

Research report

Pensioner Review Research ***HM Revenue & Customs and the*** ***Office of Tax Simplification***

December 2012

Pensioner Review Research

This research was commissioned by the HM Revenue & Customs (HMRC) Behavioural Evidence and Insight Team and Personal Tax Customer & Strategy Directorate on behalf of the Office of Tax Simplification.

About Personal Tax Customer & Strategy

Personal Tax Customer & Strategy works with colleagues in Personal Tax and across HMRC to use customer insight to design, deliver and operate services for individual customers.

About the Office of Tax Simplification

The Chancellor and Exchequer Secretary launched the Office of Tax Simplification on 20 July 2010 to provide the Government with independent advice on simplifying the UK tax system with the objective of reducing compliance burdens on both businesses and individual tax payers. In July 2011 the Exchequer Secretary endorsed the OTS proposal to review the taxation of pensioners.

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Research requirement (background to the project)

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In July 2011 the Exchequer Secretary endorsed the OTS proposal to review the taxation of pensioners.

The OTS produced an interim report with in March 2012 that highlighted priority areas for short and longer term service improvement as well as policy and legislative changes for further investigation.

Since then the OTS has consulted with pensioner groups, voluntary sector organisations, tax practitioners and commissioned internal analysis from DWP and HM Revenue & Customs (HMRC) to inform their final recommendations.

This primary research was commissioned by the OTS to focus on the experiences of pensioners who did not pay for tax advice and or use charities such as Tax Help for Older People or Taxaid. The research aimed to better understand how the needs of this population could be better served in order to inform the OTS's final recommendations.

Moving forward the research will also be used to inform HMRC's design and development of pensioner services so that they are more efficient and improve the customer experience overall.

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Specifically the research focused on:

Exploring pensioners' understanding of the tax system and their entitlements, including:

- Awareness of taxation of the State Pension
- Awareness and understanding of tax codes and personal allowances

Understanding how pensioners manage their tax affairs, including:

- Do they manage their affairs themselves or through family members?
- Who do they ask for advice?
- How do those with caring responsibilities deal with their affairs?
- How far they rely on official vs. informal advice?

Gauging responses to potential simplifications to pensioner taxation and administration, in order to establish the impact of scenarios involving the:

- R85 form (*Getting your interest without tax taken off*) and process
- R40 form (*Claim repayment of tax deducted from savings and investments*) and process
- A 10% Savings Rate scenario

Exploring the trade-offs pensioners are prepared to make between simplification and financial benefit if any, including:

- Testing a range of scenarios which involve varying levels of complexity and financial benefit
- Talking through current experiences of dealing with complexity e.g. negotiating other financial decisions which involve complexity vs. financial benefit
- For example, would/do they make a calculation of the likely amount received vs. the effort involved in deciding whether or not to claim an allowance or tax rebate due

Who did the work (research agency)

The research was conducted by Steel Magnolia from September to November 2012.

The qualitative fieldwork was completed from 8 to 26 October 2012.

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Method, data and tools used, sample

The qualitative fieldwork was comprised of a mix of mini-group discussions (comprising of 4-5 participants each) and face to face, in depth interviews.

In total, 83 participants were spoken to via:

- 4 mini-group discussions with pre-pensioners in the HMRC Willing & Able attitudinal segment
- 4 mini-group discussions with pensioners in the HMRC Willing & Able attitudinal segment
- 4 mini group discussions with carers (who were also pensioners) in the HMRC Willing & Able attitudinal segment
- 8 in depth interviews with pre-pensioners in the HMRC Unaware attitudinal segment
- 9 in depth interviews with pensioners in the HMRC Unaware attitudinal segment
- 5 in depth interviews with pensioners who lived in a rural location
- 4 in depth interviews with pensioners from the Black, Asian and Minority Ethnic (BAME) population - (2 x Black African, 1 x Asian and 1 x Chinese)

The criteria for taking part in the research:

- All paid income tax
- Male and Female
- Geographical spread across England (North, South and the Midlands), Scotland, Wales and N. Ireland.
- Primarily an urban population but including some people specifically in rural locations
- *Age range from 60-79 years old
 - pre-pensioner: 60-67 years old
 - pensioner: 60-79 years old

*(no age cap but what 'fell out' naturally from the recruitment)

- A mix of people who were currently or had been in Self Assessment (SA) and PAYE
- A mix of socio-economic groups – BC1/C2D
 - B - Intermediate managerial, administrative, professional e.g. bank manager, teacher
 - C1- Supervisory, clerical, junior managerial e.g. shop floor supervisor, bank clerk, sales person
 - C2 - Skilled manual workers e.g. electrician, carpenter
 - D - Semi-skilled and unskilled manual workers e.g. assembly line worker, refuse collector, messenger)
- A spread of ethnicities (reflective of the general population of pensioners)

A pre-pensioner was defined as someone thinking of retiring within the next 12 months i.e. taking income from a pension (state, workplace or private).

A pensioner was defined as aged 60 or over, in receipt of pensions (including the State Pension) or otherwise retired and living wholly or partly off investment income, which might be

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a return from savings, rent from property or other unearned income. In either case, they might also have some earnings from employment.

A carer was defined as caring for or managing the tax affairs of anyone in their family (parents, aunts, uncles, spouses or partners) who was considered frail or vulnerable. (They were also all pensioners themselves).

Main findings

1. Context: understanding pensioners

In this sample, there was a marked difference in the experience of retirement and pensions amongst the older (70+) pensioners. Those 70+ (minority of the sample) were more likely to have had a 'job for life', had to retire at 65 and had their State Pension plus one other 'workplace' pension to live on. They 'saved for things' and lived within their means.

Those 69 or less (majority of the sample) were more likely to have had a number of jobs through their life and therefore had a number of small pension pots which they had or would have income from. Some were working past retirement age because they:

- wanted to keep their lifestyle going (more BC1)
- needed the money in order to live (more C2D)
- wanted to work because they enjoyed it

Some had taken their personal and/or workplace pension before 65 to have income to live on whilst continuing to work. Some had become self-employed as they approached State Pension age (more BC1).

For those who were retired and chose not to work, their lives remained active and busy, with many wondering how they ever managed to fit work in. Their hobbies and interests were diverse from sport, to socialising, to gardening, to walking, going to the gym, to crafts, creative interests and travelling or going on holiday.

Family was a big focus with support flowing both ways. Grandparents were often caring for and supporting their grandchildren whose parents were on lower incomes.

Internet usage was widespread amongst the more affluent BC1's, less so amongst older 70+ pensioners and C2D's.

Most of the research participants who were in SA were filing and paying their tax online, only a minority were filing paper returns.

Those filing paper returns did have a computer but chose not to use it because it was easier to keep track of their inputs with the paper form and the form also acted as a check when collating information to fill in the SA return.

Pensioner Review Research**2. Exploring pensioners' understanding of the tax system and their entitlement**

In this sample, two distinct groups emerged – 'Passive' and 'Active'. The key drivers of these groups were their knowledge of the tax system, attitudes to paying tax and how they handled their money.

The 'Passive' group (who were more likely to be the less well off, those in PAYE, pensioners and some carers) had little or no understanding of the tax system. They were uncertain or didn't know that they would have to pay tax on their pension so it came as a big shock to them when they realised they were paying tax. They **did not see the State Pension as 'income'** to them it was an entitlement, what they had to live on and what provided security in old age. This group had a fixed amount of money coming in, were less financially literate and felt that tax was inherently complicated, even if they had no interaction with the system.

The 'Active' group (who were more likely to be the more affluent, those in SA, pensioners and pre-pensioners and some carers) had a better understanding of the tax system but at best they didn't expect to have a good understanding. They mostly saw their State Pension as income and were aware that they had to pay tax on their pension income. Although amongst this group some felt that tax was paid on their private and/or workplace pension but not the State Pension. To pay tax on their State Pension felt like 'paying twice'. This group was more financially literate, actively moving money around and more likely to be receiving money from sources other than pensions.

Some quotes from pre-pensioners and pensioners about the State Pension and tax....

"I didn't know. I thought (my State Pension) was tax free." Female, C2D, Pre-pensioner, PAYE, NI

"I was aware that I would have to pay tax as I have some income from flats I rent out." Male, BC1, Pensioner, SA, Wales

"(£8105 is) tax free? So what I'm earning above that is what is being taxed? You see I don't understand this. That's interesting." Male, C2D, Pensioner, PAYE, BAME, North of England

"That is what I do not understand. I thought when you retired you did not pay income tax at all. I suppose it must be related to how much you are receiving in a year..... I found out through my friends who are in similar circumstances." Female, BC1, Pensioner, PAYE, Scotland

"I suppose, the pension I receive from my late husband will not be taxed maybe because that will be part of an allowance. I think it is taxed now. I presume that when I get the State Pension, which I don't get until I'm 62, I presume that will be taxed. I can't remember. There is how much you can earn before you are taxed?" Female, BC1, Pre-Pensioner, PAYE, North of England

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In this sample, most were aware they would stop paying National Insurance contributions (NICs) after State Pension age but they only became aware as they approached or reached State Pension age:

- recalled a letter from HMRC
- were told by their employer
- noticed they were no longer paying it on their payslip

Almost all knew what the term, Personal Allowance meant but didn't know how much it equated to in monetary terms, how to calculate it or that it may increase at 65 years old.

All were aware of the term 'tax code' but the majority didn't understand how tax codes were calculated or applied when they reached State Pension age.

This did have consequences. It was reported by many pensioners in PAYE that multiple coding notices caused anxiety, as they weren't expecting them and didn't understand why they received them i.e. that each tax code related to a particular source of income.

It also usually resulted in them contacting HMRC to understand why they had received them. They felt it was an error even though, in terms of tax liability, it was not.

In this sample, some pensioners expressed positive comments about the system for paying tax:

- Tax was right and necessary, fair, tax has to be done (more BC1)
- Some in SA found it to be easy and it became easier having completed the first year's form
- Those in PAYE thought the system for paying tax seemed 'simple'

However, most also expressed negative feelings; the most widely held feeling was that the system was "unfair".

HMRC was perceived as intimidating, a law unto itself, an organisation that was seen to have created complicated processes and forms.

This sample appeared to report more problems with filling in forms in general and an inability to cope with complex instructions and jargon related messaging. Consequently when tasked with filling in HMRC forms they:

- Worried about getting 'it' wrong
- Were anxious about completing forms in case they were inaccurate or incomplete, particularly those in SA as they knew there were penalties to pay
- Emotionally felt out of control as they didn't know what the consequences of their 'wrong' behaviour would be

They also expressed the need to be reassured whenever HMRC contacted them; (especially if it was unexpected contact) that it was not going to be 'bad news'.

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Some quotes from pre-pensioners and pensioners about how they felt about the system for paying tax.....

"The system is intimidating, prying and unfriendly. The system has the right to deduct tax at source; often taking more than is necessary and the onus is on people to claim refunds." Female, BC1, Pre-pensioner, PAYE, South of England

"I dread and hate doing it. I worry about getting it wrong. I loathe form filling per se. No real reason." Female, BC1, Pensioner, SA, South of England

"I don't understand it. It's not like I take a letter from Inland Revenue and understand exactly where they are coming from, they give bands and amounts and figures all around." Male, C2D, PAYE, Pensioner, BAME, PAYE, North of England

"I feel you have to abide by its (HMRC's) rules and hope you get everything right on the tax return."

Male, C2D, Pensioner, PAYE, Wales

3. Understanding how pensioners manage their tax affairs

All the pensioners in this sample managed their own tax affairs and sought advice from various sources. Those in PAYE had different needs from those SA and this was reflected in terms of who they turned to for advice and when.

Pensioners in SA, some of whom historically had an accountant but now managed their own tax affairs, often sought help and reassurance when filling in their SA form. This reassurance role was provided by close family who were seen as having more financial or technical knowledge than them and provided "a second pair of eyes".

For pensioners in PAYE, at transition from pre-pensioner to pensioner, some pensioners had unexpected contact from HMRC such as receiving (via post) a change in tax coding, multiple tax coding notices or a notice of tax under or over payment and they would contact HMRC directly as they needed 'expert' advice.

For PAYE Pensioners who started in other employment (after retiring) or who had income from dividends (or rent) and had to fill in SA forms for the first time, this new experience often resulted in them contacting HMRC, as they required expert advice.

Some quotes from pensioners about their experience of the tax system, tax coding notices and interactions with HMRC

"Previously I got a tax code every year; I would check my tax code, that's it. So I had very little to do with the tax office at all. Never had a rebate; was never overtaxed. Now I have quite a bit of contact..... It is very confusing because I get so many of these things (tax

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codes). It feels a bit baffling. I feel a bit intimidated by the system, there seems to be so many labyrinths, and sometimes it feels like I am dealing with something threatening.” Male, BC1, Pensioner, SA, Scotland

“I have to be very careful now I am managing on a limited income... You can't afford to be mad on anything.....It was so complicated with all the changes that there is no way I could check it out for myself. I couldn't afford to employ someone to do it. We argued backwards and forwards but in the end it had to be paid.” Female, BC1, Pensioner, PAYE, Scotland

The advice received on the phone was usually thought to be helpful and positively received although occasionally some pensioners complained about the difficulty of getting through.

Some pensioners had also received face-to-face advice on filling in forms that had resulted in a number of satisfied customers.

The carers in our sample who managed the tax affairs of pensioners had little interaction with the tax system.

For tips on savings and managing money (though not for tax) various sources of media were used e.g.: Martin Lewis: *Money Saving Expert*, Paul Lewis: *Radio 4 Money Box*, *Money Mail*

4. Gauging responses to potential simplifications to pensioner taxation and administration, in order to establish the impact of each –

- the R85 Form (*Getting your interest without tax taken off*)
<http://www.hmrc.gov.uk/forms/r85.pdf>,
- the R40 Form (*Claim repayment of tax deducted from savings and investments*)
<http://www.hmrc.gov.uk/forms/r40.pdf>
- the 10% savings rate. <http://www.hmrc.gov.uk/tdsi/ten-per-cent-guidance.htm>

In this sample, most pensioners didn't perceive interest from savings as income and had no understanding that they may be entitled to claim tax back.

The majority of pensioners understood that their savings that were not in ISAs would be taxed. As interest rates were so low and because many (particularly C2Ds) didn't keep large amounts of money in a savings account the amount of money they paid in tax was very low.

The term 'savings income' was not entirely clear to all - did it mean the income from savings before tax or the interest they received i.e. with the tax taken off?

There was low awareness of the R85 Form (*Getting your interest without tax taken off*), and a lack of understanding of who was eligible to use it. The minority who were aware had used it:

- For children/grandchildren

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- Because they had worked abroad
- Because they were prompted by their bank

There was minimal awareness of the R40 Form (*Claim repayment of tax deducted from savings and investments*) and a lack of understanding of who was eligible to use it. For many it was just not relevant:

- They had no savings (minority of C2D)
- For many savings actually meant 'extra money' in their current account
- Their savings were in an ISA
- Their income was such they would not be eligible to claim it back (BC1)

There was low awareness of the 10% Savings Rate, a reflection of a limited understanding of the tax system and their entitlements.

In order to assess their understanding of how the 10% savings rate was applied a 10% Savings Rate scenario for an imaginary taxpayer Frieda, was presented.

Most eventually grasped the concept (*pay 10% as opposed to 20% on a certain amount over the Personal Allowance if it came from savings*) from the scenario shown but the majority couldn't understand how to complete the tax calculation.

They had difficulty with understanding the terms 'pension only income' and 'savings income' that were the basic building blocks required to be able to undertake the calculation.

Without this understanding it was difficult for those who might have been eligible to calculate if their pension income and separately, their savings income, qualified them for a reduction in tax.

Additionally it was difficult for most in this sample to imagine who would have enough savings to make it applicable (not them) or why it existed at all.

The overall initial reaction to such a large amount of complexity for such a small amount of reward was - *"It's just not worth it!"*

However after this 'tax education' and time to think, some participants had a different reaction - *"I'm entitled to it, I need every penny!"* *"The Government aren't going to get it!"*

This does not necessarily mean that pensioners would fill in the R40 form to claim a repayment of tax as the form itself was perceived as being too long and complex.

In this sample, participants spontaneously commented that £100 was the least amount of financial reward required to warrant such a level of complexity.

Some quotes from pre-pensioners and pensioners about the 10% savings rate.....

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"I don't entirely understand the 10% savings rate as I don't entirely understand how you differentiate savings income from other income. I don't know whether savings income is pension income." **Female, BC1, Pensioner, SA, South of England**

"I think I understand it but I would find it very difficult to work out. I find the whole concept very confusing." **BC1, Female, Pensioner, SA, South of England**

"If I was going to get another £500 I would claim but if it's small I won't. I haven't filled out a form for 13 years and I don't see the point in getting involved for another £100 that is £2 per week, it's not even the cost of a pint of beer." **C2D, Male, Pensioner, PAYE, Wales**

"I can't grasp it, it's terrible.... It's not sinking in. The pension and the savings are two separate entities, am I right there, how it's taxed? You're now bringing this into the pension... I would accept what you are telling me and would accept it from HMRC, but I really don't fully grasp it, if you want to know the truth, being perfectly honest with you... There is a block." **BC1, Female, Pre-Pensioner, PAYE, North of England**

5. Understanding complexity - exploring trade-offs pensioners are prepared to make between simplification and financial benefit

When exploring trade-offs with this sample, we found that most were willing to give information about their finances for a tax reduction. (The tax reduction amounts tested were £100, £300 and £1000)

The information being asked for seemed pertinent for those in SA as - *"I do it anyway!"* and *"have the information to hand"* and carers who felt responsible for doing it on behalf of the person whose affairs they managed or looked after.

They expected the process to gain a tax reduction to be complex although they thought it shouldn't be.

The majority were extremely likely to claim money back because they felt that if they were entitled to it they would want to claim it back, a sense that they would want to claim what is *'rightfully mine'*.

More research would need to be done to understand whether people would give the information asked for and take the time required to fill in a form in real life, especially if they had no way of knowing how much the 'financial reward' would actually be.