple's allowance, like the blind person's allowance (which we discuss in section D of this Chapter below) is transferable between spouses and civil partners. The minimum allowance, assuming full tapering has been applied, may be transferred in full or shared between the couple if an election is made to do so before the beginning of the relevant tax year. The rest of the allowance is allocated to the husband (in the case of pre-5 December 2005 marriages) or to the higher-earning partner (in the case of marriages or civil partnerships from 5 December 2005, or other couples who have elected for the newer rules to apply). However, if there is any unused surplus from the husband or higher-earning partner, the balance may be transferred to the wife or other partner.

**3.30** HMRC data provided to the OTS suggests that some 40,000 couples transfer married couple's allowance between them.

**3.31** In the year of death of a spouse or civil partner, the full allowance for the year remains due (i.e., there is no proportionate reduction, as there is in the year of marriage or civil partnership registration), but quite often the deceased's tax liability cannot absorb the full married couple's allowance and there is a balance to be transferred to the survivor. This surplus is currently thought to go unclaimed in many cases.

**3.32** However, it is hoped that improvements to HMRC's form R27<sup>17</sup>, a new version of which the OTS understands should be launched from April 2012, will go some way to addressing this problem.

**3.33** As with age-related allowances, the OTS has not yet formulated any recommendations in relation to the married couple's allowance, except to the extent that it is a priority area for further review in our second stage report. However, again we list some of the possibilities for review and reform:

- consider the policy rationale of retaining the married couple's allowance;
- consider giving it as an allowance against income in the same way as the personal allowance or blind person's allowance, which would remove the complications of the relief being restricted to 10% and minimise the differences with other personal

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<sup>17</sup> see forms Annex C; and section L of this Chapter below

allowances. The amount of the allowance would need to be considered in the context of cost to the Exchequer;

- halve the allowance and give relief on it at 20%, thus removing the confusion of the 10% rate. This would also reflect the way the allowance is already shown on many PAYE Coding Notices (form P2), i.e. in order to give the correct 10% tax relief, half of the married couple's allowance is added to the taxpayer's personal allowance on their form P2;
- do not taper the allowance. Instead, set a higher income threshold (perhaps aligned with the higher rate threshold for administrative ease) at which point the higher allowance is removed all at once. But, as with age allowances, this has obvious marginal rate or 'cliff edge' consequences;
- when tapering the allowance, introduce a disregard for a certain amount of savings income so that HMRC can calculate the restriction on the allowance via an automatic 'P800' end of year reconciliations, thus taking many pensioners out of self assessment. The tax cost of so doing, depending on the level of disregard, might be counteracted by administrative savings as a result of processing fewer self assessment tax returns;
- simplify the basis on which the allowances are tapered. For example, the meaning of 'adjusted net income' for the purposes of assessing whether income is over the abatement threshold could be simplified;
- clarify the way it is shown and explained on taxpayers' PAYE coding notices. Although the OTS understands that HMRC has been addressing some problems where taxpayers were being given the full allowance in their codes, not restricted to take account of the relief only being due at 10%, it will be important to check the 2012/13 coding notice run to ensure this problem has been resolved. We would therefore anticipate keeping this under review in the second stage of the pensioner review. In any event, the mechanics and explanations of how the allowance is shown should still be reviewed;
- consider replacing the married couple's allowance with increased age-related personal allowances (and consider making them transferable). Although the OTS appreciates that there are significant revenue implications, in terms of overall cost to the Exchequer, the next stage of our review could consider this in more detail. For example, those claiming pension credit might be entitled to less benefit if their overall net-of-tax income (on which their benefit claim is based) is increased as a result of tax reform, which could have some balancing effect;
- review how the differences in marriages pre/post 5 December 2005, and election for new rules to apply, could be simplified. In particular, should the post-2005 rules apply to all;
- review and aim to simplify HMRC form 18 and form 575 which respectively relate to transferring the married couple's allowance and transferring surplus allowances between spouses and civil partners; and
- abolish the apportionment of the relief in the tax year of marriage or registration of civil partnership, which seems to be an unnecessary complication and would give a straightforward simplification of the rules. Of course, it would be helpful to know how many claims there are each year to calculate an approximate cost of so doing. There is, however, a concern that if there are only a few new claimants each year (see box below), the cost of changing the rules and HMRC's systems as a result



could be disproportionate to the simplification achieved, if this measure went through in isolation.

### Box 3.D: Data on marriages and civil partnership registration

The OTS has looked for data on the number of marriages and new civil partnerships registered by those potentially eligible for the married couple's allowance.

**Civil partnerships:** The data we have found shows that, across the UK there were 325 new partnerships registered in the age 65 and over group in 2010<sup>18</sup>. We have not found data for those born before 6 April 1935.

**Marriages:** In 2008, 1,148 men and 436 women over the age of 75 were married in England and Wales<sup>19</sup>. We have only been able to locate data for Scotland<sup>20</sup> and Northern Ireland<sup>21</sup> for marriages in the age 55 and over range, which is not representative of those who could claim married couple's allowance.

## C. Sundry reliefs

### C.1 Qualifying maintenance payments to ex-spouses

**3.34** In a similar vein to the married couple's allowance, there is a residual income tax allowance available to those born before 6 April 1935 who are making maintenance payments to a former spouse.

**3.35** Those who qualify for the relief are entitled to a tax reduction of 10% of the amount of the payments or, if less, the equivalent of the minimum married couple's allowance (that is, £2,440 @ 10% for the 2011/12 tax year, i.e. £244)<sup>22</sup>.

**3.36** The OTS understands that some 6,900<sup>23</sup> taxpayers were still claiming this relief in 2007/08, of whom 3,200<sup>24</sup> complete self assessment tax returns. It is presumed that the rest claim it year on year through their PAYE coding. In the same way as the married couple's allowance, the number of claimants is likely to diminish over time with the latest birth date for claiming it fixed at 6 April 1935 and indeed as the latest data available at present is for 2007/08, the numbers may already be lower than shown above.

**3.37** Although the number of claimants is minimal and likely to diminish, our review has not identified any particular complexity with the relief itself or its claimants. There might therefore be little perceived simplification if it were abolished.

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<sup>18</sup> [Office for National Statistics, Civil Partnership Formations 2010: Table 4 Civil Partners \(numbers\): by year, age group, country of formation and sex](http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm:77-224152)  
<http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm:77-224152>

<sup>19</sup> Office for National Statistics, Age at marriage and previous marital status, final 2008 figures: Tables 3a and 3b  
<http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-210946>

<sup>20</sup> General Register Office for Scotland, Vital events reference tables 2009: Table 7.1, Marriages, by sex and age, Scotland, 1946 to 2009  
<http://www.gro-scotland.gov.uk/statistics/theme/vital-events/general/ref-tables/2009/marriages.html> (in 2009, 1,873 men and 1,075 women aged 55 and over were married in Scotland)

<sup>21</sup> Northern Ireland Statistics and Research Agency, Marriages by sex and age, 1948 to 2010, Table 7.1  
<http://www.nisra.gov.uk/demography/default.asp11.htm> (in 2010, 328 men and 184 women aged 55 and over were married in Northern Ireland)

<sup>22</sup> Part 8, Chapter 5 Income Tax Act 2007

<sup>23</sup> HMRC data

<sup>24</sup> HMRC data

**3.38** However, given its link to the married couple's allowance and origins in an earlier system of tax relief for maintenance payments, it nonetheless may warrant further review in the context of a wider married couple's allowance review. The OTS's review of the married couple's allowance as part of the second stage of the pensioners' review will therefore have regard to this linked relief.

## C.2 Relief for interest to acquire an equity release annuity

**3.39** There is a further obscure relief for interest on a loan taken out to purchase a life annuity (an equity release)<sup>25</sup>. In 1999 the relief was spared from the general cull of MIRAS relief, and this section remained for loans taken out before 6 April 1999.

**3.40** In 1999, it was estimated that there were 10,000 borrowers eligible<sup>26</sup>, who had to be 65 or over at the time the loan was made. Therefore, the youngest of those eligible must now be some 78 years old and the number remaining eligible for the relief is likely to be low.

**3.41** Removing this relief would in turn enable removal of all of the remaining MIRAS legislation still in ICTA 1988. This is arguably a significant simplification.

**3.42** The abolition of life assurance premium relief (LAPR), now included in Finance Bill 2012<sup>27</sup> following a recommendation by the OTS is a useful precedent for how to manage such an exercise. As with LAPR, the impact of withdrawal of this relief will need to be considered carefully, together with appropriate compensation methods.

## D. Blind person's allowance

**3.43** The blind person's allowance (BPA) is an additional allowance for individuals who are certified blind or severely sight impaired (the rules varying depending on where in the UK the taxpayer lives). The OTS review of tax reliefs<sup>28</sup> considered the allowance in some detail, saying that the relief was 'not used by the majority of blind people as they do not earn sufficient income and there may be better ways to assist those with a visual handicap'. There was also regular evidence that some of those able to use the relief do not claim it, and lack of appreciation of transfer possibilities.

**3.44** We thought that the relief should be abolished and the relief potentially available given in more direct ways to those potentially eligible. However, we recommended 'not abolishing this relief until an alternative and equivalent funding route is put in place'. Annex E of the final tax reliefs report set out our thinking on this relief in full.

**3.45** This allowance was again brought up by many to whom we spoke in the information-gathering stages of the pensioner tax review.

**3.46** This is because the incidence of blindness increases with age, as noted in Annex E of our reliefs review:

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<sup>25</sup> Section 365 ICTA 1988 (not rewritten as part of the Tax Law Rewrite project)

<sup>26</sup> Explanatory notes to Finance Bill 2009, clause 36 as introduced, <http://archive.treasury.gov.uk/financebill/1999/c36.html>

<sup>27</sup> See HM Treasury Consultation on draft legislation for Finance Bill 2012, [http://www.hm-treasury.gov.uk/d/ots\\_life\\_assurance.pdf](http://www.hm-treasury.gov.uk/d/ots_life_assurance.pdf)

<sup>28</sup> [http://www.hm-treasury.gov.uk/d/ots\\_review\\_tax\\_reliefs\\_final\\_report.pdf](http://www.hm-treasury.gov.uk/d/ots_review_tax_reliefs_final_report.pdf)

### Box 3.E: Extract from OTS review of tax reliefs - blind person's allowance

"E.8 The major reason for this is that most blind people have insufficient income to claim the allowance, but other potential reasons include:

We understand that up to 40,000 people each year become blind or severely sight impaired ("SSI"). A further reason for the low take up is that for many of these people it occurs later in life and therefore the BPA is not known about, and tax is low down the list of priorities when an individual is coming to terms with being blind;

Most of these individuals are over 75 and, as they may also have other disabilities, they may receive certain other benefits. Few of these individuals are likely to have sufficient taxable income to utilise BPA;

..."

**3.47** The different qualification criteria for the allowance according to where in the UK the taxpayer is resident contribute to its complexity, with the rules for Scotland and Northern Ireland being different from those in England and Wales.

**3.48** When talking to pensioner advisers in Scotland, the illogicality of the criteria for claiming BPA for taxpayers living there was raised. Given that the vast majority of people with eyesight impairment in Scotland are thought to be over the age of 60<sup>29</sup>, why link the allowance to the individual's capability 'to do any work for which eyesight is essential'<sup>30</sup>? The same rules apply in Northern Ireland.

**3.49** This definition could, in itself, deter those with degenerating eyesight in older age from claiming the relief, as the wording of the law could be misinterpreted to the effect that to be entitled one has to be of working age.

**3.50** We appreciate that our earlier recommendations on the BPA were not taken forward. However, given the strong link between sight impairment and older age and the views we have gathered from pensioner advisers, we believe that we would be failing in our brief to identify complexity if we did not raise the matter again in this review. In short, we have to reiterate our earlier conclusion and recommendation, that the available funds for the relief would be better utilised by direct grant rather than the poorly-used tax relief.

## E. Savings taxation

### E1 The 10% savings rate

**3.51** Another repeated theme in our pensioner review has been the complexity of the 10% savings rate<sup>31</sup>, introduced with effect from 2008/09<sup>32</sup> after the abolition of the starting rate of tax at 10%.

**3.52** The 10% starting rate for savings does not cause complexity for pensioners alone, as it can be claimed by taxpayers of any age provided they meet the qualifying criteria. Given, however, that older people who have retired are often on incomes low enough to claim the rate, and

<sup>29</sup> See, for example, the DeafBlind Scotland website which quotes "Most deafblind people are over 60 years of age and have become dual sensory impaired as part of the ageing process."

[http://www.deafblindscotland.org.uk/index.php?option=com\\_content&view=article&id=67:fast-facts&catid=39:deafblindness&Itemid=55](http://www.deafblindscotland.org.uk/index.php?option=com_content&view=article&id=67:fast-facts&catid=39:deafblindness&Itemid=55)

<sup>30</sup> Section 38 Income Tax Act 2007

<sup>31</sup> Section 7 Income Tax Act 2007

<sup>32</sup> Section 5 and Schedule 1(2) Finance Act 2008, effective from 2008/09 and subsequent tax years

might have some savings, pensioners are more likely to be eligible for it than other segments of the population.

**3.53** The general view is that this rate is not applied to all taxpayers who should qualify for it. This is because the taxpayer either has to be in self assessment or submit an R40 repayment claim in order to get the benefit of it. Due to people's lack of awareness of the rate and the intricacies of working out whether or not it applies, many therefore do not understand they can make a repayment claim for the 10% of the 20% tax that was deducted on their savings income but which falls in this band. HMRC data suggests that there are some 387,000 'pensioners' (using the OTS definition of people aged 60 or over who are in receipt of any form of pension) in contact with HMRC who are benefiting to some extent from the 10% savings rate. Those pensioners are either in self assessment or know that they can claim for repayment of tax.

**3.54** One complication of the relief is that the savings rate band is notionally absorbed by other income over and above the personal allowance. Therefore, to the extent that a pensioner's cumulative pension (or, say, rental) income exceeds his or her personal allowance, the benefit of the 10% rate against savings income is lost.

**3.55** For 2011/12, the starting rate band of 10% applies to savings income up to £2,560 over the personal allowance.

**Box 3.F: Example:**

Frieda, aged 67, has pension income of £12,250 a year. She has taxable interest on savings of £1,000 gross, on which £200 tax is deducted at source. Her entitlement to the savings rate band (potentially £2,560) is reduced to £250 by virtue of the £2,310 excess of her pension income over her personal allowance of £9,940. Therefore, she can claim a tax repayment of £25 as a result of the 10% savings rate.

**3.56** In considering the case for removal of this complex 'relief', the OTS will need to do further work. It will be necessary to consider the numbers affected by any proposals and whether there would be a mechanism for compensating them. Such compensation could, for example, take into account that there could be administrative cost savings as a result of fewer repayment claims (R40) being made. It is clearly possible that any such compensation would be indirect, i.e. not precisely targeted at those who lose out; but that is a policy matter and beyond the remit of the OTS.

## **E2 Registering for interest paid gross on bank and building society deposits**

**3.57** Form R85 is used by non-taxpayers to register to receive gross interest on bank and building society deposits. This is currently, however, an 'all or nothing' arrangement in that a person can only register for gross interest if they believe they will be a non-taxpayer for the year based upon their total anticipated income including the interest.

**3.58** Many pensioners have two or more savings accounts. It has been suggested that there would be a cashflow benefit for pensioners, as well as a possible reduction in R40 repayment claims submitted to HMRC, if this policy were to be relaxed so that taxpayers could register for gross interest on some accounts but not others. This could allow them to obtain the benefit of their personal allowance without having to file an interim R40.

### Box 3.G: Example

Hannah, aged 71, has pension income of £8,500. She has interest of £1,000 from Bank A and of £1,200 from Bank B. Her 2011/12 personal allowance is £9,940. Because her total income is greater than her allowance, she cannot use Form R85 to get gross payment, even though her pension plus interest from Bank A is less than her allowance. If she could choose to complete an R85 for Bank A but not for Bank B, the amount of tax deducted only on interest from Bank B would be much closer to her actual liability to tax.

**3.59** Furthermore, if the taxpayer is in self assessment because they are “in receipt of savings or investment income (from which tax has been deducted) of £10,000 or more (before tax)”<sup>33</sup> they have to have tax deducted on all of their savings interest in-year, and wait to reclaim it after the end of the tax year. The law prohibits them from making a provisional tax reclaim in-year, for example by filing an interim R40<sup>34</sup>.

**3.60** This can be a particular problem for pensioners who are reliant on savings to supplement pension income.

**3.61** In considering this issue further in the second stage of our review, we will aim to investigate the numbers of pensioners adversely affected by the current situation and would welcome any suggestions as to how an alternative system could be put in place which makes life easier for taxpayers but minimises risk to the Exchequer.

### E.3 Form R85 following a bereavement

**3.62** R85s might no longer apply when a pensioner loses a spouse or civil partner. The survivor may have been a non-taxpayer prior to their loss but, due to inheriting pension income and other assets from the deceased, their position may change.

**3.63** If R85s are not withdrawn at that point, an underpayment of tax can arise.

**3.64** However, to date there has been no trigger to warn the survivor of this issue. Government information available in the form of Department for Work and Pensions’ (DWP) booklet DWP1027<sup>35</sup> does not provide any information. However, the OTS has noted that the notes accompanying the new style form R27, planned for introduction from April 2012, do include a section on reviewing R85s for the surviving spouse. This is a welcome development.

### E.4 Repayment claims

**3.65** The repayment claim form R40 (for tax overpaid on savings income) is currently available on paper only. Representations have been made to the OTS that it would be administratively simpler for many pensioners and advisers, as well as for HMRC, if the form could be filed online. Of course, we are not suggesting that the form should only be available online: as we discuss in section N, pensioners, more than any other group of taxpayers, need continuing access to paper as well as other methods.

<sup>33</sup> SAM100050 - <http://www.hmrc.gov.uk/manuals/sammanual/sam100050.htm>

<sup>34</sup> Section 42(2) of the Taxes Management Act 1970 (TMA) requires that “... where notice has been given under section 8, 8A or 12AA of this Act, a claim shall not at any time be made otherwise than by being included in a return under that section if it could, at that or any subsequent time, be made by being so included”. However, interim refunds of PAYE are permitted by virtue of the exclusion from this rule set out in Section 42(3) TMA (for example by filing form P50 where employment ceases – see forms Annex C, or form P53 where too much tax has been deducted on taking a lump sum from a small pension, otherwise known as ‘trivial commutation’ – see section H of this chapter.

<sup>35</sup> Last revised January 2009 - <http://www.dwp.gov.uk/docs/dwp1027.pdf>

**3.66** We understand from HMRC that concerns around possible frauds delayed the introduction of an online R40 but that HMRC is currently developing an online version of this form. This report endorses the benefit of that work and we hope that it will lead to online availability in the near future.

## **E.5 Dividends on overseas shareholdings**

**3.67** The OTS has noted that there are complications if pensioners hold shares in foreign companies. For instance, many might have held accounts with previous mutual societies which have now been subject to take over from abroad, e.g. Abbey National, taken over by Banco Santander.

**3.68** HMRC has introduced some simplification for self assessment taxpayers in that foreign dividend income of up to £300 can now be reported on the main return, rather than completing the foreign pages. But if income increases above that level so that the foreign pages must be completed, the OTS has heard that pensioners struggle to understand HMRC's accompanying guidance notes. Moreover, the treatment of up to £300 of foreign dividends as UK dividends does not extend to the criteria for requiring a self assessment return to be filed: any amount of foreign income puts a person into self assessment<sup>36</sup>.

**3.69** This is, however, not an issue exclusive to pensioners and has not been a subject of primary investigation in preparation of this interim report. Nevertheless, we suspect that it is a bigger issue for pensioners than for younger taxpayers given that the demutualisation of the majority of societies like Abbey National and others occurred in the late 1980s and early 1990s and that those benefiting from demutualisation were perhaps likely to be older savers at the time. We would therefore not rule out further investigation of this point.

## **E.6 Purchased life annuities**

**3.70** A purchased life annuity is the exchange of a capital sum for a regular income. For tax purposes, part of the receipt is treated as a return of capital and part is taxable income (taxed in the same way as savings interest).

**3.71** In the early stages of preparing this interim report, it was suggested to the OTS that there is some confusion between the tax treatment of this type of annuity and ordinary pensions.

**3.72** At this stage, the OTS has not obtained any particular evidence of those complexities, nor were these type of annuities raised in many instances during the meetings we held around the UK. We deduce that information provided by the annuity providers suffices to help annuitants. However, it may well be that there is scope for the initial notifications to annuitants to spell out more clearly what will happen to the annuity as regards tax.

## **E.7 Interest information from deposit-takers**

**3.73** Both agents and taxpayers have told the OTS that it can be difficult to obtain accurate interest details from banks and building societies for inclusion on tax returns, to prepare repayment claims or to check P800 tax calculations from HMRC.

**3.74** It is perceived that this is an increasing problem with fewer banks and building societies issuing end of year tax certificates as a matter of course.

**3.75** Agents waste time (and costs) on taxpayers' behalf trying to reconcile details and unrepresented taxpayers may make errors in manually totalling interest figures and may forget some accounts.

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<sup>36</sup> See <http://www.hmrc.gov.uk/sa/need-tax-return.htm> which says: "You must complete a tax return if you have any foreign income that's liable to UK tax".

**3.76** The suggestion has been put to the OTS that it should be compulsory for deposit-takers to send all account holders certificates of interest and tax deducted each tax year<sup>37</sup>.

**3.77** The OTS notes, however, that our review has not included discussions with deposit-takers, so further work on this aspect would be needed prior to formulating recommendations.

## **F. The state retirement pension and its interaction with certain other benefits**

### **F.1 Fundamental points – the origins of complexity and considering whether the state pension should be taxable at all**

**3.78** Taxation of the state pension was a common theme amongst those consulted. The historical background to the taxation of the state pension is summarised in Annex A.

**3.79** There are many misconceptions amongst the pensioner population over how taxation of the state pension currently works. The key point is probably that many people do not understand that it is taxable at all<sup>38</sup>. Furthermore, many of those who do understand that it is taxable feel that this is unjust, given that they have contributed through the national insurance system throughout their working life.

**3.80** This misunderstanding is compounded by the fact that the state pension is paid by the DWP without PAYE applying. This leads to many coding problems. We explore this aspect further below.

**3.81** There is some feeling that because there is no tax relief on national insurance contributions (NICs) which count towards eventual entitlement to the state pension, the state pension should not be taxed when it is paid out. Contrasting this to private pension savings, where tax relief is generally available on pension contributions and part of the eventual fund can be withdrawn tax-free, the confusion is perhaps understandable. We acknowledge that pension contributions are not deductible for national insurance contributions purposes but the symmetry is maintained with no national insurance contributions on pensions.

**3.82** For many pensioners, the reason for distinction between different Government departments is unclear. Whether it is HMRC or DWP they are dealing with, their perception is usually that it is 'all government' and so they should be able to communicate through a single entry point. It can therefore come as a surprise that HMRC does not necessarily have all the same information about the taxpayer that is held by the DWP. Moreover, the distinction between local and central Government can be unclear as is what data is shared (or not, as the case may be) between the two. This may be a factor for those pensioners claiming council tax benefit and help with housing costs, for example.

**3.83** Whilst a single entry point into Government to deal with tax and benefits matters together might be difficult to achieve, more coordinated working and guidance between different departments would be a step forward. Longer term, with the Government consulting on modernising the personal tax system for individuals and improving transparency, there are opportunities to explore greater links between HMRC and DWP systems. Moreover, pre-filling of data from the DWP onto HMRC tax forms and pre-population of Real Time Information (RTI) data on the DWP's systems for the purposes of benefit calculations (as envisaged for Universal

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<sup>37</sup> Section 975(2) Income Tax Act 2007 says "(2) If the recipient requests it in writing, the person must provide the recipient with a statement showing — [details of interest and tax]". This contrasts with the position for gains on life assurance policies where the insurer is obliged to send the information – s 552(1)(a) ICTA 1988.

<sup>38</sup> See Annex D to this report. HMRC data submitted to the OTS quotes from the DWP's Attitudes to Pensions: The 2009 Survey, thus: '37% of respondents were not aware of any rules about pensions and tax' and 'less than half (41%) were aware that Pension Income is subject to tax like regular income'.

Credit) is likely to result in taxpayers having a greater perception of Government as a single entity rather than separate departments with different responsibilities.

**3.84** It is therefore essential to address at an early stage how these developments are to be communicated – both for the benefit of today’s pensioners and those of the future – and what their responsibilities are in terms of checking that everything is working as it should be.

**3.85** The dividing lines between different parts of Government can cause problems for those receiving other state benefits, particularly those which might be paid with the state pension.

**3.86** Some benefits are not taxable – for example: attendance allowance, pension credit, winter fuel payments, the Christmas bonus and cold weather payments. Yet pensioners often do not understand the distinction and might therefore mistakenly include them with their state pension when filling in a self assessment tax return, or struggle to reconcile the figure on their PAYE coding notice or PAYE annual reconciliation calculation.

**3.87** The possible solutions to the problems are manifold. None of the options below should be taken as recommendations of the OTS at this stage, but for completeness the discussions have included:

- leave the system as it is but explain it better to taxpayers (this applies to both HMRC and DWP);
- improve the communications between HMRC and DWP;
- exempt the state pension from tax altogether;
- get the DWP to operate PAYE on the state pension (universally, or in cases where total state pension exceeds the personal allowances);
- issue a ‘P60’ equivalent form for the state pension at the end of the tax year, clearly showing the amount of taxable state pension and any other taxable benefit; and
- change the basis of taxation of the state pension from an entitlement basis to a receipts basis, thereby overcoming problems of working out the amount of state pension to be taxed, which can be a particular problem in the first year of payment and when payments are made four or 13 weeks.

**3.88** Indeed, an eventual simplification strategy might comprise a combination of one or more of the above or other possibilities. These will be explored further in the second stage of our review. The OTS acknowledges that issues affecting the DWP and its administration of the state pension will need to be taken into account.

## **F.2 Tax and a new state pension – the current system and changes already in progress**

**3.89** We understand that HMRC and the DWP are working together to improve the flow of information about the state pension and thereby aim for prompt and accurate collection via PAYE coding of the tax due on it, where possible.

**3.90** The DWP currently informs HMRC of new state pensions through a paper process. The DWP generates form P46DWP where it accepts a claim to state pension and

- the customer provides a PAYE reference; or
- the amount of state pension in payment is more than £38 a week.

**3.91** The P46DWP includes the rate of state pension payable and is sent to HMRC within three months (or less) of the pensioner reaching their entitlement date. The form often includes an ‘initial’ award where a ‘final’ figure has not been determined at the time of a claim being accepted. HMRC applies the information to the pensioner’s records on or after their entitlement



date. State pension is not included in tax codes before the entitlement date is reached. Revised tax codes are issued at this point.

**3.92** Where HMRC decides that there is income tax liability that can be met using PAYE, the P46DWP (slip) is detached from the P46DWP form and sent to an internal capture group within HMRC. This team captures the information from the slip onto an electronic file which is emailed regularly back to DWP. The purpose of this is to ensure that the DWP sends HMRC annual updates for these cases of the revised amount of state pension payable from the following 6 April. The annual updates normally take place in December or January.

**3.93** As a result of a joint working initiative between HMRC and the DWP, the OTS understands that HMRC plans to automate the P46DWP process for state pension recipients from October 2012. The project includes an electronic interface with the DWP on which state pension information will be passed to HMRC for all new recipients.

**3.94** Information will be passed to HMRC on the state pension entitlement date, by which time it is expected that a high proportion will be confirmed final amounts. DWP will also send amendments where payable amounts change, something that is not within the current process (this can happen in particular on the death of a spouse when the surviving spouse's pension may be increased). On receipt of state pension payable amounts, HMRC will trigger automatic tax code calculations. The proposed changes offer the benefit of ensuring that tax codes include the latest, most accurate state pension information.

**3.95** However, there are strong views that this does not go far enough to simplify the tax system for state pensioners.

**3.96** There are also concerns that the interim solution adopted between October 2011 and the launch of the fully automated system from October 2012 could lead to some pensioners still paying an incorrect amount of tax.

**3.97** This interim solution is that HMRC will automatically insert an amount of basic state pension into the PAYE tax code when an individual reaches pension age. The aim was to reduce considerably the number of pensioners who face unexpected large underpayments after the end of year reconciliation. However, as HMRC will only be inserting an estimated amount of state pension, a significant level of inaccuracy will still remain.

**3.98** Whilst the OTS understands the rationale for this interim measure, concerns have been raised that there are insufficient safeguards for those pensioners where an estimate is used in their code, to ensure that the right tax is paid at the end of the year. For example, those who have deferred taking their state pension may nonetheless find their PAYE code has been restricted and, if they do not understand or take appropriate action, they could significantly overpay. It is therefore essential that HMRC undertakes to review all records where a basic amount has been inserted in the absence of a final figure, and to ensure that those cases are reconciled after the year end. In so doing, HMRC must ensure that the reconciliations use final and accurate state pension figures from the DWP or contacts the pensioner if there is any doubt.

### **F3 PAYE and the state pension**

**3.99** Although the OTS is mindful that there would be costs involved for Government if the DWP were to operate PAYE on state pensions, this suggestion was made almost unanimously by those to whom we talked in the information-gathering stage of our review. Before any firm recommendation can be made on this point, there needs to be a detailed review of the costs and benefits, including HMRC's and the DWP's capacity to manage the transition to new arrangements and to deal with enquiries.

**3.100** The state pension is often the largest source of a pensioner's income. Therefore if it were on a par with other pensions taxed under PAYE, it would normally be the source to which a pensioner's personal allowance is allocated.

**3.101** It might not be necessary to operate PAYE on all state pensions to achieve some simplification, but operating it on a limited basis could reduce the number of pensioners within self assessment. As a starting point, all state pensions would need to be within the scope of PAYE, but many would naturally fall out of tax with personal allowances exceeding pension income.

**3.102** The cost implication of operating PAYE on the state pension in certain cases might therefore be offset to some extent by the reduced cost of administering self assessment for those same pensioners. On its introduction, the new system would of course need to be explained to pensioners. HMRC and DWP would need to develop clear communications on the transition. This is the same with any change, but the intention is of course to make pensioners' tax easier to explain and deal with in the future which might mean accepting an additional cost in the short term.

**3.103** HMRC data for 2009/10 suggests there are some 47,000 pensioners with state pension as their only source of income who currently have to file self assessment tax returns each year as there is no other mechanism for collecting the tax due from them. This is because the state pension is paid to them gross yet it exceeds the personal allowance to which they are entitled. For some female pensioners under the age of 65, this might be the basic personal allowance; for others aged 65 or over, this would apply where the state pension exceeds the age-related allowance. Some administrative easement is provided for this group in that HMRC should supply them with a short tax return (SA200)<sup>39</sup>.

**3.104** Whilst 47,000 out of the total pensioner population is a small proportion, there are other state pensioners who are in self assessment because the state pension is paid gross. Those who have small amounts of private pension income which is not large enough to enable their whole tax liability to be collected from it under PAYE also have to complete annual tax returns. This can be because of the overriding limit of 50% on the amount of income that can be deducted from PAYE income when operating a K code<sup>40</sup>.

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<sup>39</sup> See [SA200 Short tax return on HMRC website](#)

<sup>40</sup> See Regulation 2(1) (Interpretation) of the Income Tax Pay As You Earn Regulations 2003 (SI 2003/2682) for the meaning of the overriding limit – being 50% of the payment concerned - and regulation 23(5) for its application in the context of K codes

### Box 3.H: Example

Bill, aged 66, has state pension income of £221.15 a week from April 2011. He also receives a pension from his former employer of £25 a month. For the 2011/12 tax year, his total income is therefore £11,800. He is entitled to an age-related personal allowance of £9,940, so £1,860 of his income will be taxed at 20%, i.e. tax due of £372. A code of K155 will be operated against his private pension, but the overriding limit will be applied, so tax of just £150 will be deducted under PAYE, leaving a balance of £222 to be collected under self assessment.

Note in this example that even disapplying the K code overriding limit of 50% and collecting 100% of the private pension as tax would still leave a liability of £72 due under self assessment.

How would Bill's position differ if PAYE were operated on his state pension?

A PAYE code of 994P would operate against the state pension, and a BR code against the private pension.

He would not have to fill in self assessment returns, as all his income would be taxed at source. Furthermore, he would not have to set aside funds to pay his tax liability on 31 January following the tax year, as he currently does under self assessment.

**3.105** By requiring the DWP to operate PAYE on the state pension, there is potentially a further administrative saving for pensioners on low incomes who are also claimants of state benefits. Entitlement to pension credit is, for example, calculated on net of tax income. This presents a problem for state pensioners who are in self assessment, and in particular women in receipt of the state pension but not yet entitled to the higher age-related income tax allowances. The DWP default to calculating pension credit on the gross state pension and claimants do not always realise that they are able to adjust their income figure for the tax due under self assessment. Making this adjustment is also potentially an administrative complexity for the DWP.

**3.106** If the state pension were paid net of tax from the outset, this complexity would disappear. However, we do acknowledge that there is an administrative burden to bring the state pension into PAYE, the scale and full impacts of which need to be identified through further work.

### F4 Information from the DWP about the state pension

**3.107** At present, state pensioners are notified by the DWP of their state pension entitlement at various points:

- before it starts to be paid on a first claim;
- when the rate of payment changes; or
- just before the beginning of the new year (i.e., in the spring before the new rates of pension begin in early April).

**3.108** The only other information state pensioners receive is from their bank statements which show the amount of benefit credited, which may be the state pensions plus an amalgamation of non-taxable benefits such as attendance allowance.

**3.109** From this, it is often difficult for taxpayers and their advisers to determine the correct amount of taxable state pension to record on a tax return (or to separate out taxable state

pension from other non-taxable benefits), or to check the state pension restriction in a P2 coding notice. Tax advisers in practice report that taxpayers often send them the wrong year's state pension figure with their tax return information. For example, many clients send the letter confirming the rate of pension payable from April 2012 with their 2011/12 tax return information, whereas the adviser actually needs to know the figure from April 2011.

**3.110** Moreover, pensioners in self assessment who are unrepresented are likely to make errors<sup>41</sup> when completing their tax returns as a result of not having ready information as to their taxable state benefits. This is potentially costly for HMRC if those returns then have to be corrected, or indeed could be very costly to the taxpayer if the error goes unnoticed and they overpay tax as a result of returning non-taxable items with their state pension. These problems are compounded if they go undetected for a number of years.

**3.111** A reduction in this type of avoidable error could save on administration for HMRC which would release resources to direct towards other, arguably more productive, work.

**3.112** A change in administration – the DWP providing a 'P60 equivalent'<sup>42</sup> at the end of the tax year – is therefore perceived by many as an easy step towards practical simplification. The feasibility of the DWP providing this information and the associated costs would of course need to be taken into account. These are factors which could be explored in more detail in the second stage of our review.

**3.113** In bereavement cases, it has also been put forward that DWP should automatically issue details to the administrators of an estate of how much state pension was paid in the final tax year to date of death, for the purposes of finalising the deceased's affairs. Anecdotally, it often takes several attempts to obtain this information.

## **F5 Raising awareness of how the state pension is taxed**

**3.114** Representations have been made to the OTS from those consulted that there is insufficient or poor information given to state pensioners about the tax status of their state pension and how the tax on it will be collected, particularly for those claiming the state pension for the first time.

**3.115** In preparing this interim report, the OTS has been advised that HMRC does not proactively send detailed information to new state pensioners about how their state pension will be taxed. Leaflet IR121 *Approaching retirement, a guide to tax and national insurance* is available online<sup>43</sup> (although HMRC will provide hard copies of information on request). The DWP has advised us that the award notice and statement of details advising state pensioners of their new (or revised) entitlement to state pension includes the following paragraph in relation to income tax:

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<sup>41</sup> HMRC figures show that for 2009/10, they made corrections of 25,267 main tax returns and 10,512 short tax returns in respect of state pensions. The split of represented/unrepresented taxpayers amongst these figures has not been identified, and more information as to the type of errors would be needed to draw any firm conclusions.

<sup>42</sup> The ideal would be for this P60 equivalent to list all payments by the DWP, making it clear which are taxable, and which are not.

<sup>43</sup> <http://www.hmrc.gov.uk/leaflets/ir121.pdf>

### Box 3.I: Extract from DWP information to new state pensioners

#### Income Tax

State pension is taxable. You should tell your Tax Office about the amount of state pension you will get and the date you will start receiving it from.

There is more information about this in leaflet *Income tax and pensioners*. You can get this leaflet from any HM Revenue & Customs office or Tax Enquiry Centre. Their phone numbers and addresses are shown in the business numbers section of the phone book. Look under HM Revenue & Customs.

We will send you a statement once a year. Keep the statement, as the details will help you if you have to fill in a tax form.

**3.116** However, it seems the DWP is still using an earlier title for the HMRC leaflet IR121 which is now called *Approaching retirement, a guide to income tax and national insurance contributions*. HMRC has agreed that they will liaise with the DWP to update this reference.

**3.117** In any case we note that many new pensioners will not have a 'tax office' if they have been dealt with via PAYE and few will have access to a local office these days. It would be much better to give a standard address to contact and also clear details of how the pension will (or will not) be taxed.

**3.118** We understand that the DWP also has two other information leaflets relating to the state pension – the BR33<sup>44</sup> and the BR1<sup>45</sup>. Although these do make reference to the state pension being taxable, they do not specify how tax will be collected on it.

**3.119** Failure to make taxpayers aware of how the state pension is taxed can lead to pensioners getting into debt and being unable to pay when they eventually realise their liability. This awareness perhaps arises only when a self assessment tax return is issued and completed after the end of the tax year. Depending on when the taxpayer claimed their state pension during the tax year, this could be some considerable time later, particularly if the tax return is not completed soon after it is issued.

**3.120** This can lead to situations in which pensioners ignore self assessment tax returns as they do not understand why they would need to fill one in; or to them not having set aside funds to pay the tax due under self assessment. In extremes, it could lead to the tax being irrecoverable and has certainly led to a lot of unexpected tax bills.

**3.121** It is difficult enough for pensioners to adjust to their post-retirement income levels without a later and unwelcome surprise that there is tax to pay on their state pension. As above, this strengthens the case for deducting tax from the state pension at source; but at the very least, it is a clear case for ensuring that HMRC or the DWP provide appropriate information to pensioners so that they can make provision for the tax which is due under self assessment if they are likely to be taxpayers. This is particularly important as those affected are likely to be low-income pensioners, as in the example of 'Bill' at Box 3.H above.

<sup>44</sup>

[http://www.direct.gov.uk/prod\\_consum\\_dg/groups/dg\\_digitalassets/@dg/@en/@over50/documents/digitalasset/dg\\_180223.pdf](http://www.direct.gov.uk/prod_consum_dg/groups/dg_digitalassets/@dg/@en/@over50/documents/digitalasset/dg_180223.pdf)

<sup>45</sup>

[http://www.direct.gov.uk/prod\\_consum\\_dg/groups/dg\\_digitalassets/@dg/@en/@over50/documents/digitalasset/dg\\_180391.pdf](http://www.direct.gov.uk/prod_consum_dg/groups/dg_digitalassets/@dg/@en/@over50/documents/digitalasset/dg_180391.pdf)

**3.122** When HMRC adjusts a PAYE code to include the state pension, a note will be included on the P2 Notice of Tax Code, the precise nature of which will vary according to the circumstances.

**3.123** Other information is available online, including, as noted, HMRC's leaflet IR121 for those approaching retirement. The Directgov website includes information about how the state pension is taxed<sup>46</sup>, the tax<sup>47</sup> element of which is replicated on the HMRC website<sup>48</sup>. The OTS is not clear, however, how pensioners would know to look for that information without any apparent prompt from HMRC to do so. It is one thing to have information available, but whether it reaches its target audience is quite another. We discuss this further under the heading of 'Digital exclusion' within section N of this Chapter.

## F6 Deferred state pensions

**3.124** Thus far, the OTS has gathered little evidence of complexity or problems in the context of how deferred state pensions are taxed once the pension is eventually claimed – whether by way of a lump sum, deferred for 12 months or more, or as an increased pension.

**3.125** However, deferred state pension lump sums are subject to a separate tax regime<sup>49</sup>, in that the lump sum is taxed only at the rate of tax that the pensioner otherwise pays on his or her income of the year of receipt. This means that if they are otherwise a non-taxpayer, no tax is paid on the lump sum; if they are a basic rate taxpayer, basic rate tax is paid; and so on. But the lump sum cannot move the pensioner into a higher income tax band, nor does it count as income for the purposes of tapering age-related and married couple's allowances, nor does it move capital gains into the 28% band.

**3.126** The DWP operates PAYE to a limited extent on these state pension lump sums, either deducting no tax at all or a flat rate of tax according to the pensioner's declaration of what their tax position is on their other income. The taxpayer may also claim their pension but defer the lump sum until after commencement of the next tax year if it is more advantageous to do so for tax purposes.

**3.127** Confusion can arise if a pensioner takes both a trivial commutation lump sum from a private pension (the taxable element of which is taxed as 'normal' pension income, i.e. it can change the taxpayer's final marginal rate – see section H of this Chapter) and a state pension lump sum, only to encounter different tax treatments.

**3.128** Problems also arise in terms of the complexity of a pensioner deciding whether or not to defer. Although tax is only one element of that decision, it can play a significant role, particularly in the context of when to take an eventual lump sum if their income, and therefore tax rate, is likely to fall in future. As part of the next stage of our review, further review of the information available<sup>50</sup> as to the tax consequences for those considering deferral and exploring whether additional tools or support would be helpful to pensioners facing this type of decision may be a useful exercise.

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<sup>46</sup> See <http://www.direct.gov.uk/en/pensionsandretirementplanning/statepension/index.htm>

<sup>47</sup> 'Tax on your state pension', see

[http://www.direct.gov.uk/en/MoneyTaxAndBenefits/Taxes/TaxOnBenefitsPensionsAndMaintenance/DG\\_172143](http://www.direct.gov.uk/en/MoneyTaxAndBenefits/Taxes/TaxOnBenefitsPensionsAndMaintenance/DG_172143)

<sup>48</sup> See <http://www.hmrc.gov.uk/pensioners/pension-statepension.htm>

<sup>49</sup> In sections 7 to 10 Finance (No. 2) Act 2005

<sup>50</sup> A 63 page booklet is available from the DWP entitled 'State pension deferral – your guide' (last updated April 2011). See

[http://www.direct.gov.uk/prod\\_consum\\_dg/groups/dg\\_digitalassets/@dg/@en/@over50/documents/digitalasset/dg\\_200597.pdf](http://www.direct.gov.uk/prod_consum_dg/groups/dg_digitalassets/@dg/@en/@over50/documents/digitalasset/dg_200597.pdf)

## G. Welfare benefits, other than the state pension

**3.129** We have already referred to the confusion which can be caused as a result of some other state benefits being paid alongside the state pension.

**3.130** Although our review is limited to tax simplification, with the pensioner tax review there are natural crossovers to welfare benefits, not least because there is not always a clear dividing line between working and retirement ages. Indeed, this line is likely to become increasingly blurred over the coming years with changes to the state pension age and people continuing to work for longer if they remain fit to do so beyond traditional retirement age. This is particularly so with the abolition of compulsory retirement ages.

**3.131** As noted in the introduction section to this interim report, there is no clear definition of the term ‘pensioner’. There are those who, for example, are forced to stop work early due to ill-health or perhaps find themselves struggling to find work and are reliant on state support after they have been made redundant late in their working life.

**3.132** Although we have not had the opportunity to review the matter in detail for this interim report, this could be an area in which simplification is necessary. As many benefits merge into Universal Credit, a separate pension credit remains for older people, and it is important to be clear about the tax status of benefits. For benefits which are means-tested, it is also necessary to be clear how income is defined and whether it is net of tax income, especially where systems are being automated so that the DWP uses HMRC data to calculate benefits entitlement. Where data collected for one purpose is used for another, it is therefore essential to ensure that the correct data is transmitted. In simplification terms, it would be ideal if the same data (income measure) were to be used for all purposes.

**3.133** Descriptions of benefits can be confusing. For example, people who have stopped work early due to ill health might be receiving employment and support allowance (ESA), but there are two types: income-based ESA is not taxable, whereas contribution-based ESA is taxable. But they are both described as ESA and usually the claimant will not know which type they are getting, which makes it impossible for them to understand their tax situation. It also causes problems for their (often voluntary sector) advisers, who might have to contact the DWP to ascertain which type is being paid.

**3.134** It would be much simpler if all benefits were treated the same way for tax purposes (probably non-taxable) and all calculated on the same income basis (probably on gross, pre-tax income). Such a pattern would have major policy implications as well as requiring very significant system changes. As such the goal is unlikely to be achieved quickly – though it is arguably one that should be a target – the holding remedy is clearer information and the introduction of a Form P60 for benefits as discussed above.

## H. Accessing funds in small pension pots

**3.135** Another variation to the standard pension is ‘trivial commutation’ of small pension pots, i.e. the exchange of accrued pensions for a lump sum, instead of taking a regular income. This is allowed in limited circumstances, for those who have succeeded in amassing only small private pension savings throughout their working life.

**3.136** The tax treatment of such lump sums is not subject to the same ‘simplified’ regime as for deferred state pension lump sums. Instead, 25% of the lump sum is tax-free and the other 75% is taxable (taxed at source under PAYE by the pension provider) as normal pension income, i.e. it can result in the pensioner being taxed at higher rates than they otherwise would be.

**3.137** While the OTS acknowledges that the Government has consulted on Early Access to Pension Savings<sup>51</sup> and the taxation of small pension pots is still subject to ongoing review within HM Treasury and HMRC, this report would not be complete without also acknowledging that this remains an area of complexity for pensioners.

**3.138** We note that one further change to the rules is already in progress. Regulations are to be made to extend the provisions which allow individual small pension pots up to a value of £2,000 to be commuted for a lump sum (in addition to the £18,000 overriding limit), to apply to personal pensions, as well as occupational pensions<sup>52</sup>. There is, however, no limit on the number of occupational pensions which can be drawn in this way, whereas for personal pensions, an individual will be allowed a maximum of two in a lifetime.

**3.139** The rationale for limiting commutation of small personal pension funds to two is that individuals have more control over personal pension funds and could fragment larger pots into smaller ones to access their funds by way of small lump sums. This is against the policy intent of providing tax reliefs for pension saving in return for an income in retirement. Therefore to manage fiscal risks there is a limit of two small personal pension pots per lifetime.

**3.140** Whilst the OTS understands this limitation as a proxy for anti-avoidance, it does have the unfortunate effect of adding to complexity and confusion for those with small personal pensions. It could also burden pension providers with the costs and complexity of administering more small pots than would be the case without the restriction. We do question how significant an avoidance risk exists, given the small amounts involved.

**3.141** There are, however, areas where further simplification might be explored.

## H1 Tax reclaims relating to trivial commutation

**3.142** Administrative complexity remains. The way in which PAYE operates on the taxable element of the lump sum, usually resulting in the application of an emergency tax code (the basic, i.e. not age-related, personal allowance code used on a 'month 1' basis), means that the majority of pensioners taking a trivial commutation lump sum will be over-taxed at source and have to claim a repayment.

**3.143** The repayment claim is made using form P53, the processes for which do not always work smoothly. The claim also has to be administered in two stages – an in-year claim to obtain the refund as soon as possible, followed by an end of year reconciliation (either through completion of a further P53, HMRC issuing a P800 calculation, or completion of a self assessment tax return, depending on the circumstances).

**3.144** This therefore suggests that it might be better, particularly with the opportunity of RTI introducing changes to the PAYE system in the near future, to review the application of the PAYE Regulations to trivial commutation lump sums and consider ways of either preventing the overpayments from arising at the outset, or by using RTI data to identify overpayments and issue refunds automatically and at a much earlier stage in the process.

**3.145** In the meantime, however, the OTS is aware that HMRC has recognised the administrative issues around trivial commutation and is currently running a project on this subject. Working closely with Tax Help for Older People, the Low Incomes Tax Reform Group and pension industry representatives, the project is seeking to improve the quality of guidance given by HMRC to pension scheme members to offer greater clarity of options at the point of entitlement, to significantly redesign the P53 and to simplify the associated process for claiming repayment.

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<sup>51</sup> [http://www.hm-treasury.gov.uk/d/consult\\_early\\_access\\_pension\\_savings\\_summary\\_responses.pdf](http://www.hm-treasury.gov.uk/d/consult_early_access_pension_savings_summary_responses.pdf)

<sup>52</sup> See <http://www.hmrc.gov.uk/pensionschemes/small-pots-guidance.pdf>



**3.146** In addition, the OTS recommends that form R43 (which non-resident taxpayers use to claim trivial commutation tax refunds) is reviewed as a matter of priority, as it is out of date.

## H2 Further review of the legislation

**3.147** There is also complexity within the trivial commutation rules themselves.

**3.148** Consistency with other pension rules is one area of contention. To take a trivial commutation lump sum, the pensioner has to be aged 60 or over, i.e. five years older than the earliest normal retirement age of 55 for private pension savings. Also, the state pension age for women is gradually increasing from an original base of 60 to be aligned with that of men, and then the state pension age for both will increase first to 66 then higher. It might be apposite to review whether an age of 60 for this purpose continues to be appropriate. At this stage, however, we make no recommendation on this subject, merely noting it as a point of inconsistency.

**3.149** There is a further complexity in having a '12-month rule': i.e. that if a pensioner has multiple small pots, all trivial commutations have to be paid within a 12 month period commencing when the first commutation is paid.

**3.150** This rule can cause complications for taxpayers who discover another small pension too late to draw it within the 12 month window. As there is already an overriding monetary limit of £18,000 on the amount which can be taken as trivial commutation lump sum payments, there could be an argument to simplify the rules by removing this restrictive time limit.

**3.151** Such a change would also simplify matters for pension providers who are currently left with the burden of administering small pension pots for those who have missed the 12 month window.

**3.152** With the introduction of auto-enrolment in pension schemes from April 2013, coupled with the increasing number of jobs individuals have in a working lifetime, it is easy to envisage that the number of pensioners reaching retirement age with a number of small pension pots is likely to increase.

**3.153** Since the trivial commutation limit was decoupled from the lifetime allowance in Finance Act 2011<sup>53</sup> it has now been fixed at £18,000 without any provision for regular adjustment for inflation. Similarly, the other small pots limit has been fixed at £2,000 since it was introduced. There is an argument for annual indexation of both limits in line with inflation to maintain in real terms the availability of the provisions (which are in themselves a simplification measure). This would preserve the benefits of the limits for pensioners and pension providers.

## I. Overseas pensions paid to UK residents

**3.154** Whilst HMRC states that currently some 76,000 UK resident pensioners have an overseas pension, the OTS suspects the numbers who will have such sources of income will increase in future, given greater international mobility of workers.

**3.155** For this reason, now might be an ideal time to review the tax position of overseas pensions paid to UK residents.

### I1 The 10% deduction

**3.156** In Annex A, we explore the history of granting a 10% deduction against foreign pension income, so that only 90% of the income is taxable in the UK.

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<sup>53</sup> paragraph 4 Schedule 18 FA 2011, amending paragraph 7 Schedule 36 FA 2004

**3.157** Some of those to whom the OTS spoke suggested that this deduction may be under-claimed, given that knowledge of its existence is likely to be limited.

## **I.2 Guidance on taxation of overseas pensions**

**3.158** We have also gathered examples of pensioners finding it difficult to determine the UK tax treatment of foreign state, occupational or private pensions. Taxpayers might assume that because their overseas pension is not taxable in the country of origin, it is not taxable in the UK either.

**3.159** Cases have also been seen where the taxpayer incorrectly claimed double tax relief in the UK for tax deducted in the country of origin, unaware that they should have applied to have it paid gross in that country (or claimed a refund in that country) because the UK has sole taxing rights as the country of residence. The incorrect claim has only later been revealed through HMRC compliance activity.

**3.160** It is suggested that HMRC guidance in this area requires review and improvement.

**3.161** We also note the practical difficulties that arise with fluctuating exchange rates<sup>54</sup>. This is inevitable but we think that the issue needs to be considered to see if there is a way of managing modest fluctuations.

## **J. Collecting tax – PAYE**

**3.162** The change of PAYE computer from the former Computerisation of PAYE (COP) system to National Insurance and PAYE Service (NPS) has been the subject of a good number of submissions to the OTS. This is because of what might be termed 'legacy issues', with the new system now identifying cases where taxpayers were not having the correct PAYE deductions from their income in the past. We support the move to NPS is overall positive once the initial problems have been sorted out.

**3.163** Pensioners have not escaped the impact of these changes. For approximately 250,000 state pensioners, the Government announced that tax for certain past years would not be collected where data from the DWP was not matched to their tax records which caused tax to be under-deducted from them<sup>55</sup>.

**3.164** The OTS is concerned that there is still some complexity working its way through the system for tax years up to and including 2010/11. Whilst the object of this report is to look at the complexity of the system as it is now, we would not be fulfilling our brief if we did not mention these issues and their continued impact as underpayments are collected, perhaps spread over a number of tax years. It is also important to learn from this situation in order to identify how simplification could be achieved in future.

**3.165** The lesson to be learned from the past is that it is better to ensure so far as possible that the correct tax is paid as early as possible, preferably within the tax year in which it is due, to avoid overpayments or underpayments accruing which have to be reclaimed or collected later. It also emphasises the need for prompt, regular PAYE reconciliations – something we understand that HMRC has in hand.

**3.166** This is especially important for pensioners who are often on a fixed income and for whom debt may be something which has been avoided throughout their working life and which would

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<sup>54</sup> It is worth noting that this is a much greater problem in Northern Ireland compared with the rest of the UK, due to the numbers of pensioners drawing pensions from the Republic.

<sup>55</sup> Written Ministerial Statement on 11 January 2011 by the Exchequer Secretary to the Treasury (David Gauke MP), see <http://www.publications.parliament.uk/pa/cm/cmtoday/cmwwms/archive/110111.htm>

be a source of serious concern, particularly if it arises unexpectedly as has been the case with many tax underpayments.

**3.167** This makes the reform of the PAYE system with, from 2013, the addition of RTI<sup>56</sup> important for pensioners. Under RTI, HMRC will have data available to them much earlier and, although there will always be the need for PAYE reconciliations, the OTS hopes that these developments will lead to improvement in the accuracy of coding for pensioners.

**3.168** Issues raised and suggestions put forward to the OTS during preparation of this interim report are outlined below, although these should not be taken as recommendations of the OTS. However, the volume of issues and possible solutions suggested does indicate that this is an area requiring more detailed examination in the second stage of our review. We acknowledge, though, the work HMRC has already been doing in this area.

## J.1 Eliminate any errors remaining in NPS

**3.169** We understand that HMRC has recently been conducting a 'deep dive' review in conjunction with the agent community as part of the NPS stabilisation programme. From this, HMRC hoped to identify and eliminate ongoing issues with the software. It may be that matters are now settling down and the problems put to the OTS during our review were of historical rather than current interest.

**3.170** However, we do think that a further review should take place after the 2012/13 coding run. We understand this will be taking place as we finalise this interim report. It is therefore an issue to which we would like to return in the second stage of our review.

## J.2 A single, reconciled statement to replace multiple P2 coding notices

**3.171** For those with multiple small pensions, receiving a coding notice for each can be confusing, so it has been suggested that HMRC should issue taxpayers with a single, collated and reconciled statement of PAYE codes instead of issuing multiple coding notices to taxpayers.

**3.172** Also, the PAYE Regulations provide certain exclusions for the issue of PAYE coding notices, so taxpayers might not get them for all sources which can further contribute to confusion and complexity. Sending a coding notice for every source of PAYE income might have cost implications for HMRC, but it would better enable taxpayers to check their affairs. In this respect, there is now a potential difference in treatment between self assessment (SA) and PAYE taxpayers, as SA taxpayers should now be able to view their PAYE codes online, but the latter cannot<sup>57</sup>.

**3.173** Some of those we consulted thought that a single, reconciled statement or coding notice was one of the longer term goals on introduction of NPS. Progress to date has been limited to HMRC introducing a system last year to send two coding notices to a taxpayer in the same envelope; but those with more than two sources still receive multiple envelopes.

**3.174** Such an exercise could be made easier if the codes were in themselves easier to understand.

**3.175** PAYE tax codes are usually made up of numbers and a letter, for example 747L being the basic personal allowance tax code for many people in 2011/12.

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<sup>56</sup> RTI is the proposed system under which employers and pension payers will submit data to HMRC as payments are made to employees and pensioners, rather than an annual submission as is currently the case.

<sup>57</sup> See <http://www.hmrc.gov.uk/news/view-payee-online.htm>

**3.176** Matters become complicated when a pensioner has multiple sources of PAYE income, with parts of their personal allowance allocated to each. As noted in section B, married couple's allowance causes particular difficulties.

**3.177** It has been suggested to the OTS that it might be clearer for pensioners (and indeed others) if the PAYE system were to use the full allowances in the number rather than knocking off the final digit. The letter would need to be retained for other purposes, but retaining the full allowance figure (e.g. 7,475L instead of 747L) would seem to make codes, and their accompanying notes, simpler to explain.

**3.178** Furthermore, 'K codes' cause complexity and are notoriously difficult to understand. These arise when the sum of the deductions from allowances (i.e. the income or other adjustments taken into account in arriving at the code) is greater than the sum of a taxpayer's allowances. So if, for example, a pensioner has a state pension of £10,000 and a personal allowance of £9,940, a K code might be applied against their private pension income.

**3.179** Reducing the numbers of K codes in operation for pensioners would in turn reduce the challenge of having to understand them, and we discuss how this could be achieved by operating PAYE on the state pension at section F of this chapter, above.

**3.180** In the absence of PAYE being operated on the state pension, a further suggestion is that HMRC should provide better explanations of K codes.

### J.3 Payslips for pensioners

**3.181** It has also been suggested that it would be helpful if HMRC could provide an indication on coding notices of how much tax the individual should expect to see deducted from each source, so that it can be checked against payslips. The OTS acknowledges that this would be difficult for HMRC, but we believe the feasibility of so doing could be explored, particularly in the context of the wider transparency agenda<sup>58</sup>.

**3.182** Furthermore, we understand that many pension companies now only send an annual P60 and do not send monthly payslips (or they only send a payslip or statement when the amount of the pension or tax code changes). This makes it difficult for pensioners to understand their income and tax position. Employers are obliged to issue payslips<sup>59</sup>. Queries over why pension providers have no such obligation, and whether they should, have been raised regularly in the initial stages of our pensioner taxation review.

### J.4 Starting to receive a pension

**3.183** In some cases where pensioner tax underpayments arose for earlier tax years which have now been reconciled by the NPS system, P46(Pen) procedures do not always seem to be followed. That is, that pension providers may not have notified HMRC of a new source of pension income as they should have under the PAYE Regulations<sup>60</sup>, thus causing, or contributing to, the underpayment.

**3.184** The absence of the P46(Pen) means that information about the new pension is not supplied to HMRC immediately and therefore HMRC would not know to review the pensioner's PAYE codes and issue a correct coding to the pension provider. As a result of the pension provider applying an emergency (personal allowance 'month 1') code in the meantime, substantial underpayments have accrued where the pensioner was already getting the benefit of their personal allowance against another source of PAYE income.

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<sup>58</sup> See [Modernising the personal tax system - tax transparency for individuals](#)

<sup>59</sup> Section 8 Employment Rights Act 1996, – see <http://www.legislation.gov.uk/ukpga/1996/18/section/8>

<sup>60</sup> Chapter 3 Part 3 of the Income Tax (Pay As You Earn) Regulations SI 2003/2682

**3.185** The law has little comfort to offer the pensioner in such situations, because HMRC has no real means of enforcing the submission of the P46(Pen) – for example, there are no penalties for failure to comply. In the meantime, the pension provider is likely to have operated the default code specified in the Regulations, which is, technically speaking, correct. HMRC’s view is that the pensioner themselves should have been aware that the default code was resulting in insufficient tax deductions and, further, that they should have known to contact HMRC and asked them to review the code<sup>61</sup>. However, given many pensioners’ particular difficulties and poor understanding of their taxes and the PAYE system (See Annex B) it is difficult to see how they would know to take such action. For example, if the P46(Pen) is not completed by the company, the pensioner is unlikely to know, as there is nothing to trigger the pensioner to check HMRC’s website to check if HMRC had received a copy of the P46(Pen).

**3.186** There is therefore some suggestion that HMRC should have stronger powers to force pension payers to correctly apply the PAYE Regulations. Also, using the existing Regulations, HMRC’s employer compliance teams could undertake a review of this area to ensure that P46(Pen) procedures are followed.

**3.187** It is hoped, however, that once RTI is fully operational, HMRC should be able to identify much sooner cases where employers and pension providers are not operating the PAYE code they have been issued and to take corrective action.

**3.188** Furthermore, P45 and P46(Pen) procedures vary depending on how the person becomes a pensioner.<sup>62</sup> This is a crucial matter for making sure a pensioner’s tax affairs are correct from the time they start drawing their income; or at least to ensure that no underpayment of tax arises of which they are notified on a later reconciliation of their PAYE records. Again, the introduction of RTI might improve matters in that HMRC should be made aware of new pensions much sooner and be able to reconcile taxpayer records to minimise any underpayment accruing. But even so, it might be preferable to amend the regulations to require use of a default code of ‘BR<sup>63</sup>’ on payment of a new pension instead of the emergency code, which gives a personal allowance on a month 1 (non cumulative) basis.

**3.189** Oddly enough, these same Regulations come into effect when a pensioner takes a trivial commutation lump sum (see section H above on small pensions) but often lead to over-taxation in that scenario.

**3.190** We think that now is an opportune time, with RTI in prospect, to review the operation of these Regulations to identify possible changes.

**3.191** The operation of these Regulations causes problems within certain professions from which early retirement is common, but where the taxpayer finds work elsewhere or takes another job with the same employer on different terms, e.g. armed forces, NHS workers, police.

## **J.5 Annual reconciliation and tax calculation forms P800**

**3.192** A common issue put forward to the OTS is that taxpayers, including pensioners, have difficulty in understanding the P800 end of year reconciliations sent to them advising of an overpayment or underpayment of tax.

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<sup>61</sup> <http://www.hmrc.gov.uk/incometax/check-right-tax.htm#1> says, “Check that the different letters and numbers that make up your tax code are right. This is really important if you’ve got more than one job or source of income - or if you change jobs a lot.” HMRC’s website <http://www.hmrc.gov.uk/incometax/starting-work.htm#7> also says “Your employer will send HMRC a P46(PEN) Notification of Pension Starting form and give you a copy to keep. HMRC will use the information to give you a new tax code and make sure you pay the right amount of tax.”

<sup>62</sup> See Regulations 55 and 58 SI 2003/2682

<sup>63</sup> i.e. deduction of tax at the basis rate

**3.193** For example, the form can include estimated figures (such as estimated bank interest) but there is no indication on the calculation of this fact. It can also omit non-PAYE income if HMRC does not know about it. The taxpayer is not alerted to the fact that the calculation is wrong.

#### **Box 3.J: Example**

A Tax Help for Older People adviser assisted Mrs K in claiming tax repayments on her bank interest for a number of tax years. Subsequently, in December 2011, she was sent a P800 tax calculation for the 2010/11 tax year, without any repayment claim having been made. This calculation included an estimate of £1,000 bank interest for the year, with tax deducted of £200 and produced a tax repayment of £162.72.

If she had received less bank interest than estimated, with consequently less tax deducted at source, this repayment of tax would have been excessive. However, the P800 calculation itself gave no indication that the interest figure was estimated.

**3.194** Also, there is often a very limited explanation on the form as to why an underpayment or overpayment of tax has occurred. It can be difficult for the pensioner with multiple pensions (or indeed employment income in addition to pensions) to understand the calculation as all are conflated into a single line 'PAYE income' on the face of the calculation<sup>64</sup>.

**3.195** Whilst we understand that the above does not only affect pensioners, addressing these complications could achieve significant simplification for that sector of the population, as they are more likely to have multiple PAYE income sources<sup>65</sup>.

### **J6 Ceasing work in the tax year and claiming a repayment**

**3.196** Form P50 is used to claim a repayment of PAYE before the end of the tax year. In a pensioner context, one of its uses is where the taxpayer has retired permanently and is not receiving a pension from their former employer.

**3.197** The OTS understands that this form is often found to be complex by those attempting its completion and it may, together with the processes surrounding it, benefit from further review and simplification.

### **J7 Determining pensioners' PAYE codes and form P161**

**3.198** Currently, HMRC procedures for determining pensioners' PAYE codes revolve around form P161 and, in bereavement cases, form P161W.

**3.199** Automated triggers for the current P161 pension coding form issue are:

- a woman reaches state pension age (currently moving from age 60 to 65<sup>66</sup>);
- a man reaches 65 (state pension age, and also the age at which age related allowances need to be considered);
- a woman reaches 65 (the age at which age related allowances need to be considered); and

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<sup>64</sup> For a graphic illustration of the problems that can be caused by P800s, see *Robert E Clark v HMRC* (First Tier Tribunal TC01164)

<sup>65</sup> The OTS notes that there are other groups which might be likely to have multiple sources of PAYE income – examples include agency workers, seasonal workers and students.

<sup>66</sup> Under the Pensions Act 2011 women's state pension age will increase more quickly to 65 between April 2016 and November 2018. From December 2018 the state pension age for both men and women will start to increase to reach 66 in October 2020.

- a new occupational pension starts and is advised to HMRC on a P46(PEN) electronic starter form (as long as a P161 has not been triggered within the previous three months).

**3.200** The planned automated flow of state pension information from DWP to HMRC, together with the opportunities offered by the introduction of the NPS has resulted in a review of form P161 and its automated triggers.

**3.201** As a result of this review, HMRC envisages that, by October 2012, the only automated trigger for the new P161 will be when a man or woman reaches 65 (the age at which age related allowances need to be considered). The form however will be reduced from a 2 page (4 side) form to a 1 page (2 side) form. Its purpose will also change, the questions being aimed at obtaining the additional income information needed to calculate age allowances. It will not include questions relating to information HMRC already holds, such as state pension.

**3.202** In turn, HMRC envisages that the volumes of forms P161 issued will be reduced, from 1.25 million currently (the number for the last complete tax year i.e. 2010/2011)<sup>67</sup> to a projected figure of up to a million from October 2012.

**3.203** The state pension age will move from 65 to 66 in due course, but the trigger for age-related allowances and form P161 is linked to age 65.

**3.204** The OTS understands that an online version of the form is also under development and is planned to be available from October 2012, which is welcome as long as the paper option and a telephone helpline remain to support those do not have on line access.

**3.205** Whilst these are welcome developments, the OTS notes that there remains concern amongst external parties that pensioners might not have the opportunity to check all the data that HMRC holds about them and on which subsequent coding is based. Suggestions for aiding this process have included sending a pre-populated form to pensioners to check the details; or, as suggested above, developing a single statement coding notice which reconciles all the data and sets it out clearly for the pensioner to follow.

**3.206** We also note that processes for the self-employed reaching state pension age might need to be reviewed. In such cases, the P161 is not issued automatically and HMRC's website advises the self-employed as follows:

**Box 3.K: Extract from HMRC website guidance on form P161**

"When you're nearing State Pension age you'll receive form P161 Pension Coding asking for details of your age and income, including pension income. It's very important that you complete and return this. However if you're self-employed you won't automatically receive the form - you'll need to request it from HM Revenue & Customs (HMRC) or download one below."<sup>68</sup>

**3.207** But some self-employed people will draw on private pension income when they retire, which will need PAYE coding, and so it would seem logical to have some automatic procedure in place for them, as there is for employees. The statement in the box is also confusing and contradictory, first implying that taxpayers will receive the form, then saying that they might have to ask for it.

<sup>67</sup> HMRC data

<sup>68</sup> <http://www.hmrc.gov.uk/pensioners/approaching-why.htm>

**3.208** As noted above, HMRC is implementing changes to the P161 system. We understand that the self-employed will still not be sent the new age allowances claim form automatically, as HMRC will anticipate that their claim to such allowances will be made on their self assessment tax return. However, the OTS is concerned that there might be gaps in this process, for example where the self-employed retire before age 65 (perhaps through choice or ill-health) and live off other means such as capital or investments (i.e. non-PAYE income) in the meantime. This is a matter for further consideration in the second stage of our review, during which time we understand the new P161 processes will be implemented.

## K. Collecting tax – self assessment

**3.209** HMRC data for 2009/10 shows that there were some 2.3 million pensioners in self assessment (SA) for that year, using the OTS's definition outlined in the introduction to this report. Of those, some 1.5 million filed by internet, 342,000 filed full paper tax returns and 474,000 filed the short paper tax return.

**3.210** Our review has sought to identify whether there are ways of minimising the number of pensioners who have to file tax returns each year, as this obligation can create administrative complexity for the pensioners and their advisers. There is also a cost to HMRC in processing the returns, collecting tax payments and dealing with associated queries and correspondence.

**3.211** The OTS has also noted suggestions for simplifying SA processes.

**3.212** Suggestions have included:

- Apply a tolerance to the tax owed under self assessment by low-income pensioners in the same way as there is a PAYE tolerance for end of year reconciliation, below which no tax is collected. This is - £50 for the 2010/11 tax year. This could remove pensioners with small liabilities from the system, with the tax cost potentially offset by administrative savings for HMRC. It is acknowledged, however, that this might be difficult to achieve for pensioners alone, so could have wider implications.
- Giving the taxpayer the option to elect for the K code overriding limit 'the 50% rule'<sup>69</sup> not to apply, if it means that all their tax can be collected via PAYE instead of SA.
- HMRC should investigate pre-populating self assessment returns with data already held on the department's systems. Some hold the view that HMRC often has all the data it needs to work out the tax and the return is just a formality, for example in some cases where age allowances are tapered but the taxpayer has PAYE income only<sup>70</sup>. The OTS notes that work has already begun on identifying support for pre-population of forms alongside greater transparency, so we hope that the second stage of our review can help to inform this further by taking into account the results of the current consultation on modernising the personal tax system<sup>71</sup>.
- HMRC generates unnecessary administration and subsequent taxpayer contact/queries by making small amendments to tax returns. For example, as outlined above, mistakes often occur where taxpayers return an incorrect amount

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<sup>69</sup> Where a K code is operated it must not cause the tax deducted from any payment of income to be more than 50% of the income – regulations 23(5) and 28(5) of the PAYE regulations read with the definition of "overriding limit" in regulation 2

<sup>70</sup> See SAM100050 – some taxpayers whose age allowances are tapered may, on request, be removed from self assessment if their affairs are straightforward.

<sup>71</sup> HMRC consultation document 'Modernising the administration of the personal tax system: Tax transparency for individuals'



of state pension. HMRC data shows that, for 2009/10, 25,267 corrections were made to main tax returns and 10,512 to short tax returns. HMRC's adjustment may only make a very small difference to the tax liability, in which case the cost of making the correction and dealing with the associated queries could exceed the tax charged.

- These problems might be minimised by other solutions put forward in this interim report, for example, taxing the state pension at source or providing a P60 equivalent for state pension to minimise error. But otherwise, HMRC might consider whether there is merit in disregarding small discrepancies in the figures and suppressing tax calculations which make less than, say £10 difference, to the tax liability. More work would need to be carried out to ascertain the practicality of this proposal, for example, HMRC might not know the impact on the tax liability until the work has been done, in which case there might be little administrative saving; or indeed it might be necessary to accept that the £10 difference would apply either way and therefore potentially cost taxpayers where the error was in HMRC's favour.
- There is only a single box for private pension income on the paper SA tax return so the taxpayer has to add up all pensions, and add up the tax deductions, then enter each as a single figure (although there is a separate box for lump sums). They then have to list how the figures are made up (specifying each separate pension) in the additional information 'white space' of the return. This can lead to arithmetical errors and confusion.
- HMRC should review their policy of not 'coding out' overseas pension income paid to UK residents<sup>72</sup> which in turn leads to those affected having to fill in self assessment returns<sup>73</sup>. Exchange rates will vary the annual amount received but rarely by significant amounts over a year (e.g. in one case quoted by Tax Help for Older People, a Canadian pension ranged between about £794 and £803 a month). Coding out is administratively simple and improves cashflow for the Exchequer, leaving just the balancing exercise via SA or the P800 reconciliation process. In fact, the PAYE Regulations provide that HMRC **must** have regard to 'any other income of the employee which is not PAYE income' unless the employee objects, so this policy may in fact be *ultra vires*<sup>74</sup>. HMRC figures suggest that 76,000 UK pensioners have an overseas pension but the OTS suspects this number will increase in future with greater international mobility during working lives.

## L. Support for bereaved pensioners

**3.213** Bereaved taxpayers and the implications of dealing with bereavement are of course not matters exclusive to pensioners. However, it is naturally more likely that older people are likely to lose a spouse or civil partner and therefore have to deal with the tax consequences.

**3.214** There are three elements to consider:

- finalising the tax affairs of the deceased;
- tax on the estate (although inheritance tax is outside the scope of this review, there is income tax and sometimes capital gains tax to deal with during the administration of the estate); and

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<sup>72</sup> <http://www.hmrc.gov.uk/manuals/pommanual/payee130055.htm>

<sup>73</sup> <http://www.hmrc.gov.uk/manuals/sammanual/SAM100050.htm>

<sup>74</sup> See PAYE Regulations (SI2003/2682), regulation 14 (Matters relevant to determination of code), in particular regulation 14(1)(f)

- the tax affairs of the surviving spouse or civil partner, which may well have changed due to pension income or other assets having been inherited from the deceased.

**3.215** All of these complications come at a difficult time for the surviving partner and their family (if they are fortunate to have other family or friends to support them).

**3.216** The OTS understands that HMRC is already engaging in some work internally, in conjunction with some sections of the charity community, to ease the burden on bereaved taxpayers.

**3.217** When a taxpayer loses a spouse or civil partner, there is frequently a shift in their own income levels (for example, due to starting to receive a widow's pension). The PAYE system often does not react sufficiently quickly or efficiently and a tax underpayment might occur.

**3.218** It is a welcome development therefore that the OTS understands HMRC is planning to introduce from April 2012 a new version of form R27 *Potential repayment to the estate*. It is intended that this new version will have two key enhancements over the former version:

- the facility to nominate an agent on the R27, as opposed to sending a 64-8; and
- the introduction of a section that brings the tax consequences of the bereavement on the surviving spouses and civil partners into consideration.

**3.219** The OTS believes that this should help towards simplification for those affected, and believes that HMRC should continue to evaluate the success of this measure and explore whether there are any other opportunities to exploit information from the 'Tell us once' initiative when a death is registered to ensure HMRC takes prompt action in as many areas as possible.

**3.220** It has been suggested that HMRC's main contact centre staff may not have sufficient breadth of training to deal with this particular situation and a dedicated bereavement helpline might therefore help ease the burden. We understand that HMRC is already working on this and a single point of contact for the bereaved to contact HMRC about income tax issues should be in place by April 2012. HMRC has also committed to look at the scope for joined-up working across the rest of HMRC's business over the next 12 months. We welcome this initiative.

**3.221** The OTS understands that HMRC is also undertaking a review of its standard correspondence in bereavement cases. Again, this is a welcome development.

**3.222** It is perhaps also worth noting here that Lord Freud, Minister for Welfare Reform, has recently commissioned a review of bereavement benefits, which includes both a social research project to better understand people's recent experience of receiving bereavement benefits and a consultation document<sup>75</sup>. The OTS recommends that HMRC consider carefully the research being conducted, to see whether it offers any insights into bereaved pensioners' tax experiences.

## M. National insurance contributions (NICs)

**3.223** The OTS has some concerns that future complexity could arise for pensioners if changes to the state pension age are not aligned with national insurance contributions policy. We are of course aware that integration of the administration of income tax and NICs is the subject of consultation and review. Indeed, that review stemmed from an earlier OTS recommendation<sup>76</sup>.

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<sup>75</sup> DWP consultation: Bereavement Benefit for the 21<sup>st</sup> Century, December 2011

<http://www.dwp.gov.uk/consultations/2011/bereavement-benefit.shtml>

<sup>76</sup> [http://www.hm-treasury.gov.uk/d/ots\\_review\\_tax\\_reliefs\\_final\\_report.pdf](http://www.hm-treasury.gov.uk/d/ots_review_tax_reliefs_final_report.pdf), see page 12

**3.224** One example of confusion in the current system is that class 1 and class 2 contributions cease at state pension age whereas class 4 is charged for the whole year in which one reaches state pension age. This is a source of confusion, especially for those who reach state pension age early in the tax year.

**3.225** Another point to note is that NICs cease at state pension age for workers, but employers continue to pay them. However, we have not considered this to be a matter within the scope of our review as it is a policy matter and outside the remit of the OTS.

## **N. Other administrative issues**

**3.226** The OTS has found that complexity arises not only from the difficulties of the underlying legislation, but also in how it is communicated to taxpayers.

**3.227** Administrative complexity is not exclusive to pensioners, but as part of this review, the OTS received a number of comments from contributors as to how pensioners could be helped to navigate the tax system. These included:

- HMRC should give a clear call to action in written correspondence, or make it clear if letters are for information only;
- HMRC should aim to resolve an issue at the first point of contact. Pensioners complain that it takes a number of calls, letters or both to HMRC to resolve a query;
- improve pensioners' ability to get through to helplines – indeed that there should be a dedicated pensioner helpline;
- improve responses to post, including faster handling of post and answering all points raised; and
- review the ability to access face to face services, including home visits; and
- Introduce a dedicated voluntary sector helpline.

**3.228** The key is that HMRC must recognise that the pensioner population is far from homogenous and that they have varying needs in terms of ways of accessing information. HMRC must continue to provide all methods of accessing information.

**3.229** Equally, the OTS acknowledges that HMRC has made, and is continuing to make efforts, to address some of the above points.

**3.230** For instance, HMRC has put in place a dedicated pensioner team on their helplines and the OTS has received some positive feedback from this initiative. It is understood that HMRC is also working with the agent community to review handling of post and to consider options for working with tax agents, including the voluntary sector, with the aim of making it easier for taxpayers to be assisted by others without necessarily having a traditional agent '64-8' relationship in place.

**3.231** If successful, these initiatives are welcome simplifications. We suggest that the OTS continues to monitor developments throughout the second stage of the pensioner tax review.

### **N1 Face to face services, including home visits**

**3.232** From those the OTS has consulted in the compilation of this report, there is a strong view that pensioners are more likely to need face to face support to deal with their tax affairs than others.

**3.233** At present, this support can come from:

- HMRC itself;

- the paid agent community;
- the voluntary sector, including specialist tax charities

**3.234** HMRC does not specifically record the number of home visits to pensioners. However, they have been able to tell us that there were 3,234 home visits in total in 2010/11 and that home visits are only made to the elderly, disabled, recently bereaved and those with caring responsibilities or mental health problems.

**3.235** By contrast, we understand that Tax Help for Older People, a service run by the charity tax volunteers, conducted 2,354 home visits to pensioners in the year to 31 December 2011 and, in that same period, they helped 1,923 others face to face at a variety of venues across the UK.

**3.236** Although a direct comparison cannot be made between HMRC and the DWP, the two departments having quite different functions, the DWP has advised us that for 2010/11, their Local Service (now DWP Visiting) conducted 465,000 visits, either at community based locations or by home visit. 91.5% (425,000) of these face to face contacts were to pensioners. It is estimated that 98% (417,000) of these contacts were conducted by home visit.

**3.237** Providing face to face services to meet pensioner needs of course does not simplify the system itself, but can make a complex system easier to navigate.

**3.238** Indeed, we understand that HMRC has received positive feedback from the pensioner community surrounding their offices in East Kilbride. Staff from that office's 'Customer Focus Unit' attended events run by local councils to support and educate pension and benefits recipients and raise awareness of tax.

**3.239** As part of this, the staff have put together paper information for pensioners (HMRC's web-based IR121, supplemented by other material printed from the HMRC website) to hand out at the meetings and have reported that this was well received. By offering this direct communication with the pensioner population, they have been able to answer simple queries, allay fears and concerns, and guide pensioners on how their tax will work in retirement and what to look out for.

**3.240** The OTS view is that a combination of initiatives is required to help simplify tax for pensioners and one factor is ensuring there are avenues for face to face support where it is needed.

## N.2 Digital exclusion

**3.241** As noted above, the HMRC contact centre in East Kilbride has found it useful to have a paper leaflet helping to explain pensioner tax matters to distribute at events where they meet taxpayers. Other organisations<sup>77</sup> also produce paper leaflets to help pensioners understand tax matters as part of their overall preparations for retirement.

**3.242** But our initial review has found that the bulk of HMRC's tax information for pensioners, as well as others, is now only available online. This might be via the Directgov website, Businesslink for the self-employed or HMRC's website.

**3.243** Taxpayers do not necessarily know to look for information on the internet, particularly if there is nothing to prompt them to do so. And for pensioners, there is a further hurdle in that their usage of the internet is generally considered to be lower than for other sectors of the population.

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<sup>77</sup> For example, Tax Help for Older People

**3.244** In the third quarter of 2011, there were still over 2.25 million people in the UK aged 65 to 74, and over 3.31 million aged 75 and over who had never used the internet<sup>78</sup>.

**3.245** While finding information online and conducting transactions online, with HMRC and others, might have become the norm and the simplest option for many, the OTS is concerned that some pensioners are being excluded. Simplification options might come in the form of help from other organisations to access online information or support pensioners to contact with HMRC online.

## **O. Gift aid**

**3.246** Non-taxpayers can have a tax refund restricted or even unwittingly create themselves a tax liability, if their tax liability does not cover the tax reclaimed by a charity or community amateur sports club on a gift aid donation.

**3.247** Pensioners often find it difficult to understand this issue and therefore whether or not to make a gift aid declaration in respect of their donation.

**3.248** Basic rate tax is reclaimed by the receiving organisation on a donation made under gift aid. At current rates, this means that for every £80 donated, £20 is reclaimed. But this relies on the donor having paid at least as much income or capital gains tax as the amount claimed back by the charity on the donation. Therefore, if the donor is a non-taxpayer or is taxed at the 10% savings rate, they may not have paid sufficient tax on their income to cover the tax on their =gift.

**3.249** The OTS has not yet investigated this area of complexity at great length as it did not feature strongly in discussions with those consulted in the initial stages of our review. It is also an issue for the general taxpayer population, though anecdotally we note that the concerns about creating a tax liability by making a mistake with the gift aid declaration do seem to loom large with older donors who may be inclined to be more generous.

## **P. Care and support employers**

**3.250** The OTS review of pensioner taxation has noted that there are a number of older people who may become employers of those who care for them in their own home. They may do so by engaging carers out of their own means, or through use of 'direct payments' from local authorities.

**3.251** This enables people to tailor their care needs to their individual circumstances, but can become a minefield if the implications of employment law and the tax consequences that follow are not understood. In short, they become employers ('accidental employers') with PAYE reporting requirements.

**3.252** This is not an issue exclusive to pensioners, as it can affect people of other ages who have care needs due to a disability.

**3.253** The complexities of this situation could form the basis for a separate report in its own right. As the OTS understands that work is ongoing between HMRC and external stakeholders to help offer support to those affected, we have not investigated it in detail. We would, however, endorse that it seems right to focus resources and attention in simplifying compliance with the PAYE regulations for these employers, and that support will be needed on the transition to RTI in the coming months.

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<sup>78</sup> Office for National Statistics, Internet Access Quarterly Update 2011, Q3  
<http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-238450>

## Q. Capital gains tax

**3.254** Capital taxes were raised in the initial stages of our review, but only on the periphery. The OTS's focus has been on income tax issues and the interactions with welfare benefits to a much greater extent.

**3.255** It is in principle more important that attention is paid to simplifying the income tax system for pensioners, in that more people are likely to benefit as a result. That is not to say, however, that we should not note in this report that capital gains tax (CGT) can be an issue for some pensioners.

**3.256** For example, if a taxpayer needs to go into care (whether through living with other family members or into a care home), it can be that their own home is rented out or perhaps left vacant. Although there are provisions within the private residence rules for retaining relief for the final 36 months of ownership, regardless of occupation, and letting relief, a risk may still remain that full relief is no longer available on an eventual sale. To address this, an additional provision within the private residence legislation could be inserted to allow for periods when the owner was unable to occupy their own home due to personal care needs.

**3.257** The OTS has also found that pensioners can be confused between inheritance tax and CGT. They may have heard of the 'seven-year rule' for gifts not to be counted for inheritance tax, but unwittingly trigger a CGT charge by giving away chargeable assets to the next generation and failing to understand the implications of so doing.

**3.258** The OTS is willing to do more work in this area, if it is thought useful. We would note at this stage that there are a lot of pitfalls for the older taxpayer who may be contemplating gifts: for example, the fact that a gift of an asset triggers a CGT disposal, and that retaining some sort of use of the asset can lead to income tax complications under the 'pre-owned assets' rules<sup>79</sup>.

## R. Foreign income, other than pensions – non-UK domiciled pensioners

**3.259** The OTS received some comments that the changes made in recent years to the taxation of non-UK domiciled individuals have introduced complexity, as in some instances there could now be a UK tax issue where there was none before.

**3.260** Pensioner cases can come to light where, for example, older people join other family in the UK after retirement but might retain property or funds overseas.

**3.261** We have not explored these issues in depth in the initial stages of the review, partly because consultation on domicile rules was continuing in late 2011 and the issues are not exclusive to the pensioner population.

## S. Pensioners retiring abroad

**3.262** With freedom of travel increasing in recent decades, there are some pensioners who choose to retire abroad. The OTS acknowledges here that the scope of the initial information-gathering has been UK-based and we have therefore not received much in the way of evidence of UK tax complexity arising for those who have made the choice to retire overseas. This is therefore an area to which we might wish to return in the second stage of our review, or perhaps as part of a later project.

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<sup>79</sup> [http://www.hmrc.gov.uk/poa/poa\\_guidance1.htm](http://www.hmrc.gov.uk/poa/poa_guidance1.htm)

**3.263** We have, however, touched on some areas in our meetings with various pensioner representatives and received some written contributions from British pensioners living abroad.

### **S1 Administrative problems of living overseas**

**3.264** Depending on the country in which a taxpayer lives, the postal system can vary in terms of the length of time it takes to deliver post; or indeed vary in reliability such that there may be little certainty that the item will ever arrive at its intended destination.

**3.265** With improvements in technology, it might be possible to ease such problems if HMRC were to have a clear email channel or secure Government Gateway system for those living overseas to communicate with them.

**3.266** It has also been suggested to the OTS that it can be difficult to get a tax repayments sent to a non-UK bank account and that HMRC finds it difficult to recognise an overseas address in their systems.

**3.267** A further problem for those living overseas who file SA tax returns is that they are not able to use HMRC's free online filing software, as the facility does not include the residence pages. This means they have to purchase third party software so to do<sup>80</sup>.

**3.268** Although we have not carried out an in-depth review of the material, a query from a pensioner living overseas which came to the OTS email inbox highlighted how difficult it is to navigate the guidance on HMRC's website for those who wish to applying for UK pensions to be paid gross. A form is available to apply for double tax treaty relief<sup>81</sup> but finding it is not straightforward. Completing it is also likely to be a challenge for many pensioners given its layout and complex language.

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<sup>80</sup> <http://www.hmrc.gov.uk/sa/software.htm#1>

<sup>81</sup> Form DT-Individual <http://www.hmrc.gov.uk/cnr/dtindividual.pdf>





# 4 Priority areas for further review and consideration of reform

4.1 After having gathered input on the complexities of pensioner taxation, set out in Chapter 3 of this interim report, the OTS has sought to prioritise those areas to which precedence should be given in the second stage of our review.

4.2 As noted in Chapter 2, by combining our research, feedback from the meetings we held around the country and results from a survey of our Committee members, we have given a priority rating of high, medium or low to various areas below.

4.3 Again, we must stress this does not mean that the OTS is not prepared to consider those areas of lesser priority if we have the time, resources and support of Ministers to do so. Some areas we have marked as of low priority for the next stage of our review because we know work is already ongoing within HM Treasury or HMRC, perhaps also in consultation with external parties. We have acknowledged this where appropriate and emphasise the importance of such work continuing.

4.4 Whatever the priorities the OTS has set out, we welcome comments from readers of this report on any aspect of the contents.

4.5 First, we summarise the priority ratings we have given to each area in a table below, then we move on to explain the reasons in more detail. We have identified in the table whether matters require policy attention or changes in legislation, or administrative simplifications. There are some crossovers, as some issues arise from both complexity of the law itself compounded by complex administration.

4.6 We have also summarised in the table below the suggestions we have made in Chapter 3 for short term improvements whilst longer term reform of pensioner taxation will be given more detailed consideration in the second stage of our review. We have also identified those matters which could be taken forward by the Government for immediate consideration.

**Table 4.A: Priorities list and suggestions for short term improvements**

| Issue   | Priority rating for second stage of the OTS pensioner review |                | Suggestions for short term improvements or matters to consider immediately                          |
|---|--|----------------|---|
|   | Policy reform/ legislative change                            | Administrative |   |
| <b>A. Age-related allowances</b>                              |  |                |   |
| A.1 Further consideration of simplification possibilities     | High   |                |   |
| A.2 Further consideration of improvements to HMRC's processes |  | High           | HMRC could review their records for cases where the allowances might be due but not claimed.        |
| <b>B. Married couple's allowance</b>                          |  |                |   |
| B.1 Further consideration of simplification possibilities     | High   |                | Repeal redundant legislation which provides for a differential rate of allowance for the under-75s. |

| Issue  | Priority rating for second stage of the OTS pensioner review |                | Suggestions for short term improvements or matters to consider immediately  |
|--|--|----------------|---|
|  | Policy reform/ legislative change                            | Administrative |   |
| B.2 Further consideration of improvements to HMRC's processes  |  | High           | HMRC could review the forms relating to married couple's allowance and provide clearer explanations of it on the P2 notice of coding.   |
| <b>C. Sundry reliefs</b>   |  |                |   |
| C.1 Relief for qualifying maintenance payments   | Medium   |                |   |
| C.2 Relief for interest to acquire an equity release annuity   | High   |                | Review the possibility of repealing this provision and consequent repeal of MIRAS legislation remaining in ICTA 1988.   |
| <b>D. Blind person's allowance</b>   |  |                |   |
| Blind person's allowance   | Medium   |                | The OTS will not be reviewing this again in the second stage, but suggests the Government reconsider the OTS's previous conclusions that the available funds for the relief would be better utilised by direct grant rather than the under-used tax relief. |
| <b>E. Savings taxation</b>   |  |                |   |
| E.1 The 10% savings rate – considering the case for its removal  | High   |                |   |
| E.2 Registering for gross interest on savings accounts – consider changes to the R85 system                        | High   |                |   |
| E.3 R85s following a bereavement   |  | High           | HMRC and the DWP should review booklet DWP1027 to include this issue along with other improvements to it on tax-related matters.  |
| E.4 Repayment claims - administrative improvements   |  | Medium         |   |
| E.5 Dividends on overseas shareholdings  | Low  | Low            |   |
| E.6 Purchased life annuities   | Low  | Low            | HMRC could review the information providers of these products make available to new annuitants to ensure that it is clear on how they are taxed.  |
| E.7 Interest information from deposit-takers – consider compulsory issue of interest and tax deducted certificates | Medium   |                |   |

| Issue  | Priority rating for second stage of the OTS pensioner review |                                    | Suggestions for short term improvements or matters to consider immediately  |
|--|--|------------------------------------|---|
|  | Policy reform/ legislative change                            | Administrative                     |   |
| E.6 Obtaining tax refunds on savings   | Medium   |                                    |   |
| <b>F. The state retirement pension</b>   |  |                                    |   |
| F.1 Tax and a new state pension – the current system and changes already in progress |  | Medium                             | HMRC should undertake to review all records where a basic amount of state pension has been coded out in the absence of a final figure, and ensure that those cases are reconciled after the year end using final, accurate figures from the DWP or contact the pensioner if there is any doubt. |
| F.2 PAYE and the state pension   | High   |                                    |   |
| F.3 Information from the DWP about the state pension – considering a 'P60 Benefits'  |  | High                               |   |
| F.4 Raising awareness of how the state pension is taxed                              |  | High                               | HMRC and the DWP should review current information, particularly addressing the immediate anomalies the OTS has identified in Chapter 3 of this report.   |
| F.5 Deferred state pensions – reviewing tax information                              |  | Medium                             |   |
| <b>G. Welfare benefits, other than the state pension</b>                             |  |                                    |   |
| G.1 Interaction between tax and benefits   | Medium   |                                    | HMRC and the DWP should review the guidance available to pensioners on the tax status of welfare benefits, particularly those paid with the state pension, with the aim of moving towards providing a 'P60 benefits'.   |
| <b>H. Small pension pots</b>   |  |                                    |   |
| H.1 Tax reclaims relating to trivial commutation                                     |  | Low (but we endorse ongoing work). | HMRC should review form R43 as a matter of priority as, for example, it still includes reference to the first £70 of interest on an NS & I Ordinary Account being tax exempt, an obsolete relief abolished following the OTS review of tax reliefs.   |
| H.2 Further review of the legislation  | Low (but we endorse ongoing work).                           |                                    | Consider annual uprating for inflation of the fixed trivial commutation limits of £18,000 and £2,000, and removing the 12-month window for trivial commutations.  |

| Issue  | Priority rating for second stage of the OTS pensioner review |                                    | Suggestions for short term improvements or matters to consider immediately  |
|--|--|------------------------------------|---|
|  | Policy reform/ legislative change                            | Administrative                     |   |
| <b>I. Overseas pensions paid to UK resident pensioners</b>               |  |                                    |   |
| I.1 The 10% deduction – review   | Medium   |                                    |   |
| I.2 Guidance on taxation of overseas pensions – review                   |  | Medium                             | HMRC should review its guidance, particularly to help those with cross-border issues between Northern Ireland and the Republic of Ireland.  |
| <b>J. Collecting tax – PAYE</b>  |  |                                    |   |
| J.1 Eliminate any errors remaining in NPS                                |  | High                               |   |
| J.2 A single, reconciled statement to replace multiple P2 coding notices |  | High                               | As this is likely to be a longer term objective, HMRC should consider reviewing existing guidance on complex areas (K codes, for example) as a first step towards simplification. |
| J.3 Payslips for pensioners  |  | Low                                |   |
| J.4 Starting to receive a pension  | High   |                                    | HMRC should consider the operation of the PAYE Regulations for new pensions together with RTI developments.   |
| J.5 Annual reconciliation and tax calculation forms P800                 |  | High                               | HMRC should look at how soon essential changes could be made, such as flagging estimated figures and providing breakdowns of 'PAYE income'.                                       |
| J.6 Ceasing work in the tax year and claiming a repayment                |  | Low                                | HMRC should review the extent to which form P50 is used by pensioners and its practicality in such cases.   |
| J.7 Determining pensioners' PAYE codes and form P161                     |  | High                               |   |
| <b>K. Collecting tax – self assessment</b>                               |  |                                    |   |
| K.1 Self assessment – operational improvements                           |  | High                               |   |
| <b>L. Support for bereaved taxpayers</b>                                 |  |                                    |   |
| L. Support for bereaved taxpayers  |  | Low (but we endorse ongoing work). |   |
| <b>M. National Insurance Contributions</b>                               |  |                                    |   |

| Issue   | Priority rating for second stage of the OTS pensioner review  |  | Suggestions for short term improvements or matters to consider immediately   |
|---|---|--|--|
|   | Policy reform/ legislative change   | Administrative   |  |
| National insurance contributions  | Low (because of the consultation on merging the operation of income tax and NIC already in progress). |  | The Government should look carefully at the situation for those reaching retirement, particularly with further changes to the state retirement age in progress, and ensure that complexities are minimised so far as possible. |
| <b>N. Other administrative issues</b>                                       |   |  |  |
| N.1 Face to face services, including home visits                            |   | High   |  |
| N.2 Digital exclusion   |   | High   |  |
| <b>O. Gift aid</b>  |   |  |  |
| Gift aid  | Low   |  |  |
| <b>P. Care and support for employers</b>                                    |   |  |  |
| Care and support for employers  | Low (but we endorse the ongoing work).  |  |  |
| <b>Q. Capital gains tax</b>   |   |  |  |
| Capital gains tax   | Low   |  |  |
| <b>R. Foreign income, other than pensions – non-UK domiciled pensioners</b> |   |  |  |
| Foreign income, other than pensions – non-UK domiciled pensioners           | Low   |  |  |
| <b>S. Pensioners retiring abroad</b>  |   |  |  |
| S.1 Administrative problems of living overseas                              |   | Low (but we would welcome further submissions as regards problem areas). | HMRC should review the problems noted in section1 of Chapter 3 above to see if any improvements can be delivered.  |

## A. Age-related allowances

### A.1 Further consideration of simplification possibilities

4.7 There is great appetite for simplification of age-related allowances. The issues discussed to date and ideas for review, ranging from small changes to outright abolition, were outlined in Chapter 3.

4.8 We would stress again that the OTS has not reached any conclusions as to the best way forward with age-related allowances, nor have we formulated detailed recommendations. However, we know that there is little support for leaving both the structure of the allowances and the way they are administered as they are.

4.9 Our recommendation at this stage is therefore that age-related allowances should be a **high priority** in the second stage of our review and that we would like to consider ways in which they could be simplified.

### A.2 Further consideration of improvements to HMRC's processes

4.10 As well as fundamental simplification of the rules, there are strong views that the administration of age allowances could be simplified. Whilst we note that HMRC already has some plans to change the claims process, we have concluded that the second stage of our review should give **high priority** to exploring how further simplification could be achieved.

## B. Married couple's allowance

### B.1 Further consideration of simplification possibilities

4.11 The OTS could view the married couple's allowance together with age allowances to formulate overall recommendations on a pensioner tax strategy, or it could be considered as a standalone item for simplification. Either way, we have found strong support for reviewing the allowance.

4.12 Although various ideas have been discussed in the initial stages, as outlined in Chapter 3 above, we have not yet reached any firm conclusions. The OTS therefore recommends that this is a **high priority** area for the second stage of our pensioner review.

### B.2 Further consideration of improvements to HMRC's processes

4.13 Similarly, there is support for reviewing further the administration of the married couple's allowance and looking to identify simplification opportunities. This again is a **high priority** area.

4.14 As an interim measure, HMRC could engage with interested parties to review the forms relating to married couple's allowance and provide clearer explanations of it on the P2 notice of coding.

## C. Sundry reliefs

### C.1 Relief for qualifying maintenance payments

4.15 On its own, we have received little evidence of complexity of this relief, and mixed responses from our Committee about its priority in our review.

4.16 However it is, in some respects, linked to the married couple's allowance. The OTS therefore recommends that we consider it further as part of the second stage of our review as a **medium priority**. If substantive changes are eventually recommended to the married couple's

allowance, leaving this relief untouched, might be out of step with wider policy changes.

## C.2 Relief for interest to acquire an equity release annuity

4.17 For the reasons identified in Chapter 3, we believe that the Government should give immediate consideration to repeal of this relief, as a high priority.

## D. Blind person's allowance

4.18 As the OTS has looked at blind person's allowance before, we conclude that further work on it **should not be included in the second stage** of our review. We believe the conclusions and recommendations in our earlier report remain valid and accordingly do not believe it is worth us devoting further resources to its review.

4.19 Nevertheless, in this interim report **we recommend that the Government consider again the proposals put forward in the OTS's review of tax reliefs**, given that the pensioner review has given support to our previous recommendations by highlighting the particular issues for older people.

4.20 With an ageing population in prospect, we believe it is important for the Government as a whole to consider how support can be offered and accessed in the most straightforward and appropriate manner for those who develop health problems associated with older age, such as (but not limited to) loss of sight. For reasons previously outlined, the current regime of tax relief falls short of those objectives.

## E. Savings taxation

### E.1 The 10% savings rate – considering the case for its removal

4.21 There is strong support for abolition of this rate, which is viewed as poorly targeted, not understood, under-claimed and unnecessarily complex.

4.22 But a fundamental question is whether, perhaps as part of an overall package of simplification measures, those who would suffer a tax cost from its abolition could somehow be compensated.

4.23 The OTS therefore recommends that we consider these issues further as a **high priority** in the second stage of our pensioner tax review.

### E.2 Registering for gross interest on savings accounts – consider changes to the R85 system

4.24 As noted in Chapter 3, the form R85 process for registering to receive gross interest is currently 'all or nothing', i.e. you are either a non-taxpayer and can receive all your interest gross, or you are a taxpayer and it must all be taxed at source with a repayment being claimed.

4.25 The OTS has received strong support for considering how this might be changed so that pensioners with a small tax liability could opt to have interest paid gross on some accounts but paid net on others. In the initial stages of our review, however, we have not had the opportunity to consider in detail how such a system might work. We therefore recommend this is carried forward as a **high priority** to the second stage of our review.

### E.3 R85s following a bereavement – improvements to guidance

4.26 The OTS welcomes improvements to the R27 notes from April 2012. However, we suggest a further short term improvement could be achieved if HMRC and the DWP were to work together, with interested external parties, to review booklet DWP1027 to include this issue (along with improved guidance on other tax matters). This is a high priority.

## E.4 Repayment claims – administrative improvements

4.27 Simplification opportunities in this area include reviewing the Form R40 and its processes. As noted in Chapter 3, the OTS understands that HMRC is already doing some work in this area, in particular looking at the possibility of introducing an online version of the form. For this reason, we would not intend to devote significant resources in the second stage of our review to this area, but would mark it as of **medium priority**, keeping a watching brief on developments from HMRC.

## E.5 Dividends on overseas shareholdings

4.28 Whilst the taxation of dividends on overseas shareholdings is an area of complexity, the OTS has found it to be of lower priority than other areas. It is also not an issue exclusive to pensioners.

4.29 For those reasons, we have concluded that it is a **low priority** for the second stage of our review, both in terms of policy and administration.

## E.6 Purchased life annuities

4.30 Similarly, although these annuities can be a source of confusion for those who have them, the OTS has not been made aware that problems are widespread and the overall view of our Consultative Committee was that they are of lower priority than other areas.

4.31 Consequently, we again suggest that this is a matter of **low priority** for the second stage of our review, but that HMRC could carry out a review of the information given by product providers to new annuitants as to how the annuity will be taxed.

## E.7 Interest information from deposit-takers – consider compulsory issue of interest and tax deducted certificates

4.32 Our Committee members' responses were mixed on this issue, split evenly between those who felt it was of higher priority and those who marked it as lower priority. Notably, however, none of the members suggested that the OTS should not consider the matter at all.

4.33 Our conclusion is therefore that we should consider it in the second stage of our review as a **medium priority**.

# F. The state retirement pension and its interaction with other benefits

## F.1 Fundamental points – the origins of complexity and considering whether the state pension should be taxable at all

4.34 Views on this were put forward, but were very mixed, with some believing the OTS should consider it as a priority, others believing it should not be considered at all. It is however a major policy matter and as such is specifically outside our remit – though we have to have regard to the simplification benefits that could result in taking our work forward.

4.35 Of course, it is linked to the other issues, and the OTS has to move forward to the second stage of the review from a base point. Our initial conclusion is that we should work on the basis that the state retirement pension remains taxable, but that there are very strong arguments for changes to improve how it is taxed.

4.36 Changing the basis of taxing the state pension to a receipts rather than entitlement basis could be a matter for further consideration, but this is arguably linked to the other matters above. We are inclined to proceed on the basis that the complexities could be minimised by



improving information (such as providing a P60 equivalent) rather than changing its basis of taxation but we are open to views on this point.

## F.2 Tax and a new state pension – the current system and changes already in progress

4.37 The OTS welcomes efforts HMRC and DWP are making to improve the processes for taxing the state pension. This is of **medium priority** and in the second stage of our review will be to keep a watching brief on these developments.

## F.3 PAYE and the state retirement pension

4.38 Of all the policy changes discussed during the initial stages of our review, taxing the state pension at source came up most frequently and was listed as the **highest priority** in our survey of Committee members.

4.39 We therefore believe it essential to carry out further work on this in the second stage of our review. This would include considering the costs and practicalities of making such a change as against the potential savings and number and profile of pensioners it might help.

## F.4 Information from the DWP about the state pension – considering P60 benefits

4.40 From the meetings held during preparation of this interim report and responses from surveying our Committee members, there is near-unanimous support for improving the information given to state pensioners. Confirmation is needed of how much is taxable for a tax year, at the appropriate time, i.e. at the tax year end, or following death of the pensioner.

4.41 In conjunction with considering PAYE on the state pension, this is therefore a matter of **high priority** for the second stage of our review.

## F.5 Raising awareness of how the state pension is taxed

4.42 As outlined in Chapter 3, and supported by our initial findings, assessing how information is provided to new state pensioners about how their state pension is taxed is a matter of **high priority**.

4.43 However, the OTS would first need to establish whether we will recommend changes to the way in which the state pension should be taxed, i.e. by operating PAYE on it, before recommending what guidance should follow.

## F.6 Deferred state pensions – reviewing tax information

4.44 Little evidence was gathered of complexity in this area in this first stage of our review. However, with people continuing to work for longer, we would like to explore whether more people are deferring their state pension and whether existing tools and support are adequate for those facing this type of decision to understand the tax and related consequences. We therefore consider this of **medium priority** for our second stage.

# G. Welfare benefits, other than the state pension

## G.1 Interaction between tax and benefits

4.45 From the initial stages of our review, we have found support for the OTS to carry out further work in identifying complexity caused as a result of differences between the definition of income for tax purposes and DWP benefits such as pension credit.

4.46 Gauging the responses of our Committee members, we believe this is a matter of **medium priority** for the next stage of our review.

## H. Small pension pots

4.47 Overall, the OTS has found strong support for further review of pensioners' access to small pension pots and how they are taxed.

### H.1 Tax reclaims relating to trivial commutation

4.48 The OTS understands that work is ongoing between HMRC and external parties to review how tax reclaims relating to trivial commutations can be simplified. The complexities identified from the initial stages of our review, for example in reclaiming tax via form P53 for UK resident taxpayers and form R43 for those living overseas, support the importance of those continuing efforts.

4.49 Indeed, for those living overseas, reviewing form R43 appears to be a matter of priority as it still includes reference to the first £70 of interest on a NS & I Ordinary Account being tax exempt<sup>1</sup> - a redundant relief previously identified by the OTS and repealed in paragraph 4 Schedule 26 Finance Act 2011.

4.50 However, given that others are already working on this area, the OTS concludes that it should be a **low priority** area for the second stage of our pensioner review.

### H.2 Further review of the legislation

4.51 Given that we understand work is continuing between HM Treasury, HMRC and external stakeholders, the OTS suggests that we may not be able to contribute anything more at this stage. We note that, acknowledging the potential for higher incidence of them in future, the DWP is also currently consulting on improving transfers and dealing with small pension pots<sup>2</sup>. We therefore mark this as a **low priority** for the second stage of our pensioner taxation review, but add our support to the existing work to the extent that changes to the rules could achieve simplification.

## I. Overseas pensions paid to UK residents

### I.1 The 10% deduction - review

4.52 Responses from our Committee members indicate that this is of lesser importance than some other areas when considering priorities for the second stage of the OTS review.

4.53 Nevertheless, we do believe that this is potentially an area of increasing importance in the future and, if resources allow, we would therefore like to devote some further time to it. We therefore mark it of **medium priority**.

### I.2 Guidance on taxation of overseas pensions - review

4.54 Views from our Committee members were mixed on the subject of reviewing guidance from HMRC on the UK taxation of overseas pensions paid to UK residents, including how and when double tax relief can be claimed. We therefore conclude it should be of **medium priority** for the second stage of our review.

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<sup>2</sup> <http://www.dwp.gov.uk/consultations/2011/small-pension-pots.shtml>

## J. Collecting tax - Pay As You Earn

### J.1 Eliminate any errors remaining in NPS

4.55 The OTS considers that it is a matter of **high priority** for the second stage of our review to gauge whether PAYE coding accuracy is increased or whether problem areas remain. This should be identifiable from feedback on the 2012/13 coding run which is currently taking place.

### J.2 A single, reconciled statement to replace multiple P2 Coding Notices

4.56 Most of our Committee members thought that a single, reconciled statement of coding should be HMRC's aspiration. We therefore think it is of **high priority** for the second stage of our review to consider this further.

### J.3 Payslips for pensioners

4.57 Views from our Committee members were extremely mixed on whether or not pension providers should be required to issue regular payslips. Overall, we conclude it is a **low priority** for the second stage of our review.

### J.4 Starting to receive a pension

4.58 Of most importance to our Committee members in the area of PAYE was reviewing the regulations to reduce or remove opportunities to 'dual allowances' situations to arise. The OTS believes this is a matter that HMRC could address now, particularly in view of changes to PAYE already in train with the development of RTI, and we will continue to regard it as a **high priority** matter as our work develops.

### J.5 Annual reconciliation and tax calculation forms P800

4.59 As P800 tax calculations are now a largely automated part of the PAYE calendar, we conclude that it is of **high priority** to review the complexities caused by them. Administrative matters such as showing estimated figures and explaining how the underpayment arose are of high importance.

### J.6 Ceasing work in the tax year and claiming a repayment

4.60 As the transition to pension age is becoming increasingly blurred, the OTS suggests that HMRC reviews the practical application of form P50 for pensioners and aims to simplify the process for those claiming a repayment when ceasing to work but who are perhaps not yet in receipt of pension income. However, the second stage of the OTS review is unlikely to consider this in detail and we therefore mark it as **low priority** for our purposes.

### J.7 Determining pensioners' PAYE codes and form P161

4.61 As noted in Chapter 3, there remains concern that HMRC changes to the P161 processes could lead to codes being based upon information that pensioners have not been given the opportunity to review or check and confusion could still arise.

4.62 We therefore consider that further review of PAYE administration issues should be a **high priority** for the second stage of the OTS pensioner review.

## K. Collecting tax - self assessment

### K.1 Self assessment – operational improvements

4.63 Easing self assessment processes was a popular area with our Consultative Committee. The survey results clearly show this is an area of **high priority** for the next stage of our review.

4.64 Although not all of them relevant to only pensioners, addressing the issues raised in Chapter 3 of this interim report could provide simplification for that group.

4.65 Disapplying the overriding limit of 50% deductions in 'K code' situations was also noted as a priority matter, although if PAYE were to be operated on the state pension, this is likely to be of much lesser importance.

## L. Support for bereaved taxpayers

4.66 As noted in Chapter 3, various changes already are in progress.

4.67 For example, the new processes for the DWP to notify HMRC of state retirement pensions will include notification of when there is a change in the amount of payment. This is something that the OTS understand the current paper P46DWP process does not cover but the new process should help to ensure that changes in the state pension following a bereavement will be reviewed and re-coded much more quickly.

4.68 Also, the R27 form is being improved to include a prompt to review the tax affairs of the surviving spouse or civil partner.

4.69 We think improvements in this area are at least of medium priority but given that work is already under way, the OTS considers that these matters are of **low priority** for the second stage of our review. However, the views of our Consultative Committee and evidence gathered in preparation of this interim report serve to reinforce the importance of making real progress in this area and we therefore hope to keep a watching brief on developments.

## M. National insurance contributions

4.70 National insurance contributions issues were raised on a limited basis when gathering information for this interim report. Views of our Committee were also mixed as to its priority in our review.

4.71 Given that other work is ongoing on the policy surrounding income tax and national insurance contributions looking further at administrative simplification, we are marking this as a **low priority** for the second stage of our review.

4.72 We would, however, urge that the Government look carefully at the situation for those reaching retirement, particularly with further changes to the state retirement age in progress, and ensure that complexities are minimised so far as possible.

## N. Other administrative issues

4.73 Addressing administrative issues for pensioners rated as **high priority** amongst our Consultative Committee, so the OTS would like to carry out further work in this area in the second stage of our review.

4.74 This includes reviewing how HMRC interacts with all pensioners whether by post, online, on the telephone and face to face, and how intermediaries are recognised by HMRC in helping them.

### N.1 Face to face services, including home visits

4.75 Evidence points to pensioners requiring personalised, often face to face services, so this is a **high priority** matter for us to consider.

### N.2 Digital exclusion

4.76 With many pensioners having been left behind by the online world and the incidence of

disabilities potentially affecting ability to take advantage of technology (at least without extra cost of additional equipment and software) as people get older, HMRC's support for pensioners who are digitally excluded is again a **high priority** consideration.

## O. Gift aid

4.77 The complexities of the gift aid scheme for low-income pensioners were not widely raised in the initial stages of our review. Although our Committee members mostly thought that this is an area the OTS should look at, they rated it as of lesser importance than other areas. Given also that this is not a matter exclusive to pensioners, we rate it as **low priority** for the second stage of our review.

## P. Care and support for employers

4.78 As noted in Chapter 3 of this interim report, although it is essential that HMRC offers support to older people who have to engage carers and who may become employers as a result, the OTS considers that this is a **low priority** area for the second stage of our review.

## Q. Capital gains tax

4.79 As with gift aid above, the complexities of capital gains tax (CGT) for pensioners have not come through as being of high importance thus far in our review. And again, although our Committee members mostly thought that this is an area the OTS could look at, our conclusion is that it is a **low priority** for the second stage of our review (both in terms of reviewing legislative and administrative issues).

## R. Foreign income, other than pensions – non-UK domiciled pensioners

4.80 Given that domicile issues have been subject to very recent consultation and having noted that our Committee members mostly noted this very low on their priority list, **the OTS does not intend to review this area further.**

## S. Pensioners retiring abroad

### S.1 Administrative problems of living overseas

4.81 The issues discussed in Chapter 3 for pensioners retiring and living abroad were rated largely as of **low priority** by our Consultative Committee. More research might need to be carried out in order to determine more fully the extent of complexities in this area and therefore whether it is worth dedicating further OTS resources to it.

4.82 Therefore, in view of the limitations of our initial information-gathering work in relation to overseas aspects, the OTS will remain open to further submissions from pensioners or organisations which have further examples of complexities and any ideas for simplification in this area.



# A Pensions and pensions tax reliefs: some historical notes

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## Pensions

**A.1** Pensions have been paid in the UK since at least the 1670s<sup>1</sup>, though on a rather ad hoc basis. The rationale has always been the desire to avert poverty in old age and to ensure that individuals have sufficient income in retirement, often as a continuing reward for long and faithful service.

**A.2** Since the start of the 20<sup>th</sup> century there has been a benevolent attitude to pensioners (including measures to relieve the burden of increased tobacco duty in 1947!) to protect from taxation those “too old to share in the benefits of higher earnings and rising standards”<sup>2</sup>.

**A.3** The Old Age Pensions Act 1908, which was the first step in the Liberal welfare reforms, introduced the first “modern” pension from 1 January 1909. This was a means tested non-contributory benefit of 5/- a week (7/6d for a married couple) that was paid to those over 70 with an income of less than £21 a year.

**A.4** The first contributory benefits were introduced by the Widows, Orphans and Old Age Contributory Pensions Act 1925, which provided that manual workers and others earning less than £250 a year would receive a pension of 10/- a week from the age of 65. This was not a universal benefit and it was the Beveridge Report<sup>3</sup> in 1942 that recommended a universal pension to provide protection against deprivation in old age.

**A.5** What is currently the basic state pension (BSP) was introduced from 1948 by the National Insurance Act 1946. It was also the catalyst for the increase in private earnings related occupational pension schemes; these had existed prior to World War II but as the BSP did not match the growth in average earnings in the post war period occupational pension schemes were more frequently offered by employers.

**A.6** Pensions have further developed since 1948, and developments have included the introduction of the State Earnings Related Pensions Scheme (SERPS)<sup>4</sup> between 6 April 1978 and 5 April 2002, which was replaced by the Second State Pension (S2P)<sup>5</sup>

## Taxation of pensions

**A.7** Pensions have been the subject of taxation in the UK for centuries. The Land Tax introduced in 1692 taxed “any Pension Annuity Stipend or other yearly Payment ...” at the rate of “Three Shillings for every Twenty Shillings ...”, and pensions were specifically the subject of taxation in the Income Tax Acts 1799 and 1803<sup>6</sup>, and have remained so ever since<sup>7</sup>.

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<sup>1</sup> Then and subsequently often by monarchs to favourites or national heroes and sometimes in perpetuity

<sup>2</sup> Douglas Houghton MP, Hansard HC Deb 14 June 1961 vol 642 c572

<sup>3</sup> Sir William Beveridge “Social Insurance and Allied Services” 1942

<sup>4</sup> Social Security Act 1975

<sup>5</sup> Child Support, Pensions and Social Security Act 2000

<sup>6</sup> S175

<sup>7</sup> Except between 1816 and 1842 when there was no income tax

**A.8** The subsequent history and development of the taxation of pensions is complex and only a broad outline of the current position is set out below.

### **UK pensions (not state retirement pensions)**

**A.9** All UK pensions arising from past employment or paid by a registered pension scheme are pension income and charged under Part 9 Income Tax (Earning and Pensions) Act 2003 (ITEPA 2003). The charge is on the amount “accruing” in the tax year irrespective of when paid.

**A.10** Pensions arising from past employment or paid by a registered pension scheme count as “PAYE income” and as “PAYE pension income”<sup>8</sup> unless they fall into an excluded category (e.g. annuities for dependants<sup>9</sup>).

### **Overseas pensions paid to UK residents**

**A.11** Until 1974, individuals were taxed on overseas pensions on the remittance basis whatever their place of domicile. In 1974 the remittance basis was limited to non-domiciled persons, and overseas pensions were brought into line with other income. Section 22 FA 1974 provided for a 10% deduction from pensions charged under Schedule D Case V and Schedule E (the latter being pensions payable in the UK from a foreign government).

**A.12** ITEPA 2003 brought all overseas pensions into Part 9 but maintained a distinction between those formerly within Schedule D (Chapter 4 of Part 9) and those formerly within paragraph 4 of Schedule E (Chapter 11 of Part 9). Chapter 4 charges the “full amount arising” in the tax year (paradoxically this means 90% of the actual amount) and Chapter 11 charges the full amount accruing before allowing a 10% deduction. There are specific rules determining whether a credit for foreign tax is due.

### **State pensions**

**A.13** The old age pension that was paid up until 1946 was subject to a means test. Since the exemption for small incomes was always higher than the aggregate of the annual pension and other taxable income they were never chargeable to tax, although in theory they were within the scope of income tax.

**A.14** In 1946 the National Insurance based state retirement pension (NIRP) was introduced, which was specifically made taxable under Schedule E<sup>10</sup> and was also deemed to be emoluments<sup>11</sup>. It was not subject to PAYE, though the legal basis for this is obscure. However since 2003 all state pension income is outside PAYE by virtue of regulation 4(1)(b) of the PAYE Regulations (with an exception for lump sum payments of deferred pension). Those regulations do, however, require state pensions to be coded out where there is another source of PAYE income.

### **Pensions (of all types) paid to non-residents**

**A.15** Many non-residents receiving pensions from UK-based payers are those who have emigrated since retirement and are in principle liable to UK income tax on UK source income subject to certain exclusions<sup>12</sup>, e.g. UK social security pensions<sup>13</sup>.

**A.16** Consequently a non-resident pensioner may be liable to UK tax on an occupational pension paid from the UK unless a double tax agreement exempts it from UK tax. A non-resident may be

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<sup>8</sup> Section 683(1)(b) ITEPA 2003

<sup>9</sup> Section 609 ITEPA 2003

<sup>10</sup> Section 27(2) FA 1946

<sup>11</sup> Section 24 FA 1949

<sup>12</sup> Chapter 1 part 14 ITA 2007

<sup>13</sup> Section 813 ITA 2007



entitled to personal allowances, including age-related allowance and married couple's allowance.

## Age-related Allowances

**A.17** Reductions in liability from the "standard" rate of income tax have been a feature of income tax since at least 1803. Starting in 1925/26 reliefs related to age have been introduced. These are:

- Old age relief<sup>14</sup>;
- Age exemption<sup>15</sup>; and
- Age allowance<sup>16</sup>

**A.18** The 1925 old age relief was introduced to help those over 64 on small incomes (less than £500 a year) and was given instead of earned income relief. The justification for age relief was given by the Chancellor, Winston Churchill:

**Box A.1:**

"I consider that the savings of old people on a small scale are virtually earned income, and, therefore, a person over 65, whose total income from investments or any other source does not exceed £500 a year will gain the advantage ..."<sup>17</sup>

**A.19** Age relief was repealed in 1972/73 by FA 1971.

**A.20** An age exemption was introduced alongside the age relief by section 13 FA 1957 to provide an exemption from income tax for a single person with income less than £250 (£400 for a married couple). This was replaced in 1975 by age allowance, designed to end the position where when "an elderly person's income exceeds the age exemption limit, the benefit of the higher starting point begins to be withdrawn immediately."<sup>18</sup>

**A.21** A differential age allowance was introduced in 1987 (section 26 FA 1987), which provided for an increased allowance if the taxpayer, or one of a couple, was 80 or over (reduced to 75 in FA 1989).

**A.22** During the period in question there was clear support in Parliament for maintaining the various age reliefs, even if it was not considered appropriate to increase the thresholds. Until 1971, a Parliamentary debate focussed on extending age relief. When it was introduced in 1925 the retirement age for men and women was 65. During World War II the retirement age for women was reduced to 60, but age relief continued to apply from age 65. From 1945 there were various Finance Bill amendments to amend the age relief to apply to women at age 60 but these were rejected.

**A.23** From 1990/1991 the system of personal allowances was changed to recognise independent taxation of wives' income. A new married couple's allowance (MCA) applied to married men of whatever age, with those over 65 and 75 entitled to an enhanced amount. The MCA was transferrable to the wife if the husband could not use it<sup>19</sup>. In 1992 an election was introduced for either spouse to use half (with the other half going to the other spouse) or all of

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<sup>14</sup> Section 15 FA 1925

<sup>15</sup> Section 13 FA 1957

<sup>16</sup> Section 31 F(2)A 1975

<sup>17</sup> Hansard: HC Deb 28 April 1925 vol 183 cc86-9

<sup>18</sup> Denis Healey, Hansard: HC Deb 12 November 1974 vol 881 cc273-5

<sup>19</sup> Section 257 ICTA 1988

the allowance and in FA 1994 it was changed to become a tax reduction at the rate of 20%. In FA 1999<sup>20</sup> the MCA became a transferable tax allowance available to those born before 6 April 1935 and the rate was reduced to 10%.

**A.24** For those born before 6 April 1935 making maintenance payments to a former spouse there is a further allowance giving a tax reduction of 10% for payments of £244 or less<sup>21</sup>.

## The operation of PAYE

**A.25** PAYE was introduced in 1944<sup>22</sup> when the majority of employees worked for a single employer and occupational pensions were paid to people who had fully retired and before the introduction of national insurance contribution-based state retirement pensions.

**A.26** From 1944 to the introduction of self assessment in 1995, the successive Pay As You Earn Regulations and the (then) Inland Revenue's procedures appeared to cater adequately for a pensioner who starts a job or receives a second pension. Assuming all allowances were given against the primary pension, standard or, later, basic rate tax would be deducted from the second source.

**A.27** Any overpayment or underpayment would normally be dealt with by assessment leading to either payment or recoding, though there were some "informal procedures". Most employees including occupational pensioners (but excluding those with no tax liability) were likely to be issued with a return, annually or less frequently, depending on the complexity of the person's affairs. If the individual did not make a return, the Inland Revenue would issue a form seeking information, mainly about allowances, to enable a correct coding to be ascertained.

**A.28** The operation of PAYE in 2011 is governed by the Income Tax (Pay as You Earn) Regulations 2003 (SI 2003/2682).

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<sup>20</sup> Section 31 FA 1999

<sup>21</sup> Chapter 5 Part 8 ITA 2007

<sup>22</sup> By the Income Tax (Employments) Acts 1943 and 1944 and regulations including Income Tax (Employments) Regulations 1944 (S. R. & O. 1944, No. 251) ("the 1944 Regulations").

# B

## International comparisons

**B.1** The OTS carried out some international comparisons as part of its research in preparation of this interim report. We give the results thus far in a table below, but have not as yet used these to make detailed comparisons with the UK system.

**Table 4.B: Table**

|   | Question  | India   | Japan  | Norway  | Germany   | Netherlands | United States   | Australia  | Canada   | Ireland  |
|---|---|---|--|---|---|-------------|---|--|--|--|
| 1 | Does every individual have to file a tax return (a) in every case or (b) only if their income is above a certain limit? | File return if one of 6 conditions is met (e.g. own vehicle, occupy specific floor area of immoveable property. | SA but not all file tax returns as tax is withheld by employers. Full return if various conditions apply (e.g. annual income > ¥20m). Tax on pensions generally withheld at source but return required if insufficient has been withheld or additional income (e.g. dividends) received. | Yes if taxable income or wealth. Pensioners with little income or wealth may be exempt. | No e.g. Single assessed taxpayers with income subject to withholding tax. | No          | A U.S. citizen or resident who is 65 or older, must file a return if gross income for the year is > the minimum threshold for filing status. The threshold is higher than for taxpayers < 65, and under some circumstances social security income can be either partly/completely excluded. If the only income received was social security, those benefits may not be taxable and the taxpayer does not have to file a return. | (a) No (b) yes if you had any income paid under deduction of tax, or received a "senior offset" or pensions and income exceeded a given figure. Non-filers must notify that they are not filing. | (a) no (b) yes if they are liable to tax in the year or pension income is split between spouses. | (a) No (b) a PAYE employee with untaxed income above a certain limit must file a self-assessment return. |

|   | Question   | India  | Japan | Norway  | Germany   | Netherlands   | United States  | Australia  | Canada   | Ireland  |
|---|--|--|-------|---|---|---|--|--|--|--|
| 2 | What is the state retirement age or entitlement age for pension? | Typically 58 - 60 (employer's choice) but some positions required to work to 80. Central government employees retire at 60, state government varies locally. | 65    | Early retirement age 62/<br>normal retirement age 67. | Early retirement age 65/<br>normal retirement age 67. | Early retirement age 60/<br>normal retirement age 65. | Retirement can be any time between 62 (early retirement) and full retirement age (depends on year of birth but for 2011 65). Early retirement may result in reduced monthly benefits from social security. | 65 for men, 60 for women in the process of increasing to 65 by 2013. | For old age security pension and supplementary Canadian pension Plan (CPP) 65, but for CPP can be 60 if you retire, with 60 becoming norm in 2012. | 65 for "Transitional State Pension" then eligible instead for "State Pension Contributory" at 66 rising to 68 in 2028. |
| 3 | How is old person/ senior citizen defined?                       | Senior citizen $\geq 60$ / very senior citizen $\geq 80$ )   |       |   | No  |   | Older Americans/ seniors $\geq 65$   | As in 2.   | 60 +   | varies   |

|   | Question  | India  | Japan  | Norway | Germany | Netherlands                      | United States  | Australia | Canada | Ireland |
|---|---|--|--|--------|---------|----------------------------------|--|-----------|--------|---------|
| 4 | 4. Are there different tax rates depending on age (local/ national)? Do they apply to all types of income or only certain types e.g. savings? | Resident senior citizens - 0% up to Rs250k, 10% on excess over Rs250k and up to Rs500k, Rs25k plus 20% over Rs500k, Rs85k plus 30% over Rs800k.<br>Very senior citizen - 0% up to Rs500k, 20% on excess over Rs 500k, and 60k plus 30% over Rs 800k. | Does not appear to be the case. Generally income tax paid on national, prefectural and municipal levels. |        |         | Reduced rates for those over 65. | Tax rates depend on income level and not age. Income threshold for seniors is higher and there is a higher standard deduction. | No        | No     | No      |

|   | Question  | India  | Japan | Norway                             | Germany   | Netherlands | United States  | Australia   | Canada   | Ireland  |
|---|---|--|-------|------------------------------------|---|-------------|--|---|--|--|
| 5 | 5. Are there different tax rates on pensions of any kind? | Paying branch is responsible for deducting tax at source from pension payments and allows deducting on account of relief for eligible savings. |       | For 2010 3% tax on pension income. | From 1.1.05 - new rules for old age pension (Alterseinkunftegesetz) - pension from statutory pension insurance carried over to full taxation. Specific rules also apply to social security pensions on the basis of contributory periods of employment in ghetto. |             | Private pensions fully/ partly/ not taxed depending on the taxpayer's contribution to the fund and the nature of the payments. | Most pensions and annuities are reduced for tax purposes by a deduction similar to that for purchased life annuities in the UK. | Some pension income may be split between spouses which may reduce tax. | Lump sums on retirement are exempt up to a limit, and relief may be given for "Standard Capital Superannuation benefit". |

|   | Question  | India | Japan  | Norway                                 | Germany | Netherlands | United States   | Australia  | Canada  | Ireland  |
|---|---|-------|--|--|---------|-------------|---|--|---|--|
| 6 | 6. Are there different tax allowances dependent on age? |       | Certain medical expenses provided by facility for the elderly. Some exemption for the disabled where the individual is >65 and other conditions apply. | Special tax allowances for pensioners. |         |             | Yes - social security benefits for some seniors may be partly taxed or not taxed at all. Higher standard deduction for seniors. | Yes - Senior Australian Tax Offset (SATO) is available to persons of state pension age not in prison. Offset is income limited with a taper (shade-out). There is also a "pensioner rebate" (PTO) payable to those outside SATO. SATO & PTO are transferable to spouses if in excess of income. An employee over 55 is also entitled to a "Mature Worker Wage Offset". | Yes - "Age amount" is due if over 65. It is income limited and tapered. For those under 65 and receiving occupational pension, "pension amount" may be due. | Person over 65 can claim exemption if total income is <€18000 (single) €36000 (couple). Marginal relief above that Age Tax Credit €245 given (doubled for married couples) Tax relief of up to 5% of the covenantor's total income is available on a deed of covenant in favour of a person aged 65 and over. 55 or over qualify for a higher relief on rent paid for private accommodation Exemptions for over 55s - retirement eligible for capital gains tax. |

|   | Question   | India   | Japan | Norway | Germany   | Netherlands  | United States  | Australia  | Canada | Ireland |
|---|--|---|-------|--------|---|--|--|--|--------|---------|
| 7 | Are there any specific/ increased tax deductions for old people e.g. healthcare? | R20k for medical insurance premium for senior/ very senior citizens (Rs15k otherwise).  |       |        |   |  | For seniors Medicare (state medical benefit) is not included in gross income. Certain welfare benefits, veteran benefits, food and housing benefits are also excluded. |  | No     | No      |
| 8 | Is there a state pension?  | New Pension Scheme from 1.1.10 widened to all citizens on a voluntary basis (previously just for public sector employees). No state pension system other than means tested national assistance. | Yes   |        | State pension scheme is partnership between employers, employees and state. | Yes by virtue of Algeme Ouderdans Wet (general seniority law). | Yes - social security is national state pensions payable to eligible US citizens and residents over 62.  | Yes - age pension payable at 65 for men, increasing to 65 by 2013 for women. | Yes    | Yes     |



|    | Question  | India   | Japan  | Norway | Germany | Netherlands | United States   | Australia   | Canada                      | Ireland                     |
|----|---|---|--|--------|---------|-------------|---|---|-----------------------------|-----------------------------|
| 9  | Are pensions from the state taxed? Are overseas state pensions taxed?                     | Pensions earned in India are taxed in India. Pensions from overseas are income accruing to pensioners abroad and not liable to tax in India on accruals basis. If remitted to India they are not taxable on receipts basis (taxed in India if recipient is R and OR in India). If agreement with employer that pensions received directly in India taxed on receipts basis. | Tax is generally withheld from pensions, Requirement to file if a pension is received from overseas and no tax withheld. |        |         |             | Social security benefits may be non-taxable or partially taxable depending on total other income. Taxable amount of a foreign pension is in general the gross distribution less the cost (investment in the contract) - as for domestic pensions. Only pension eligible for exclusion from taxable income is one allowed under DTA. | Yes & yes (subject to DTA).   | Yes & yes (subject to DTA). | Yes & yes (subject to DTA). |
| 10 | Are there repayable tax credits e.g. For dividends (where there is an imputation system)? |   |  |        |         |             | No  | Yes - excess imputation credits (above tax liability) are refundable. | No                          | No                          |

|    | Question  | India          | Japan          | Norway  | Germany        | Netherlands                       | United States   | Australia   | Canada   | Ireland   |
|----|---|----------------|----------------|---|----------------|-----------------------------------|---|---|--|---|
| 11 | Is online filing mandatory and are there any exceptions for older people? | Not mandatory. | Not mandatory. | Not mandatory.  | Not mandatory. | Mandatory by taxpayer or adviser. | Individual taxpayers may file in paper or electronically. | No - Individual taxpayers may file on paper or electronically.    | No - Individual taxpayers may file on paper, by phone or electronically. | No - SA returns must be filed online if they contain certain type of income.                                      |
| 12 | Are tax returns pre-populated, e.g. by including state pension amounts?   |                |                | Some e.g. With information from employer.   |                |                                   | No  | Being introduced from July 2011.                                  | No   | No  |
| 13 | Any other issues?   |                |                | Basic principle is everyone pays according to their means and receives services according to their needs. |                |                                   |   | Withholding tax applies to all pensions including state pensions. | Withholding tax applies to all pensions including state pensions.        | State pensions are taxed as in UK - as coding deduction or through SA "R85" procedure only available to over 65s. |

# C

## List of common HMRC forms for pensioners

**C.1** This list of forms covers items that pensioners encounter and may have to complete. It does not cover other forms which pension payers have to deal with (the P46(PEN), for example), nor does it cover other information-giving forms that the pensioner might receive, such as their P60 from employers and pension providers.

**Table 4.C: Table**

|    | Form reference                  | Form title  | Date last updated, if known           | Purpose   | Hyperlink (if available online)   |
|----|---------------------------------|---|---------------------------------------|---|---|
|    | <i>Pensioner-specific forms</i> |   |                                       |   |   |
| 1. | Form 18                         | Transferring the married couple's allowance         | 10/05                                 | Form 18 requests a change in the way the minimum amount of married couple's allowance is divided between the taxpayer and his or her spouse or civil partner                              | <a href="http://www.hmrc.gov.uk/forms/18.pdf">http://www.hmrc.gov.uk/forms/18.pdf</a>               |
| 2. | Form 575                        | Notice of transfer of surplus income tax allowances | 11/10                                 | Form 575 is used to transfer any unused married couple's allowance to the taxpayer's spouse or civil partner (it also covers transfer of surplus blind person's allowance).               | <a href="http://www.hmrc.gov.uk/forms/575-t-man.pdf">http://www.hmrc.gov.uk/forms/575-t-man.pdf</a> |
| 3. | P53                             |   |                                       | Claiming tax back on trivial commutation pension lump sum   | Not available online  |
| 4. | P161                            | Pension coding form                                 | 07/10<br>(NB, currently under review) | When approaching state pension age or for women approaching age 65, the taxpayer uses form P161 to tell HMRC about their income. It also serves as a claim to age-related tax allowances. | <a href="http://www.hmrc.gov.uk/forms/p161-man.pdf">http://www.hmrc.gov.uk/forms/p161-man.pdf</a>   |

|   |               |   |       |  |   |
|---|---------------|---|-------|--|---|
| 5.  | P161(W)       | Bereavement benefit coding form   | 07/10 | If a taxpayer is receiving a bereavement benefit or their spouse or civil partner has died, they use form P161 bereavement benefit coding to tell HMRC about any changes to their income because of their bereavement.   | <a href="http://www.hmrc.gov.uk/forms/p161w-man.pdf">http://www.hmrc.gov.uk/forms/p161w-man.pdf</a>   |
| 6.  | P800          | Tax calculation   |       | Tax calculation, usually sent to the taxpayer to show that there has been an underpayment or overpayment of tax.   | Not available online  |
| <b><i>General taxpayer forms, but which might be used by pensioners</i></b> |               |   |       |  |   |
| 7.  | DT-Individual | Double taxation treaty relief, application for relief at source from UK income tax and claim to repayment of UK income tax. | 07/11 | For use by an individual resident of a country with which the UK has a double taxation treaty that provides for relief from UK income tax on pensions, purchased annuities, interest or royalties arising in the UK.   | <a href="http://www.hmrc.gov.uk/cnr/dtindividual.pdf">http://www.hmrc.gov.uk/cnr/dtindividual.pdf</a> |
| 8.  | P2            | PAYE coding notice  | 03/09 | Notice to taxpayer of PAYE code to be applied to a particular source of employment or pension income.  | Not available online  |
| 9.  | P50           | Claim for repayment of tax when you have stopped working.   |       | Claim to repayment of PAYE before the end of the tax year. In a pensioner context, one of its uses is where the taxpayer has retired permanently and is not receiving a pension from their former employer.  | <a href="http://www.hmrc.gov.uk/pdfs/p50.pdf">http://www.hmrc.gov.uk/pdfs/p50.pdf</a>                 |
| 10.   | P85           | Leaving the UK - getting your tax right.  | 02/11 | If the taxpayer has left or is about to leave the UK, they use form P85 to claim tax relief or any tax refund they are owed and to inform HMRC of any UK income they continue to receive. (Not to be used if the taxpayer is already required to complete a self assessment tax return). | <a href="http://www.hmrc.gov.uk/cnr/p85.pdf">http://www.hmrc.gov.uk/cnr/p85.pdf</a>                   |
| 11.   | R27           | Potential repayment to the estate.  | 01/08 | Form to finalise the income tax position of a deceased taxpayer up to their date of death (mainly aiming to ascertain whether a repayment is due).   | <a href="http://www.hmrc.gov.uk/forms/r27.pdf">http://www.hmrc.gov.uk/forms/r27.pdf</a>               |

|     |      |   |       |   |   |
|-----|------|---|-------|---|---|
| 12. | R38  | Tax claim   | 07/05 | To claim a tax refund, or nominate someone else to receive your refund.   | <a href="http://www.hmrc.gov.uk/forms/r38.pdf">http://www.hmrc.gov.uk/forms/r38.pdf</a>       |
| 13. | R40  | Claim for repayment of tax deducted from savings and investments                        | 10/10 | Used to claim back tax if too much tax has been paid on savings interest.   | <a href="http://www.hmrc.gov.uk/forms/r40.pdf">http://www.hmrc.gov.uk/forms/r40.pdf</a>       |
| 14. | R43  | Claim to personal allowances and tax repayment by an individual not resident in the UK  | 02/11 | Can be used in a pensioner context to claim age-related and married couple's allowances, and for example to claim a tax refund on tax over-deducted on a trivial commutation payment.   | <a href="http://www.hmrc.gov.uk/cnr/r43-2011.pdf">http://www.hmrc.gov.uk/cnr/r43-2011.pdf</a> |
| 15. | R85  | Getting your interest without tax taken off   | 04/11 | Taxpayers use form R85 to tell their bank or building society that they qualify for tax-free interest on their account (because they are a non-taxpayer).   | <a href="http://www.hmrc.gov.uk/forms/r85.pdf">http://www.hmrc.gov.uk/forms/r85.pdf</a>       |
| 16. | R86  | Application to receive a joint annuity without tax taken off                            | 10/09 | Used to request that a joint annuity be paid without tax first being taken off. This involves both recipients of the annuity declaring that they are resident in the UK, contributed equally to the cost of the annuity, are entitled to a half share each of the annuity payments, and are unlikely to have to pay income tax on their total income in the current tax year. | <a href="http://www.hmrc.gov.uk/forms/r86.pdf">http://www.hmrc.gov.uk/forms/r86.pdf</a>       |
| 17. | R89  | Application to receive an annuity without tax taken off                                 | 10/09 | If the taxpayer is in receipt of a purchased life annuity (PLA), they can use form R89 to request that it be paid without tax taken off if they are resident in the UK and unlikely to have to pay income tax in the current tax year.  | <a href="http://www.hmrc.gov.uk/forms/r89.pdf">http://www.hmrc.gov.uk/forms/r89.pdf</a>       |
| 18. | R105 | Application for a not ordinary resident saver to receive interest without tax taken off | 08/06 | If the taxpayer does not normally live in the UK, they can use form R105 to apply for tax-free interest from their bank or building society.  | <a href="http://www.hmrc.gov.uk/forms/r105.pdf">http://www.hmrc.gov.uk/forms/r105.pdf</a>     |

|     |       |                            |                      |   |   |
|-----|-------|----------------------------|----------------------|---|---|
| 19. | SA100 | Self assessment tax return | 12/10                | Full tax return, or taxpayer can use online system or third party software<br>Various supplementary pages might also need to be completed, depending on the taxpayer's affairs. In particular, married couple's allowance has to be claimed on the additional information pages, SA101. | <a href="http://www.hmrc.gov.uk/forms/sa100.pdf">http://www.hmrc.gov.uk/forms/sa100.pdf</a><br>and<br><a href="http://www.hmrc.gov.uk/forms/sa101.pdf">http://www.hmrc.gov.uk/forms/sa101.pdf</a> |
| 20. | SA200 | Short tax return           | For 2010/11 tax year | The SA200 short self assessment tax return is only used when HMRC issues one. It cannot be downloaded or ordered online.  | Not available online  |

# D The pensioner population in the UK

**D.1** HMRC provided the OTS with a summary of various pensioner research and data from their archives and external sources, extracts from which are reproduced below:

## **Box D.1: Some basic information**

- number of pensioners\* (midyear 2011 est.): 12,178,000;
- number in employment (2009): 1,383,000;
- 5.57 million people of state pension age pay tax, 1.55 million of these are in self assessment;
- 30% of pensioners between state pension age and four years after have a job;
- the median expected income for the first year of retirement lies between £10,000 and £11,999; and
- approximately 3.5 million older people live alone.

*\*HMRC data is based upon state retirement age. The 2011 figures take account of planned changes in retirement age.*

## **Box D.2: Issues affecting pensioners**

Forty per cent of those aged 65-74 in the UK have a disability or limiting long-standing illness.

Many older people have levels of literacy (23%) and numeracy (53%) below those expected of school leavers.

Quoting the DWP's Attitudes to Pensions: The 2009 Survey, HMRC has told us that '37% of respondents were not aware of any rules about pensions and tax' and 'less than half (41%) were aware that pension income is subject to tax like regular income' and that 'there is a drop in confidence (28% very confident to 21% very confident) about tax knowledge between the run up to the state pension age and immediately after'.

**D.2** HMRC has offered the following insights into pensioners' dealings with HMRC, quoting from various research they have carried out:

### Box D.3: Dealings with HMRC

When dealing with HMRC, 27% of pre-pensioners accessed the HMRC website to try and resolve their query. Compared to 22% of transitional pensioners and just 12% of pensioners. Contrast this with 32% across the general population. (August 2010 figures)

In 2010/11, only 65% felt HMRC provided a service with them in mind compared to 70% across the whole population. Only 66% viewed HMRC as good at getting things right compared to 72% for all individuals.

Also in 2010/11 when asked about how straightforward their recent dealings with HMRC were only 73% of those aged 60+ rated it as straightforward compared to 80% aged 40-49 years and 81% aged 30-39 years.

When first making contact with HMRC 72% of pensioners will contact via telephone compared to just 2% who would use the internet. 20% would first make contact by post.

Pensioners have higher expectations and want a personalised service.

**D.3** The following estimates have been prepared with the latest available HMRC data set which is the 2007-08 survey of personal incomes projected to 2011-12.

| 2011-12: Taxpayers in receipt of state and/or private pension. (All figures are in '000) |              |              |           |              | 2011-12: Taxpayers in receipt of state pension (may also have private pension) |              |              |           |              | 2011-12: Taxpayers in receipt of private pension (may also have state pension) |              |              |           |              |
|--|--------------|--------------|-----------|--------------|--|--------------|--------------|-----------|--------------|--|--------------|--------------|-----------|--------------|
| Age Ranges   | SA           | PAYE Only    | Claims    | Totals       | Age Ranges   | SA           | PAYE Only    | Claims    | Totals       | Age Ranges   | SA           | PAYE Only    | Claims    | Totals       |
| Under 40   | 4            | 29           | ..        | 34           | Under 40   | -            | -            | -         | -            | Under 40   | 4            | 29           | ..        | 33           |
| 40-44  | 10           | 34           | ..        | 43           | 40-44  | -            | -            | -         | -            | 40-44  | 10           | 34           | ..        | 43           |
| 45-49  | 20           | 60           | ..        | 80           | 45-49  | -            | -            | -         | -            | 45-49  | 20           | 60           | ..        | 80           |
| 50-54  | 68           | 200          | ..        | 269          | 50-54  | -            | -            | -         | -            | 50-54  | 68           | 200          | ..        | 269          |
| 55-59  | 175          | 417          | ..        | 592          | 55-59  | -            | -            | -         | -            | 55-59  | 175          | 417          | ..        | 592          |
| 60-64  | 493          | 1,140        | 7         | 1,640        | 60-64  | 177          | 550          | 6         | 730          | 60-64  | 425          | 1,000        | ..        | 1,420        |
| 65-69  | 503          | 1,060        | 5         | 1,560        | 65-69  | 485          | 1,030        | 5         | 1,520        | 65-69  | 418          | 980          | ..        | 1,400        |
| 70-74  | 350          | 963          | 9         | 1,320        | 70-74  | 349          | 956          | 9         | 1,310        | 70-74  | 303          | 931          | 2         | 1,240        |
| 75-79  | 231          | 654          | 10        | 895          | 75-79  | 230          | 649          | 10        | 889          | 75-79  | 206          | 639          | 3         | 848          |
| 80 and Over  | 243          | 690          | 20        | 953          | 80 and Over  | 241          | 683          | 20        | 944          | 80 and Over  | 209          | 676          | 6         | 890          |
| <b>Totals</b>  | <b>2,100</b> | <b>5,240</b> | <b>51</b> | <b>7,390</b> | <b>Totals</b>  | <b>1,482</b> | <b>3,870</b> | <b>50</b> | <b>5,400</b> | <b>Totals</b>  | <b>1,839</b> | <b>4,960</b> | <b>10</b> | <b>6,810</b> |



D.4 The table below is the population of the UK of age 65 and older<sup>1</sup>

| Age   | 2005      | 2006      | 2007      | 2008      | 2009       | 2010      | 2011       |
|-------|-----------|-----------|-----------|-----------|------------|-----------|------------|
| 65    | 562,885   | 546,054   | 547,552   | 590,692   | 629,213    | 644,994   | 652,078    |
| 66    | 557,270   | 554,315   | 537,960   | 540,446   | 583,682    | 622,106   | 633,010    |
| 67    | 544,572   | 548,059   | 545,233   | 530,182   | 533,442    | 576,346   | 610,195    |
| 68    | 527,661   | 534,863   | 538,513   | 536,807   | 522,667    | 526,146   | 565,493    |
| 69    | 509,271   | 517,550   | 524,812   | 529,229   | 528,346    | 514,775   | 516,582    |
| 70    | 487,975   | 499,017   | 507,466   | 515,088   | 519,980    | 519,416   | 505,860    |
| 71    | 472,170   | 476,972   | 488,090   | 497,245   | 505,202    | 510,341   | 510,531    |
| 72    | 466,247   | 460,457   | 465,389   | 477,438   | 486,761    | 494,762   | 500,762    |
| 73    | 460,678   | 453,548   | 448,198   | 454,146   | 466,244    | 475,709   | 484,260    |
| 74    | 448,080   | 446,766   | 440,189   | 436,294   | 442,290    | 454,434   | 464,330    |
| 75    | 427,656   | 433,321   | 432,380   | 427,105   | 423,664    | 429,960   | 442,544    |
| 76    | 403,594   | 411,791   | 417,843   | 417,861   | 413,196    | 410,392   | 417,526    |
| 77    | 385,373   | 387,056   | 395,502   | 402,316   | 402,756    | 398,693   | 397,033    |
| 78    | 371,301   | 367,699   | 369,936   | 378,973   | 386,034    | 387,237   | 383,956    |
| 79    | 351,498   | 352,578   | 349,936   | 352,763   | 361,850    | 369,268   | 370,763    |
| 80    | 330,128   | 332,196   | 333,770   | 331,691   | 334,811    | 344,164   | 351,595    |
| 81    | 309,670   | 309,728   | 312,460   | 314,585   | 312,750    | 316,240   | 325,928    |
| 82    | 295,389   | 288,584   | 289,213   | 292,286   | 294,714    | 293,722   | 297,862    |
| 83    | 285,606   | 273,199   | 267,585   | 268,575   | 271,942    | 275,026   | 274,651    |
| 84    | 265,626   | 261,927   | 251,034   | 246,318   | 247,538    | 251,424   | 254,803    |
| 85    | 211,420   | 240,800   | 238,533   | 228,773   | 224,672    | 226,540   | 231,321    |
| 86    | 154,128   | 190,543   | 216,700   | 215,359   | 206,635    | 203,480   | 207,291    |
| 87    | 130,453   | 137,806   | 170,200   | 193,201   | 192,618    | 184,966   | 184,827    |
| 88    | 121,830   | 113,997   | 122,305   | 150,523   | 169,858    | 170,716   | 166,194    |
| 89    | 110,906   | 104,744   | 98,704    | 107,512   | 131,519    | 147,892   | 150,646    |
| 90    |           |           |           |           | 92,420     |           | 128,346    |
| 91    |           |           |           |           | 74,039     |           | 96,498     |
| 92    |           |           |           |           | 63,833     |           | 67,231     |
| 93    |           |           |           |           | 53,490     |           | 49,835     |
| 94    |           |           |           |           | 42,601     |           | 40,031     |
| 95    |           |           |           |           | 32,062     |           | 31,776     |
| 96    |           |           |           |           | 23,099     |           | 23,913     |
| 97    |           |           |           |           | 16,120     |           | 17,057     |
| 98    |           |           |           |           | 10,960     |           | 11,656     |
| 99    |           |           |           |           | 7,289      |           | 7,714      |
| 100   |           |           |           |           | 4,672      |           | 4,977      |
| 101   |           |           |           |           | 2,831      |           | 3,108      |
| 102   |           |           |           |           | 1,649      |           | 1,850      |
| 103   |           |           |           |           | 936        |           | 1,047      |
| 104   |           |           |           |           | 508        |           | 560        |
| 105   |           |           |           |           | 263        |           | 283        |
| 106   |           |           |           |           | 132        |           | 136        |
| 107   |           |           |           |           | 67         |           | 62         |
| 108   |           |           |           |           | 33         |           | 28         |
| 109   |           |           |           |           | 16         |           | 11         |
| Total | 9,191,387 | 9,243,570 | 9,309,503 | 9,435,408 | 10,019,404 | 9,748,749 | 10,386,160 |

<sup>1</sup> Eurostats



# E

## The evidence gathering process

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**E.1** During the last quarter of 2011, the OTS held meetings with various stakeholders in a variety of locations, as listed in table 1 below, to discuss possible issues to consider as part of the review of pensioner taxation. As part of this consultation process, the OTS has travelled to Scotland, Wales and Northern Ireland, and also across England. In so doing, we have heard the views of many advisers to pensioners, both from the voluntary sector and those acting on a professional basis, as well as from Government.

**E.2** The OTS is grateful to the various individuals and organisations that have taken the time to contribute.

**E.3** Due to the tight timescales involved between commencing our review and producing this interim report, we acknowledge that we have not met with as many individual pensioners as we would have liked. In the next stage of our review, we will aim to gauge more of their experiences and views first hand, perhaps through a research project.

**E.4** That is not to say that we have not heard from pensioners direct. Articles have been posted in many publications targeted at older people, for example SAGA magazine, the Civil Service Retirement Fellowship newsletter, The National Federation of Occupational Pensioners' newsletter and Tax Help for Older People's Tax Tips Corner. With the help of this coverage, we have received a number of emails from pensioners.

**E.5** The general press has also covered the review. Early on in our information-gathering process, we received in excess of 700 letters from pensioners as a result of an article in the Daily Mail. As well as views on the complexity of pensioner taxation, that post bag contained a number of letters from low-income pensioners who needed help with their tax affairs. We give special thanks to Tax Help for Older People for contacting those people to offer support. We are also grateful to Citizens Advice for providing us with evidence of complexities faced by pensioners.

**E.6** The independence of the OTS, and the willingness of pensioners and their advisers to engage with our work, has been complemented by the knowledge held within government. In particular, the OTS has drawn on specialists within HM Treasury, HMRC and the Department for Work and Pensions. While our focus has been on tax simplification, inevitably our review has identified issues which cross over to other areas of Government, such as welfare benefits for pensioners. Also, in a number of areas, the OTS has drawn on the analytical resources within HMRC and acknowledges the help that has been provided from within HMRC.

**E.7** The Consultative Committee of the review of pensioner tax was put in place to act as a sounding board for the work of the OTS. The OTS has engaged the Committee throughout this review, and the active involvement of the Committee members has been invaluable. However, this report sets out the view of the OTS and not of the Committee. The full list of Consultative Committee members is set out in table 2 and the OTS would once again wish to thank them for their time and contributions.

**Table E.1: Meetings held by the OTS review of pensioners' taxation**

| Venue                          | Organisation  |
|--------------------------------|---|
| <b>England</b>                 |   |
| <i>Non-government meetings</i> |   |
| Dorset                         | Tax Help for Older People, head office                        |
| Portsmouth                     | HMRC contact centre   |
| London                         | Age UK  |
| London                         | Citizens Advice   |
| Solihull                       | Tax Help for Older People, pensioner surgery                  |
| London                         | Tax Aid   |
| London                         | Paul Lewis of BBC Moneybox                                    |
| London                         | Civil Service Pensions Association                            |
| London                         | National Association of Pension Funds                         |
| New Malden, Surrey             | Discussion group, involving the tax agent community           |
| Preston                        | Discussion group, involving the tax agent community           |
| <i>Government meetings</i>     |   |
| London                         | Department for Work and Pensions                              |
| London                         | HMRC, policy, demand management and data experts              |
| London                         | HM Treasury, policy   |
| <b>Northern Ireland</b>        |   |
| <i>Non-government meetings</i> |   |
| Belfast                        | Advice NI   |
| Belfast                        | Age NI  |
| Belfast                        | Age Sector Platform   |
| Belfast                        | Access to Benefits  |
| Belfast                        | Chartered Institute of Taxation, NI Branch meeting            |
| <b>Scotland</b>                |   |
| <i>Non-government meetings</i> |   |
| East Kilbride                  | Tax Help for Older People, regional co-ordinator              |
| <i>Government meetings</i>     |   |
| East Kilbride                  | HMRC contact centre   |
| <b>Wales</b>                   |   |
| <i>Non-government meetings</i> |   |
| Cardiff                        | Tax Help for Older People, regional co-ordinator and advisers |
| <i>Government meetings</i>     |   |
| Cardiff                        | HMRC contact centre   |

**Table 4.D: Members of the review of pensioners taxation Consultative Committee**

| <b>Name</b>      | <b>Organisation</b>  |
|------------------|--|
| Bob Harris       | ICAS and McLellan Harris & Co                              |
| Ciaran Arthurs   | Advice NI  |
| Graham Sherburn  | Tax Help for Older People                                  |
| Jane Moore       | Institute of Chartered Accountants in England and Wales    |
| Karen Thomson    | Chartered Institute of Payroll Professionals               |
| Mary Pattison    | Department for Work and Pensions                           |
| Matthew Stephens | Prudential   |
| Mike Warburton   | Grant Thornton   |
| Paddy Millard    | Low Incomes Tax Reform Group and Tax Help for Older People |
| Peter Holland    | HM Revenue and Customs                                     |
| Roger Turner     | The National Federation of Occupational Pensioners         |
| Ruth Hopkinson   | HM Treasury  |
| Sally Ferguson   | Tax practitioner   |
| Sally West       | Age UK   |

### **Office of Tax Simplification contacts**

This document can be found in full on our website at:

<http://www.hm-treasury.gov.uk/ots>

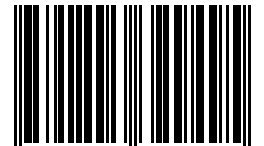
If you require this information in another language, format or have general enquiries about the Office of Tax Simplification and its work, contact:

The OTS Secretariat  
Office of Tax Simplification  
1 Horse Guards Road  
London  
SW1A 2HQ

Tel: 020 7270 6190

E-mail: [ots@ots.gsi.gov.uk](mailto:ots@ots.gsi.gov.uk)

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