

Office of  
Tax Simplification

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

January 2013



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# Foreword

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For most people, during their working lifetime, tax payments have effectively been on “autopilot”. They have benefitted from being a part of the “Pay as You Earn” (PAYE) system. This has meant that a combination of HM Revenue & Customs (HMRC) and employers have ensured that on each pay day, an employee has paid broadly the right amount of tax. If a person has been a higher rate taxpayer the benefits of PAYE have still applied.

Where savings and investment income are involved, most basic rate taxpayers find that a simple deduction of tax has been made at source and so no further action is required. For those on higher rates of tax, liabilities in this area are, in the main, sorted out via the annual self assessment return or through coding adjustments.

However, when someone decides to leave the world of work and retire, this relatively straightforward procedure changes. Gone is the simplicity and certainty of the PAYE world. A newly retired person will soon find themselves on their own when it comes to HMRC. A combination of multiple sources of income, ranging from pensions to interest on savings and investment dividends may well be high enough to incur a liability to pay tax. But the answer to the “how much should I pay” question may involve everything from the source of the income, their age, marital status or even their ability to see.

All of this can make the world of tax seem very complicated for older people. Especially as the onus still remains on these taxpayers to ensure that HMRC has all the information necessary to work out what tax needs to be paid. So in setting out to try and improve matters, the OTS involved a wide range of organisations whose purpose is to help older people with their tax affairs. They told us where they thought that tax law and HMRC’s procedures could be changed or improved so that the people they were helping could have a clearer idea, in the future, about what tax they were liable to have to pay.

In putting forward our proposals, we fully recognise the diversity of life for people over the age of 60. Some want to carry on working full time whilst others simply have a wish to enjoy the benefits of a well earned retirement. Whichever group an individual is in, they deserve to have their tax affairs dealt with in as straightforward a way as possible. That has been the objective of this report. Our aim has been to make practical recommendations that will provide taxpayers of pensionable age and above with the chance of having peace of mind about their tax affairs, especially as their years advance. We want people who have worked hard all their lives and now want some time to themselves not to have this period in their lives distressed by having to worry unnecessarily about their tax affairs.

Our interim report, published in March 2012, identified numerous areas of complexity. Many related to administrative matters, rather than legislative complexities, and it has been gratifying to see the way which HMRC and the DWP have rapidly started to act on many of the issues we identified. We congratulate those responsible: better liaison between the two departments will make a real difference to pensioners’ positions. We have included HMRC’s recent update document on our interim report, showing where progress is being made, in Annex A to this report.

In this report we have addressed a number of technical issues within the tax system that cause complexity and looked further at some administrative matters. Our recommendations are all focused on simplifying – on making life easier for pensioners. Combined with the actions already

in hand as a result of our interim report, they have a real potential to make a difference. We very much hope that the Chancellor will recognise that this report and its proposals fully reflect the concerns of today's pensioner taxpayers and accept the recommendations which we have put forward.

No report like this just happens by itself and I would like to conclude this report by paying particular thanks to our secondee Martin Gunson whose tireless efforts and great knowledge in this area of tax legislation have ensured that our recommendations are truly practical in their intent. My sincere thanks also go to the OTS's Katya Williams who brought to this project both energy as well as analytical skills without which this report could not have been produced. All of us also owe a real vote of thanks to the members of our Consultative Committee who have really engaged with our work and all contributed an enormous amount to developing this report.

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, Office of Tax Simplification



# Executive summary

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This final report is the culmination of a year and a half's work looking in detail at pensioners' experiences of the tax system. It builds on the work of the interim report on pensioner tax issues, published in March 2012<sup>1</sup>, which reviewed the tax system and compiled a list of priority areas for further review. It is these priority areas that we have considered in more detail and which form the basis of our recommendations.

As a society we are getting older and increasing numbers of us can expect to celebrate our centenary. For the purposes of this review, we have defined the pensioner population as those aged over 60 although many such people will not have ceased work. The path from work into retirement is also becoming increasingly complex with the end of a compulsory retirement age and increasing numbers of people working longer, or mixing paid work with drawing a pension.

In addition to the phasing out of compulsory retirement ages, other policy changes have occurred during the review (and will be discussed in more detail in Chapter 3). Previous rises in the personal and age allowances have taken many out of taxation and reduced the eligibility and effectiveness of many of the allowances we have reviewed. We also note that the Government's commitment to a flat-rate State Pension for new retirees will mean that future pensioners will have more certainty about their State Pension income.

For many, the most radical simplification we could recommend would be to exempt the State Pension from tax. However, this is in our view not a realistic option, even with some pragmatic adjustment to the personal allowance in exchange. Whilst noting that such an exemption would simply confirm what many mistakenly believe to be the case, one cannot ignore the large hole in the public finances it would create. There are significant issues of fairness towards other taxpayers, especially as the wealthiest pensioners would benefit most, and over the last decade, pensioners have seen their incomes increase faster than other groups<sup>2</sup> (see Chapter 3).

Our recommendations for simplifying pensioner taxation are in two broad parts: legislative change to remove complexity in the tax system, and administrative improvements which will make it simpler for pensioners to comply with their obligations and claim their entitlements.

The administrative changes we suggest will also be of benefit to many non-pensioner taxpayers who face similar complexities in managing their affairs especially in relation to savings taxation. We are looking to HM Revenue & Customs (HMRC) and the Department for Work and Pensions (DWP) to invest in improved communications and processes to ease the administrative burden on pensioners. This administrative investment contrasts with the policy recommendations which may generate some modest net gains for the Treasury, depending on what compensation is put in place. Our brief is to design a package of recommendations which are broadly revenue neutral. It is therefore important that the administrative recommendations are given equal consideration as the policy changes we propose.

A full list of recommendations can be found in Chapter 2.

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<sup>1</sup> [http://www.hm-treasury.gov.uk/d/ots\\_review\\_of\\_pensioners\\_tax\\_060312.pdf](http://www.hm-treasury.gov.uk/d/ots_review_of_pensioners_tax_060312.pdf)

<sup>2</sup> [http://research.dwp.gov.uk/asd/asd6/2010\\_11/pi\\_series\\_1011.pdf](http://research.dwp.gov.uk/asd/asd6/2010_11/pi_series_1011.pdf)

## The age allowance

Our interim report suggested that we review the complexities surrounding the age related allowance and its taper system in particular. We have not considered this proposal further as the Chancellor announced at Budget 2012 that the age related allowance would be phased out.

One personal allowance for all, with the potential elimination of tapering, is clearly a big simplification. It will remove a great deal of confusion, missed claims for the higher allowance and problems with tapering and is therefore something we would support from a simplification point of view. However, we acknowledge there may be interim complexities (and unmet expectations) for those caught in the transition.

## Administrative improvements

In our interim report in March 2012, we highlighted administrative improvements that HMRC could achieve relatively quickly. We were very pleased that HMRC rose to the challenge, and has made good progress in taking these forward. A list of our recommendations and HMRC's responses is in Annex A. Perhaps the most promising result is that our review has prompted much closer working between HMRC and the DWP, including a single point of contact for staff in each department on pensioner issues, and electronic transfer of pension information from the DWP to HMRC when someone starts to draw their State Pension.

Our review has highlighted the need to improve communications about tax and the State Pension, and how the Pay as You Earn (PAYE) system operates for those with income from several sources.

- **We recommend that every April the DWP issues a P60 type form ("DWP60") stating the amount of taxable income (from the State Pension and other taxable state benefits) which a pensioner was entitled to in the previous tax year.** This would give pensioners an accurate figure for their taxable state income and enable them to check they are paying the right amount of tax. Currently pensioners receive an annual letter from the DWP setting out their entitlement for the forthcoming year; however, they do not receive a statement of their full annual entitlement for the previous tax year. A DWP60 would also reduce the complexity which arises from payment of the State Pension on a weekly rather than monthly basis as many pensioners find it difficult to calculate their annual income for a particular tax year. This would bring the DWP into line with other pension providers and reduce errors and confusion for pensioners who complete self assessment tax returns, and help pensioners in PAYE to check their tax codes;
- **We recommend that HMRC introduces a single composite PAYE coding notice ("Form P2C") which would aggregate the various individual codes for each source of income in PAYE and provide a reconciliation to the personal allowance. This would provide explanation and reassurance, and make it easier to spot errors.** A consolidated notice will enable pensioners to see at a glance how their personal allowance is used and to check that they are paying the correct amount of tax. There will also be a wider benefit to younger taxpayers with multiple jobs who will also find it easier to check that they are paying the correct amount of tax;
- The review highlighted a widespread lack of understanding of concepts such as the personal allowance, the use and meaning of tax codes and which parts of their income are taxable. **To enable pensioners to understand these important areas**

better we recommend that the HMRC/DWP communications review (see Annex A) includes a review of communications about how the State Pension is taxed, and clearer information about how personal allowances and tax codes operate, and which documents and figures pensioners need to be aware of;

- Our work has highlighted a lack of understanding and engagement with tax issues across the working population in PAYE, even before they retire. Although we have not made specific recommendations in this area (as this is beyond our remit) we believe further education work is needed to engage taxpayers of all ages who are in PAYE about the need to understand their tax codes, personal allowance and savings taxation. This is an area of communications which merits further investigation. We note the Government's work on transparency in tax including the proposal to introduce personalised tax statements from 2014<sup>3</sup> and feel that improved communications have the potential to engage and inform more people about tax;
- We **recommend improvements to Form R85**, which is issued by banks and enables non-taxpayers to have the interest on their savings paid gross rather than after deduction of tax at the 20 per cent basic rate. Our specific recommendations to Form R85 are that:
  - **HMRC redesigns the Form R85 and helpsheet to make it easier for individuals to use.** HMRC should also liaise better with banks and building societies to ensure that taxpayers receive the correct information and advice on registering for gross interest<sup>4</sup>;
  - **HMRC considers annual checks to ensure savers are not over or underpaying tax through matching data and taxpayers' records.** This is in line with the recent suggestions of the Low Incomes Tax Reform Group (LITRG) after their most recent R85 "mystery shopper" exercise; and
- Finally as part of the Government's "Digital by Default" strategy, HMRC should provide the facility for people in PAYE to be able to submit the Form R40 (to reclaim tax paid on savings or investment income) electronically. The paper Form R40 should also be revised with clearer headings and explanations and should be tested with pensioner groups.

## Policy recommendations

The policy areas we have reviewed in detail in Chapter 5 include a range of often outdated, ineffective or badly targeted allowances and reliefs which span both income and savings taxation.

Savings taxation is an area of complexity for all taxpayers. We have looked in detail at the **10 per cent savings rate** which, as it is restricted to a narrow band of income and savings, is both complicated to understand and to claim if the taxpayer does not file a self assessment tax return.

- We **recommend that the 10 per cent savings rate is removed**, as awareness and claim levels are so low that it is ineffective in incentivising savings;

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<sup>3</sup> [http://cdn.hm-treasury.gov.uk/budget2012\\_complete.pdf](http://cdn.hm-treasury.gov.uk/budget2012_complete.pdf)

<sup>4</sup> LITRG has produced a report on a small study into how banks manage the R85 process. Their "mystery shopping exercise" found evidence of poor understanding of the R85 process from bank and building society staff and often scant information on deposit-takers' websites. For further information on the exercise see [http://www.litr.org.uk/reports/R85\\_report\\_Jan2013](http://www.litr.org.uk/reports/R85_report_Jan2013)

- Our view is that any savings incentives should be focused around Individual Savings Accounts (ISAs) as they have high levels of brand recognition and awareness and are already in place; and
- We would advise against any changes to the savings tax regime which involve complicated eligibility calculations or a reclaim process, because they create barriers to take up.

We have reviewed the **married couple's allowance** which is complex to understand and administer, and only available to people born before 6 April 1935.

Logic would suggest that this allowance is removed as there is no clear rationale for retaining it – unless it is intended to encourage over 78 year olds to marry or enter into a civil partnership. Clearly as those eligible get older, the allowance will be claimed by fewer people and will eventually become obsolete. Against this, there is the argument that the married couple's allowance for all its complexity, is at least well-established and reasonably well understood (in principle, if not in detail). Because of this, we conclude that it would be difficult to abolish the allowance.

- **If married couple's allowance is to remain we recommend that it is drastically simplified** with a removal of the current system of income abatements and changing the 10 per cent rate system to a flat-rate payment.

Another area of review has been **blind person's allowance** which does not provide a benefit to the majority of blind people whose earnings or pensions are within their personal allowance. The allowance provides the largest benefit to higher rate taxpayers.

In order to make a claim for blind person's allowance in England and Wales a person must be certified blind and be on a local authority register of blind persons.<sup>5</sup> Charities have highlighted that the requirements for registering as blind can make the blind person's allowance claims process time consuming and complex.

- **The OTS remains of the view that the blind person's allowance is ineffective in helping the general population of blind people and that it would be better if it were abolished and the funds used to provide direct grants and support to blind people.** This could involve grants to buy equipment to enable younger blind people to enter employment and increased support to access digital government services; and
- **If the abolition/grant route is not taken up, we recommend that the claims process is simplified. We agree with a proposal made by the Royal National Institute for the Blind that a medical diagnosis of blindness should trigger an automatic notification to local authorities and HMRC.**

The review has also looked at a little known relief for **interest on loans for life annuities taken out before April 2009**. This relief offers limited benefit to a small and rapidly decreasing group of pensioners and its removal would enable the remaining complex legislation relating to MIRAS (mortgage interest tax relief at source) to be abolished. This would be a significant legislative simplification:

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<sup>5</sup> In order to register as blind in Scotland or Northern Ireland a person must be unable to perform any work for which eyesight is essential.

- We recommend that sunset legislation is introduced to remove the relief for interest on loans for life annuities taken out before April 2009 at a fixed date in the future e.g. in five years' time possibly with a pragmatic adjustment to related interest payments. This should follow a consultation on the likely impact and compensation for the loss of the relief.



# 1

## Introduction

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### Background to the review

**1.1** In July 2010, the Chancellor of the Exchequer announced the creation of the Office of Tax Simplification (OTS). Following its initial reviews into small business tax and tax reliefs, the OTS wrote to the Exchequer Secretary to HM Treasury, David Gauke MP, in June 2011 setting out possible areas of future work.<sup>1</sup> In reply, the Minister invited us to work on two of our proposals: pensioner taxation and employee share schemes.<sup>2</sup>

**1.2** On 6 March 2012, the OTS published the interim report of the review of pensioners' taxation. The report reviewed a wide range of issues of administrative and legislative complexity and assigned each issue a priority level.<sup>3</sup>

**1.3** This report takes the issues identified in the interim report and has reviewed in more depth those identified as high priority. The review identified two main sources of tax complexity for pensioners:

- complex legislation and policy which may be difficult for pensioners to understand and use; and
- complex administration where processes e.g. forms, claims or taxpayer information are so complicated or inaccessible that it is difficult for pensioners to comply with their obligations or claim their entitlements.

**1.4** Since the interim report HM Revenue & Customs (HMRC) has been working on improving some of the more immediate administrative issues raised by the OTS interim report. HMRC reported on its progress over the summer and sent a formal response in November 2012 which was published on the OTS website (see Annex A.)

**1.5** The full terms of reference of the OTS review of pensioner taxation can be found in Annex C.

### The methodology of the review

**1.6** The review process involved a range of evidence gathering activities. The OTS set up a Consultative Committee of experts to advise it on the review (see Annex C for membership). For the second stage of our review, members of the committee formed three subgroups addressing the following themes: PAYE and the State Pension; policy simplifications; and HMRC administration and communications. These subgroups explored the issues raised in the interim report in detail and consulted with interested parties about the issues and possible solutions.

**1.7** We also spoke to some large organisations in financial services, retirement accommodation and local government that had a sizeable pensioner customer base. The OTS reviewed academic and research literature including work commissioned by the Department for Work and Pensions

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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)

<sup>3</sup> See Annex A for the interim report's list of priority areas for further review and HMRC's response

(DWP) and charities such as Age UK, Tax Help for Older People, the Low Incomes Tax Reform Group (LITRG) and the Royal National Institute for the Blind (RNIB). Our committee members provided a good level of insight into the needs and concerns of pensioners who pay for tax advice and those who receive help and advice through the voluntary sector. However, we were also keen to find out more about unrepresented pensioners' experience of complexity in the tax system so we collaborated with HMRC to commission external research with unrepresented pensioners.

## Research

**1.8** In autumn 2012, the OTS worked with HMRC to commission a formal qualitative research project<sup>4</sup> to explore the attitudes and experiences of pensioners in relation to taxation.

**1.9** The research was carried out by an external contractor, Steel Magnolia, and involved interviews and focus groups with 83 pensioner and pre pensioner respondents from across the UK. We specified that this external research sampled pensioners who were not paying for tax advice and were not clients of charities represented on our Consultative Committee in order to obtain a spread of pensioner opinion and test some of the assumptions from the interim report. We also specified that respondents should have an income tax liability. This was because we wanted the research to focus on the pensioners most likely to be managing their tax affairs themselves or with family support.

**1.10** The research has informed our recommendations and highlighted important areas for HMRC and the DWP to review in more detail. We therefore recommend that the research be updated in a few years to review progress against our recommendations and how far they have had an impact on pensioners' experience of the tax system.

**1.11** The findings of the research are explained in further detail in Chapter 3.

## Analysis

**1.12** Following the research findings, the OTS team worked closely with analytical and policy teams in HMRC, HM Treasury and the DWP to explore the potential costs and impacts of various simplification proposals.

**1.13** We also discussed our emerging recommendations with our Consultative Committee members to arrive at a balanced package of simplifications that we believe will make a real difference to pensioners. We are extremely grateful to the committee members for their expert advice, but should make it clear that the final judgments about what to recommend were those of the OTS.

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<sup>4</sup> <http://www.hmrc.gov.uk/research/reports.htm>



# 2

## List of recommendations

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2.1 The OTS recommendations have two broad themes: administrative and policy (legislative) changes.

### Administrative recommendations

- 1 We recommend that every April the DWP issues a P60 type form (DWP60) stating the amount of taxable income (from the State Pension and other taxable state benefits) which a pensioner was entitled to in the previous tax year. This would give pensioners an accurate figure for their taxable state income and enable them to check they are paying the right amount of tax;
- 2 We recommend that HMRC introduces a single composite PAYE coding notice (Form P2C) which would aggregate the various individual codes for each source of income in PAYE and provide a reconciliation to the personal allowance. This would provide explanation and reassurance, and make it easier to spot errors;
- 3 We recommend that the HMRC/DWP communications review (see Annex A) includes a review of communications about how the State Pension is taxed, clearer information about how personal allowances, and tax codes operate and which documents and figures pensioners need to be aware of;
- 4 We recommend improvements to Form R85, which is issued by banks and enables non-taxpayers to have the interest on their savings paid gross rather than after deduction of tax at the 20 per cent basic rate, which applies to most savings accounts. We recommend that HMRC redesigns Form R85 and helpsheet to make them more usable for taxpayers;

We also suggest that:

- a HMRC should also liaise better with banks and building societies to ensure that taxpayers receive the correct information and advice on registering for gross interest<sup>1</sup>;
  - b HMRC considers annual checks to ensure savers are not over or underpaying tax through matching their data and taxpayers' records; and
- 5 We recommend that as part of the Government's "Digital by Default" strategy, HMRC should provide the facility for people in PAYE to be able to submit the Form R40 (to reclaim tax paid on savings or investment income) electronically. The paper Form R40 should also be revised with clearer headings and explanations and should be tested with pensioner groups.

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<sup>1</sup> [http://www.litrg.org.uk/reports/R85\\_report\\_Jan2013](http://www.litrg.org.uk/reports/R85_report_Jan2013)

## Policy recommendations

- 6 We recommend that the 10 per cent savings rate is removed, as awareness and claim levels are so low that it is ineffective in incentivising savings;
- 7 Logic would suggest that the married couple's allowance is removed. There is no clear rationale for its retention and it is a source of confusion and error. However, it is at least well-established and will eventually become obsolete. Because of this, we conclude that it would be difficult to abolish the allowance. If married couple's allowance is to remain, we recommend that it is drastically simplified with a removal of the current system of income abatements and instead a flat-rate payment;
- 8 The OTS remains of the view that the blind person's allowance is ineffective in helping the general population of blind people and that it would be better if it were abolished and the funds potentially available for tax relief used to provide direct grants and support to blind people. It has been suggested that this could involve grants to buy equipment to enable younger blind people to enter employment or increased support to access digital government services;
- 9 If the abolition/grant route is not taken up, we recommend that the process of claiming the allowance is simplified. We agree with RNIB's proposal that a medical diagnosis of blindness should trigger an automatic notification to local authorities and HMRC; and
- 10 We recommend that sunset legislation is introduced to remove the relief for interest on loans for life annuities taken out before April 2009 at a fixed date in the future e.g. in five years' time, possibly with a pragmatic adjustment to related interest payments. This should follow a consultation on the likely impact and compensation for the loss of the relief.

# 3

## The wider pensioner tax context

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**3.1** For many people the transition into retirement marks a shift from relatively simple tax affairs with maybe one source of PAYE income into often managing multiple income streams. This may potentially mean having to file a self assessment (SA) tax return for the first time. Therefore in addition to commissioning research with pensioners we reviewed the evidence about pensioners' awareness of key tax concepts e.g. a personal allowance and tax codes, their financial literacy and interactions with wider government services.

**3.2** The policy context is also changing. Budget 2012 increased the personal allowance from £7,475 to £8,105 for 2012-13 for people under 65, from £9,940 to £10,500 for people aged 65-74 and from £10,090 to £10,660 for those aged 75 and over.<sup>1</sup> Following the announcement in the Autumn Statement 2012, the main personal allowance will rise to £9,440 in 2013-14.

**3.3** Conversely, the freeze in the age related allowance announced in Budget 2012 could move some pensioners with index-linked pensions into taxation. From 2013-14, the age related personal allowances will not be increased and will only be available to people born on or before 5 April 1948 for the allowance worth £10,500; and on or before 5 April 1938 for the allowance worth £10,660.

**3.4** The Government published a white paper on 14 January 2013,<sup>2</sup> confirming plans for a flat-rate State Pension (of at least £142.70 per week) from April 2017. We think this makes our recommendations around improving communications about the State Pension even more important.

### Pensioners' financial context

**3.5** According to the 2011 census,<sup>3</sup> the pensioner population is rising and in 2011, 1 in 6 UK residents were over 65 years old compared with 1 in 20 in 1911. The Office for National Statistics' (ONS) latest figures on pensioner incomes has found that the average income of pensioners grew faster between 1998-99 and 2010-11 than average earnings, with pensioners' net income after housing costs increasing by 40 per cent as compared with an increase of 11 per cent in average net earnings after housing costs during the same period.<sup>4</sup>

**3.6** However, income levels vary. The same survey found that although in 2010-11, 68 per cent of pensioner households were receiving investment income e.g. from savings or stocks and shares, half of them received £4 a week or less. A higher proportion of pensioner couples than single pensioners had income from investments or savings which contributed to them having much higher incomes on average than their single peers. In 2007-08 it was estimated that 50 per cent of pensioners paid income tax and 3 per cent of pensioners were higher rate taxpayers.<sup>5</sup>

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<sup>1</sup> [http://cdn.hm-treasury.gov.uk/budget2012\\_complete.pdf](http://cdn.hm-treasury.gov.uk/budget2012_complete.pdf)

<sup>2</sup> <http://www.dwp.gov.uk/docs/single-tier-pension.pdf>

<sup>3</sup> [http://www.ons.gov.uk/ons/dcp171778\\_270487.pdf](http://www.ons.gov.uk/ons/dcp171778_270487.pdf)

<sup>4</sup> [http://research.dwp.gov.uk/asd/asd6/2010\\_11/pi\\_series\\_1011.pdf](http://research.dwp.gov.uk/asd/asd6/2010_11/pi_series_1011.pdf)

<sup>5</sup> <http://www.publications.parliament.uk/pa/cm200809/cmhansrd/cm090611/corrtext/90611c0001.htm>

## Pensioners' financial literacy and their awareness of key concepts in tax: the OTS/HMRC pensioner research project

**3.7** In autumn 2012, the OTS and HM Revenue & Customs (HMRC) commissioned research into pensioner experiences and knowledge of the tax system. The research was carried out by an external research agency, Steel Magnolia, and involved interviews and focus groups with 83 pensioner<sup>6</sup> and pre pensioner<sup>7</sup> respondents from across the UK.<sup>8</sup> We specified that this external research sampled unrepresented pensioners who were not paying for tax advice and were not clients of charities represented in our Consultative Committee. The research sample ranged from 60-79 years in age. The research sample included a mixture of income levels (though all had to be eligible for income tax so that they would have experience of interacting with the tax system), a balance of genders and experience of paying tax through PAYE and SA. We also asked that the sample included pensioners from minority ethnic backgrounds, pensioners in rural areas and those with caring responsibilities.<sup>9</sup>

**3.8** The research carried out by Steel Magnolia for HMRC and the OTS largely supported the evidence we received from committee members indicating that the issues raised about knowledge and understanding of the tax system and the impact of complexity affect a broad spectrum of pensioners.

**3.9** The research found that many pensioners were anxious about dealing with taxation and apprehensive about making contact with HMRC. They expected tax to be complicated, although they did not think this should be the case. Many were reluctant to claim allowances or reclaim tax owed as they felt that the forms would be too complicated and they were uncertain about the likely reward as compared with the risk of opening themselves up to further scrutiny by HMRC. Much of the anxiety was caused by a lack of understanding of the tax system and a fear of "getting it wrong". There are significant lessons here for HMRC and the Department for Work and Pensions (DWP) about the need to improve communications with pensioners.

**3.10** The research highlighted two main approaches to engaging with tax and with HMRC in our research sample. Some pensioners were broadly "passive" i.e. they largely sat back and expected the system to deliver the correct tax result to them (this group mainly comprised pensioners who were used to paying tax via PAYE and those who were less affluent). This contrasted with the more "active" group who were more likely to understand and engage with their tax affairs. This group mainly comprised more affluent respondents and those who had experience of the self assessment process. Although most pensioners understood that they had a personal allowance and income exceeding this was taxed, many, particularly in the passive group, were not aware of the amount. There was also limited understanding about tax codes, in particular how they related to each source of income. This was in line with our discussions with tax advisers and the voluntary sector.

**3.11** A key finding from this research was that many of the pensioners in the sample did not consider their State Pension to be income. Many, particularly older and more passive pensioners, saw it as an entitlement from "paying their stamp" rather than as a source of income to be taxed. This is a significant issue as many remain unaware that the State Pension is taxable. The fact that state retirement pension is not taxed at source by the DWP can cause confusion and

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<sup>6</sup> The research study defined a pensioner as aged 60 or over, in receipt of pensions (including the State Pension) or otherwise retired and living wholly or partly off investment income

<sup>7</sup> 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).

<sup>8</sup> The agency spoke to pensioners in all the nations of the UK. For more details on the sample and the research findings please see <http://www.hmrc.gov.uk/research/reports.htm>

<sup>9</sup> A Carer was defined as caring for or managing the tax affairs of anyone in their family (parents, aunts, spouses or partners) who was considered frail or vulnerable. They were also all pensioners themselves.

even distress when people find out that they are being taxed. We therefore recommend that the HMRC/DWP communications review (see Annex A) includes a review of communications about how the State Pension is taxed, and clearer information about how the personal allowance and tax codes operate, and which documents and figures pensioners need to be aware of. Recommendations to improve communications around taxation of the State Pension are proposed in Chapter 4.

**3.12** Interestingly, while more affluent and “active” pensioners in the research sample viewed investment income as one of their sources of income, the majority of pensioners in our research sample didn’t view interest from savings as income. This was mainly because the sums involved were so low that the term “income” felt inappropriate. This has important implications for tax policy as in order to understand and calculate the 10 per cent savings rate, a taxpayer must understand that they have both savings income and pension income, and that the relative proportions of these affect their eligibility for the savings rate. This was particularly highlighted by the research which tested the 10 per cent savings rate through a worked example and demonstrated both the complexity and the resulting frustration when our research respondents tried to assess their eligibility for it. We review the 10 per cent savings rate and savings taxation in more detail in Chapter 5.

## Digital services

**3.13** Research commissioned by the DWP in 2010<sup>10</sup> found that while many pensioners use the internet for information, fewer use it for transactions and many are concerned about security online (three-quarters of pensioners they surveyed who used the internet had bought goods and services online but two-thirds of them were reluctant to share private information online). Internet use is also strongly associated with socio-economic circumstances with higher use and confidence among higher income groups. The majority of pensioners in our research sample who filed annual self assessment (SA) returns were filing online and were confident with computer use. However, they were also among the more affluent members of the sample.

**3.14** For those in the research sample who did not file online this was often due to a preference for paper filing (the ability to make copies of the return for their records) or hesitation in using the new technology for this purpose. This must be taken into account in the Government’s “Digital by Default” strategy because, although many pensioners will benefit from increased access to online services, provision will still need to be made for those who are unable to access these services.

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<sup>10</sup> <http://research.dwp.gov.uk/asd/asd5/rports2009-2010/rrep703.pdf>



# 4

## Making life easier for pensioners – administrative improvements

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### Introduction

**4.1** Early in the review our work highlighted areas of complexity for pensioners which could not be tackled by legislative change. A key strand of this work has therefore been reviewing the everyday issues of communications and administrative processes which create complexity for pensioners who are trying to meet their tax obligations.

**4.2** HM Revenue & Customs (HMRC) has been working on implementing some of the more immediate administrative suggestions raised by the interim report. HMRC reported on its progress over the summer and gave the OTS a formal update in November 2012, which has been published on the OTS website (see Annex A).

### A. Pay as You Earn (PAYE) and the State Pension

**4.3** One of the issues raised in both the interim and final stages of the review was the level of complexity and anxiety caused by the way the State Pension is currently taxed. The Department for Work and Pensions (DWP) does not operate PAYE on the State Pension, so any income tax liability is normally collected through adjusting the PAYE tax code applying to other sources of income being taxed under PAYE. This only works if the pensioner has sufficient other income. If there is insufficient other PAYE income, the tax has to be collected via self assessment (SA). This can lead to some pensioners being in the self assessment process to collect small amounts of tax.

**4.4** The group who are most disadvantaged by the current process are those who are placed into self assessment in order to pay the tax due on the State Pension. This can affect pensioners who made high State Earnings-Related Pension Scheme (SERPS) or State Second Pension contributions and now receive an additional State Pension which with the basic State Pension gives them an income higher than their personal allowance, and also pensioners who do not have another source of PAYE income large enough for the tax on the State Pension to be collected through PAYE – as highlighted in the interim report.<sup>1</sup> Where a pensioner has a State Pension which is higher than the personal allowance and no other income, they will have a tax liability which cannot be collected through PAYE and will therefore need to complete an SA tax return and pay the tax as a lump sum each year or each six months.

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<sup>1</sup> [http://www.hm-treasury.gov.uk/d/ots\\_review\\_of\\_pensioners\\_tax\\_060312.pdf](http://www.hm-treasury.gov.uk/d/ots_review_of_pensioners_tax_060312.pdf)

**Box 4.A: How a large State Pension can result in a pensioner having to complete a self assessment return**

Jill is 70 years old and has State Pension of £11,500 in 2012-13. She has no other income. As her personal allowance for 2012-13 is only £10,500, she will be liable to tax on £1,000 of the State Pension and will have to complete and submit a tax return and pay the £200 due.

**4.5** The OTS commissioned analysis by HMRC into the numbers affected by this and found that the number of pensioners in self assessment solely as a result of having a State Pension larger than their personal allowance was likely to be around 29,000 people<sup>2</sup> in 2010-11. The number of people who made high levels of SERPS/State Second Pension contributions who are eligible for large State Pensions is also predicted to fall. The Government's proposal to introduce a flat-rate State Pension for new retirees<sup>3</sup> will have an impact on this issue in due course.

**4.6** Where the State Pension is more than the personal allowance, a special code may need to be issued – a K code – which results in tax being calculated on more income than the pensioner is receiving from that source. There are special rules for K codes, one of which is that the tax deducted in any one week or month must not exceed 50 per cent of the taxable income.

**4.7** We are aware that the 50 per cent rule can sometimes be too inflexible. This means that in certain combinations of circumstances, insufficient tax can be collected from a pension even though the taxpayer would like more tax to be deducted from the pension so that they pay the tax due through PAYE rather than having to enter the SA process. It has been suggested that this rule could be amended to allow taxpayers the flexibility to elect to stay in PAYE in these circumstances. We suggest that HMRC reviews the current implementation of the 50 per cent rule and where flexibility for taxpayers can be increased.

**4.8** Collecting the tax on the State Pension indirectly (through PAYE on another source of income) can lead to anxiety and confusion for pensioners who do not understand why the tax taken from their private pension may appear higher than expected. It is often not clear to the pensioner that the additional tax taken is to settle their State Pension tax liability.

**Box 4.B: How taking the tax due on the State Pension from another source of income can lead to confusion.**

In 2012-13, Mohammed who is 80 years old has a State Pension of £10,500 and a pension from his former employer, ABC Limited, of £11,000. His personal allowance is £10,660. The allowances available to set against his ABC Limited pension are reduced by the amount of his State Pension to £160. He therefore has tax deducted from his ABC pension of £2,168 (£11,000 – £160 at 20 per cent). This is 19.7 per cent of his ABC pension.

Mohammed is puzzled why he is paying nearly 20 per cent tax on his ABC pension when he knows some of his income should be tax free.

**4.9** During the review many of those we consulted suggested that a solution would be for the DWP to operate Pay as You Earn on the State Pension and deduct at source. The OTS commissioned provisional estimates from the DWP and HMRC for the likely cost for the DWP to

<sup>2</sup> See Annex A to this report. The OTS commissioned HMRC's analytical division to review their internal data on the reasons state pensioners enter self assessment.

<sup>3</sup> [http://cdn.hm-treasury.gov.uk/budget2012\\_complete.pdf](http://cdn.hm-treasury.gov.uk/budget2012_complete.pdf)



operate PAYE on the State Pension, both for all pensioners and for the approximately 29,000 pensioners most affected. The DWP's initial very tentative estimate of the set up costs indicates that operating PAYE on the State Pension would have a substantial cost to the department, probably in excess of £100 million. The DWP has been unable to provide an estimate for the ongoing running costs. There was little difference in cost for operating PAYE for the small affected group or for all pensioners because the DWP considered that the State Pension might be above or below the personal allowance from year to year. It would therefore be necessary for the DWP to open a PAYE file on all pensioners not just those for whom the pension was higher than the personal allowance so that those who might or might not need tax deducted would be identified each year.

**4.10** The OTS also asked HMRC to assess the likely impact of any change. Its key concern was the size of the payroll scheme necessary (the DWP would be operating PAYE on behalf of approximately 12 million state pensioners which would be 10 times larger than the largest employer payroll that HMRC currently deals with). HMRC also highlighted the risk of such a high level of transactions to the Real Time Information computer system which is due to launch fully in April 2013. Both departments highlighted the risks involved in creating a new IT system whilst the DWP works to implement large scale changes to the welfare system such as Universal Credit.

**4.11** In the light of these projected costs, the operational risks, and the limited numbers of people who it is believed would directly benefit from this change, we have stopped short of recommending that the State Pension is brought into PAYE. We suspect that were we starting from a blank sheet of paper to design a new tax system, State Pension would be set up to operate within the PAYE system but we accept that the change from the current position would be too great an undertaking at present.

**4.12** However, given the legislative changes and that our assumptions about the likely fall in the affected population are estimates, it is something which should be kept under review. After all, all private pension providers have to operate PAYE on pension payments.

## **B. Improving communications about which income is taxable**

**4.13** Although the issue of how the State Pension is taxed causes problems for some pensioners, there is also a lack of understanding among pensioners that the State Pension is taxable at all.<sup>4</sup> This is compounded by poor communications about how the State Pension is taxed. After the initial work on the consequences of PAYE not being applied to the State Pension, the OTS looked at how these issues could be addressed by better communications about taxation and the State Pension.

**4.14** Currently many pensioners receive their pension every four weeks rather than every calendar month. If pensioners complete a self assessment (SA) return, they need to enter a figure for the amount of their State Pension entitlement for the year. As the current payment schedule does not coincide with the annual tax year, some pensioners have difficulty in calculating the annual amount of State Pension income they need to enter on their tax returns. A very common error is to take the amount paid into their bank account each month and multiply by 12 rather than 13 on the assumption that the amount is paid monthly rather than four-weekly.

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<sup>4</sup> The qualitative research we commissioned with HMRC found that pre pensioners' and pensioners' knowledge and understanding of the issue remains patchy with many unaware that the State Pension was taxed at all.

#### **Box 4.C: Common errors in calculating taxable State Pension income**

Oliver needs to complete his 2011-12 self assessment tax return, and needs to know the amount of his State Pension. He has looked at his bank statements and noted that in April 2011 he received £399.60 and then regular payments of £408.60, which he assumes are monthly, as with all his other pensions. So he takes £399.60 and  $11 \times £408.60$  giving £4,894.20. However, he hadn't realised that the amount he should declare is based on entitlement and that the payments received were actually four-weekly (so 13 in a tax year). The correct calculations would be  $52 \times £102.15$ , giving £5,311.80. The incorrect figure will result in an underpayment of £83.52 in tax plus the risk of a penalty charge – all of which could be avoided if the DWP issued a notice (which could be called a DWP60) telling him how much State Pension he was entitled to for 2011-12, as other pension providers do.

Donald has received his 2011-12 P800 PAYE statement and wants to check the pension shown is correct, so he takes the letter received in March 2012 and multiplies the amount shown by 52. However the amount relevant for 2011-12 was actually provided in a letter in March 2011 and the amount he uses represents the 2012-13 rate. He is confused and concerned that the P800 shows a figure which is £275.60 lower than what he has calculated and calls the HMRC helpline. This could have been avoided with a DWP60.

**4.15** The current HMRC SA guidance<sup>5</sup> directs pensioners to their “About the general increases in benefits” letter which the Pension Service sends informing pensioners of their entitlements (also referred to as the annual uprating letter). As pensioners are not given a full annual figure for their entitlement they must still perform a range of calculations to arrive at the correct figure for their tax return (see Box 4.D below).

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<sup>5</sup> [www.hmrc.gov.uk/worksheets/sa150.pdf](http://www.hmrc.gov.uk/worksheets/sa150.pdf)

#### Box 4.D: Extract from “How to fill in your tax return 2012” HMRC guidance<sup>6</sup>

If you received State Pension for the full year to 5 April 2012, to calculate the total amount you were entitled to for the year, multiply your weekly entitlement by 52. If your weekly entitlement changed during the year you will need to multiply each amount by the number of weeks for which it was received, up to a maximum of 52 weeks.

For the year ending 5 April 2012, if you were paid weekly or four-weekly and your payday was a Wednesday or Thursday, you need to add one extra week’s pension to the amount calculated as above because there were 53 Wednesdays or Thursdays during the full tax year.

If you received State Pension for part of the year, you will need to count the number of weeks from the date your State Pension began to 5 April 2012 and multiply this by your weekly entitlement to calculate your total entitlement for this tax year.

As a guide to the total of your weekly entitlements for a full year, if you were paid:

- weekly – add up the 52 weekly amounts as shown on your bank statement or building society passbook (if you were paid by direct debit);
- four-weekly – multiply your 4-weekly amount by 13; and
- quarterly – multiply the quarterly amount by 4.

As well as your basic State Pension, the box 7 figure should include:

- any graduated pension;
- the age addition if you are over 80;
- increases paid by the Department for Work and Pensions to uprate a guaranteed minimum pension;
- any addition for a dependent adult;
- any extra pension paid because you deferred or temporarily gave up your State Pension; and
- if you are married or in a civil partnership, any State Pension payable to you because of your spouse’s or civil partner’s National Insurance contributions.

The figure should not include:

- any addition for a dependent child;
- annual Christmas bonus; or
- Winter Fuel Payment.

They are not taxable.

**4.16** Another issue highlighted by both our interim and final review process was that of taxable social security benefits. Although a review of pensioners’ experiences of state benefits is strictly outside the scope of this review, it is clear from our consultations with committee members and our research that many pensioners are not clear about which of the benefits they receive, such as attendance allowance, and winter fuel allowance are taxable.

<sup>6</sup> [www.hmrc.gov.uk/worksheets/sa150.pdf](http://www.hmrc.gov.uk/worksheets/sa150.pdf)

**4.17** The only information they may have apart from an annual uprating letter which sets out the new levels of payment for the forthcoming year, are the credits into their bank account. These may be payments of all their state benefits and State Pension combined.

**4.18** As income tax is based on their **entitlement** to social security benefits and the State Pension rather than what they have **received** over the year calculations of the bank account credits received in a year are often incorrect for tax purposes. This makes it very difficult for pensioners to accurately calculate their annual taxable income from the State Pension and to unravel which of their benefit payments are taxable and which are non-taxable and the annual amounts of each.

**Box 4.E: Common errors in calculating taxable social security income**

Enid's daughter helps her complete her SA return. She cannot find the letter from the DWP advising Enid about the payments to be made in the next tax year so she adds up all amounts paid into her mother's bank account by the DWP. This includes the annual Christmas bonus of £10, the fuel allowance of £200 (both of which are not taxable) plus 13 payments of 'pension'. She doesn't realise that the 'pension' payments include attendance allowance of £51.85 a week which is not taxable. As a consequence Enid pays over £580 too much tax.

**4.19** One of the suggestions from the interim report was that the final stage of the review would explore the feasibility of the DWP producing an annual P60 type statement (a DWP60) in line with other pension providers. This would set out clearly the income entitlement from the DWP in the tax year, showing totals of taxable and non-taxable income. This idea was well received by both committee members and pensioner groups we consulted with. Frontline staff at HMRC we spoke to also felt this would improve the accuracy of self assessment returns and would reduce the numbers of reassurance and clarification calls from pensioners. It would also enable people to understand better their P2 coding notices.

**4.20** The OTS asked the DWP to provide an estimate of the likely costs and benefits of producing a P60 type notice for pension and benefits which would go out with the annual mailing to pensioners. They estimated that this would have a substantial set up cost amounting to tens of millions of pounds, though it would be much less than operating PAYE on the State Pension.

**4.21** The DWP also raised the issue of a new communication to pensioners prompting many calls to helplines, simply because any new official communication will cause worry and confusion, however carefully the letter is worded. We understand the point but believe that any such surge would quickly tail off – and would also mean many fewer calls requesting details of income for tax returns and other issues.

**4.22** HMRC has similarly raised concerns about a new letter increasing reassurance calls particularly as around half of the 12 million state pensioners who would receive the mailing are not chargeable to income tax. Their preliminary estimates do not project an initial cost saving because in the short term calls from pensioners asking for clarification about their taxable income (now obviated by the DWP60) may be replaced by reassurance calls. HMRC was not able to provide an estimate of the longer term impact once the communication becomes routine.

#### **Box 4.F: OTS estimate of the cost of pensioners' time in calculating their State Pension and social security income**

The OTS has tried estimating the current costs to pensioners of having to understand and complete the calculation (excluding the time spent on calls to HMRC or other sources of support). There are approximately 2 million pensioners in self assessment and we estimate that understanding and executing the calculation (either through reading the guidance, consulting with friends, charities or HMRC) will take one hour on average. Using the NAO's estimate of the cost of a taxpayer's time<sup>7</sup> at 25 pence a minute this produces a cost of £15 each per pensioner. If we assume that 10 per cent struggle with the calculation this would produce a cost of £3 million, if 25 per cent struggle this rises to £7.5 million if nearer 50 per cent struggle we estimate that this would cost pensioners in SA £15 million in lost time.

**4.23** Overall, a DWP60 for State Pension/benefits would enable pensioners to assess their taxable income for a particular tax year simply and clearly. This could be done through a separate mailing to pensioners, but it would be better as an additional notice sent out alongside the annual uprating letter or, in line with many private pension providers, the statement could be printed on the reverse of the uprating letter so that both the previous and the following years' entitlements are sent out at the same time. This would also minimise postage costs and potential increased reassurance calls to the DWP or HMRC triggered by a "new" piece of communication.

**4.24** Another suggestion is to provide the statement online so that it could be accessed when required (rather than sent to all pensioners many of whom do not pay income tax). Although this idea does have merit and would be cheaper than a paper mailing, we have concerns about whether this method would reach all the pensioners who may benefit from it. That said, we would certainly welcome the statement also being available online for those who wish to access it there.

**4.25** Despite the likely costs and risks of implementation the OTS strongly feels that on balance the benefit to the wider pensioner population (approximately 12 million state pensioners) outweighs the costs and therefore recommends that the DWP works towards producing a DWP60 as part of the wider operational and IT changes necessary to support the introduction of the flat-rate State Pension in the next few years.

**4.26** We therefore recommend that the DWP issues an annual DWP60 statement for all pensioners each April setting out the total State Pension they were entitled to in the previous tax year, along with details of any benefits received, showing clearly taxable and non-taxable amounts. We recommend both HMRC and the DWP work with pensioner groups to ascertain the best route but our expectation is that the result would be sent out with the annual uprating letter.

**4.27** We are aware that the DWP is concerned about making significant changes to its computer systems whilst bedding in large scale changes such as Universal Credit. The OTS has therefore discussed possible interim solutions with HMRC and the DWP. These include work on providing better information in the accompanying notes to the annual letter (making it clearer which benefits are taxable). However, our consultations show that engagement with helpsheets and guidance materials is often inconsistent. Therefore, we feel that a generic list of taxable state

<sup>7</sup> [http://www.nao.org.uk/publications/1213/hmrc\\_customer\\_service.aspx](http://www.nao.org.uk/publications/1213/hmrc_customer_service.aspx)

benefits within the helpsheet will not provide the individual information that a full DWP60 will offer and that we believe is needed.

**4.28** Some of the issues raised would be resolved if HMRC was able to pre populate SA returns with the information they receive from the DWP on a pensioner's entitlements for a tax year. We would encourage HMRC to do an analysis of the costs and benefits of pre population as we feel it would be of benefit to pensioners. However, this would only be of benefit if the information used is accurate and we have been made aware of instances where HMRC has used inaccurate pension information when State Pension entitlements change.

**4.29** In making this recommendation we are aware that we are calling for spending by one government department in order to save money in another. We can see a risk that the recommendation will fail because departmental budgets are kept separate. However, we feel strongly that this is an issue that needs a practical demonstration of "joined-up government".

**4.30** As a final comment in this section, we would just return to the issue of pensioners who are drawn into self assessment simply to collect a small amount of tax on their state pension (paragraph 4.3 and Box 4.A). There is no obvious route to solve this issue, though we would naturally hope that HMRC keeps the issue of a suitable de minimis threshold under review. It is difficult for us to recommend a particular level for reasons of fairness to all taxpayers. But we think that the recommendations we have made about the DWP60 (and indeed our general recommendations about improving communications around the state pension) will at least help the Jills who are drawn into self assessment deal with their tax responsibilities.

## **C. Improving communications about how tax codes are applied**

**4.31** As they approach retirement, pensioners are often moving from simple to complex tax affairs. A key issue for them is the taxation of multiple sources of income (state, personal and occupational pensions for example). This is made more complex as the divide between retirement and employment is increasingly blurred with more people working part-time while drawing part or all of their pensions. An issue for many pensioners is receiving several tax codes. Often they do not realise that they will receive a different tax code for each source of income and may become anxious about a possible error when a second or third coding notice arrives. They may also mistakenly believe all new coding notices are replacements and discard previous notices.

**4.32** During the introduction and stabilisation of HMRC's National Insurance and PAYE service (NPS) in 2010-11 many pensioners received multiple tax code notices as previous errors were rectified. Although HMRC has made considerable progress in clearing its backlog of cases and sending more accurate codes, our consultations with pensioner groups and advisers indicate that for many it is not always clear whether a second or third tax code relates to the current tax year or how each code relates to each other.

**4.33** Our interim report suggested that we explore the provision of a single composite tax code notice which would outline the code for each source of income in PAYE. This would enable pensioners to check more easily that their tax affairs were correct and would reduce the anxiety of receiving multiple notices without a clear understanding of how they are connected. There would also be a benefit to non-pensioners with multiple sources of income who may also find it difficult to check that their tax code is correct.

**4.34** We therefore recommend that HMRC introduces a single composite PAYE coding notice (Form P2C) which would aggregate the various individual codes for each source of income in PAYE and provide a reconciliation to the personal allowance. This would provide explanation and reassurance, and make it easier to spot errors.

**4.35** We accept that this recommendation will incur costs and mean even more paper flowing to pensioners initially, as we assume that the P2C would supplement the continuing flow of P2s. However, the P2C could well replace many individual P2s, assuming that the P2C includes a running list of codes. Even without this possible replacement saving, it needs to be set against the current position: ineffective and even confusing communications, causing problems for all, including HMRC who have to field many calls to helplines.

**4.36** As a further point, an HMRC frontline staff member suggested that HMRC might colour code each year's coding notices, making it easier to see which coding notices relate to a particular year. We feel that a visual approach would be helpful to pensioners. It would also help advisers where they have to review many years' worth of tax codes. Some alternative means of identifying different years would need to be found for those with impaired vision and we therefore recommend that HMRC reviews alternative provision in these cases.

## **D. Wider improvements to communications**

**4.37** The OTS's interim report suggested that the final phase should explore how best to raise awareness of how the State Pension is taxed. The research<sup>8</sup> we commissioned highlighted low levels of awareness and understanding about tax codes and the personal allowance. Examples of comments made by pensioner respondents to the research are set out in Box 4.G below.

### **Box 4.G: Quotations from the OTS and HMRC commissioned research in relation to taxation of the State Pension and the personal allowance.**

"I didn't know. I thought (my State Pension) was tax free." **Female pre-pensioner from Northern Ireland**

" (£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 pensioner from the 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 pensioner from 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 pre-pensioner from the north of England**

**4.38** One of the successes of our pensioner review has been a drive across HMRC and the DWP to promote closer working between the departments in relation to communications with pensioners. HMRC customer teams are now engaged more closely with their DWP counterparts and we were pleased to see that this has been endorsed by the frontline HMRC team we visited who reported on the benefits of having a named contact and regular communications with their pensioner counterparts at the DWP. One of the benefits of this closer working initiative has been work on a new communications strategy for pensioners. HMRC has committed itself to working

<sup>8</sup> <http://www.hmrc.gov.uk/research/reports.htm>



with the DWP on a review of communications in its response to the interim report.<sup>9</sup> Further details are in Annex A.

**4.39** We recommend that the HMRC/DWP communications review (see Annex A) includes a review of communications about how the State Pension is taxed, and clearer information about how tax codes operate and which documents and figures pensioners need to be aware of.

**4.40** We endorse HMRC's communications work and some of our committee members have offered to help in shaping and testing the final communications produced. The timetable for this has been drawn up. The OTS would like to see improvements in pensioner awareness of their tax liabilities and how tax is applied, particularly in relation to the State Pension reviewed as a priority. In addition, given what we have learned from the research and our consultation with stakeholders, we suggest the following strands to any further work in this area:

- improvements to routine communications e.g. forms, annual notices; and
- provision of better education and support around the time of retirement.

## E. Improvements to routine communications

**4.41** The pensioner research and consultations with committee members have highlighted continuing problems with the layout and language used in forms and official communications from HMRC.

### Box 4.H: Quotation from the OTS and HMRC commissioned research in relation to communications from HMRC

"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 pensioner from the north of England**

**4.42** Although the department currently runs a programme of forms testing with pensioners we feel that more needs to be done. It remains important that this work continues and we suggest that this testing needs to be with those who are not knowledgeable about the system (e.g. those who were the target of our research project) and those used to dealing with pensioners who are having difficulties (e.g. members of our Consultative Committee).

**4.43** An issue raised by the OTS Consultative Committee was how the Government's digital strategy relates to pensioner communications and how best to manage the risks of digital exclusion. The existing evidence as reviewed in Chapter 3 shows that internet usage remains a complex issue across the pensioner population.

**4.44** Younger pensioners who are more likely to have used computers in their working lives are more likely to use the internet for leisure and to conduct financial transactions. However, older and less affluent groups are less likely to own a computer or use the internet to conduct transactions. Furthermore, research commissioned by the DWP<sup>10</sup> found that although three-quarters of pensioners they surveyed who used the internet said they buy goods and services online, two-thirds said they were not willing to pass on personal information over the internet. This may mean that even pensioners who transact online may be wary of doing so in a tax context.

<sup>9</sup> [http://www.hm-treasury.gov.uk/d/ots\\_hmrc\\_response\\_to\\_ots\\_pensioner\\_review\\_interim\\_report.pdf](http://www.hm-treasury.gov.uk/d/ots_hmrc_response_to_ots_pensioner_review_interim_report.pdf) Also see Annex A.3 for further information on HMRC and DWP's planned communications review.

<sup>10</sup> <http://statistics.dwp.gov.uk/asd/asd5/rports2009-2010/rrep703.pdf>



**4.45** This raises the issue of potential digital exclusion of groups within the pensioner population who may not have access to a computer and those who are reluctant to conduct transactions online. We would suggest that this is addressed as part of HMRC's review of communications and service delivery planning. It seems to us that pensioners will need non-digital methods for some time to come.

**4.46** The OTS endorses HMRC's move to handle the majority of calls from pensioners in one pensioner centre in Cardiff. This enables call handlers to build up expertise in dealing with pensioner queries and should improve the service offered.

**4.47** The transition into retirement is a key life event which may span several years and one which many pensioners manage with little official guidance. **We recommend that HMRC and DWP review of communications considers providing a pack which makes clear the key areas of tax pensioners will need to become familiar with; tax codes, personal allowances and taxation of different sources of income.** Any pack should also include information on their key entitlements (such as reclaiming tax on savings interest where appropriate, national insurance and allowances) and their liabilities and responsibilities (the taxation of the State Pension, the importance of checking tax codes, notifying HMRC of changes in circumstances).

## **F. Form R85 simplifications – getting your interest without tax taken off**

**4.48** The R85 form<sup>11</sup> enables non-taxpayers to have the interest on their savings paid gross rather than after the 20 per cent basic rate is deducted. Our review has found that the rules are not applied consistently correctly, and that many do not use the R85 and so may have tax deducted unnecessarily.

**4.49** Where tax has been deducted unnecessarily an R40 form can be completed to reclaim the tax paid on interest (or to apply the 10 per cent savings rate). Pensioners questioned during the OTS and HMRC research found the R40 process off-putting, so improving the R85 process would reduce the numbers needing to reclaim tax.

**4.50** The helpsheet<sup>12</sup> which goes with the R85 form provides a step by step calculation of a person's tax liability to help them determine their eligibility – this can be both time consuming and confusing, leading to mistakes both in terms of wrongful claims and missed opportunities. The need to carry out an annual review of the taxpayer's affairs is not made clear to claimants. This is particularly important to those whose income may fluctuate around their personal allowance.

**4.51** The Form R85 itself makes it clear that those completing it must have read the helpsheet before completing the form, to make sure they are eligible to do so.<sup>13</sup> The research carried out by HMRC and the OTS found that pensioners were confused by having two separate papers – if the helpsheet is necessary to complete the form, why not have it all as one form?

**4.52** In January 2013, the Low Incomes Tax Reform Group<sup>14</sup> (LITRG) reported on a "mystery shopping" exercise into obtaining Form R85 from banks and building societies. The exercise (though limited by a small sample) found that deposit-takers performed poorly in terms of giving out both the R85 and its helpsheet together. In fact, only on 5 out of 52 occasions did their mystery shoppers successfully obtain both the R85 and an up-to-date helpsheet together.

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<sup>11</sup> <http://www.hmrc.gov.uk/forms/r85.pdf>

<sup>12</sup> <http://www.hmrc.gov.uk/helpsheets/r85-helpsheet.pdf>

<sup>13</sup> Form R85 opens with the statement "To check whether you are entitled to receive interest without tax being taken off, you must read R85 Helpsheets for the current tax year first."

<sup>14</sup> [http://www.litr.org.uk/reports/R85\\_report\\_Jan2013](http://www.litr.org.uk/reports/R85_report_Jan2013)

Despite the limited sample this exercise does indicate that practice varies between and within institutions. In order to ensure greater consistency we would suggest that the helpsheet should be an integral part of the form, to ensure that individuals receive the full and correct guidance. **We therefore recommend that HMRC redesigns the Form R85 and helpsheet to take into account the findings of the LITRG research and make it more usable for taxpayers. HMRC should also see how it can liaise better with banks and building societies to ensure that taxpayers receive the correct information and advice on registering for gross interest.**<sup>15</sup>

**4.53** Guidance needs to be better about completing an R85 for one account whilst having tax deducted from another if the taxpayer is on the margin of being in the tax net. As it stands, individuals should only complete the R85 if they are non-taxpayers. They should not complete it if only some of their savings income falls into their personal allowance. Some taxpayers on the margin of being in the tax net have multiple savings accounts. The legislation can be interpreted as saying that an R85 can be completed for one (or more) accounts and not for others, the criteria being that the income should still be under the tax threshold. Some taxpayers follow this route. HMRC is clear that the R85 is an “all or nothing”: that individuals should only complete the R85 if they are non-taxpayers. They should not complete it if only some of their savings income falls into their personal allowance. We think there is merit in both routes: the “R85 for some” helps taxpayers’ cash flow; the “all or none” is simpler. What is needed is clear guidance that sets out the preferred route, and ensuring that consistent messages are given out.

**4.54** A risk of giving out more information about how to get income paid without tax deducted is encouraging more claims from people who are ineligible. However, redesigning the R85 to include the helpsheet as an integral part of the form should minimise this, as it ought to ensure that individuals understand they should only complete the form if they are a non-taxpayer. Currently incorrect use of the R85 would be treated as a compliance issue but we would suggest that the penalty regime be reviewed to explore how best to manage compliance issues whilst encouraging take up of the R85 process.

**4.55** Finally, HMRC is now developing its future strategy for communicating with taxpayers, much of which will be “Digital by Default”.<sup>16</sup> Part of future communications will include ‘personal tax statements’ for individuals<sup>17</sup> and online accounts for people to communicate personal tax changes to HMRC. In order for these statements to give a comprehensive view of individuals’ tax situations; we suggest that taxable savings income and tax deducted must be included.

**4.56** We also suggest that HMRC should consider how savings income information will be gathered and included in future communications with individuals about their overall tax position, and how this might improve the R85 process in future. Increased automation of the process ought, in theory, to be possible if best use is made of the future capability to reconcile data to individuals’ accounts. This is also in line with the findings of the LITRG report.

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<sup>15</sup> LITRG has produced a report on a small study into how banks manage the R85 process. Their “mystery shopping exercise” found evidence of poor understanding of the R85 process from bank and building society staff and often scant information on deposit-takers’ websites. For further information on the exercise see [http://www.litrg.org.uk/reports/R85\\_report\\_Jan2013](http://www.litrg.org.uk/reports/R85_report_Jan2013)

<sup>16</sup> <http://www.hmrc.gov.uk/about/2012-digital-strategy.pdf>

<sup>17</sup> ‘See Budget 2012. “...the Government will: ... provide from 2014–15, a new Personal Tax Statement for around 20 million taxpayers. This will detail the income tax and National Insurance contributions (NICs) they have paid, their average tax rates, and how this contributes to public spending; ...” [http://cdn.hm-treasury.gov.uk/budget2012\\_complete.pdf](http://cdn.hm-treasury.gov.uk/budget2012_complete.pdf)

## **G. Form R40 simplifications – claim for repayment of tax deducted from savings and investments**

**4.57** The R40 form<sup>18</sup> is completed to reclaim tax applied to savings interest and other situations where tax has been over deducted. It was identified as complex in the interim report and the OTS and HMRC commissioned research found it off-putting to the pensioners in the sample. The form asks for the claimant to assess their income and therefore there are many sections, some of which relate to very few pensioners e.g. trust and settlement income. This can be confusing to the pensioner taxpayer population who may attempt to put information in all sections.

**4.58** The OTS subcommittee reviewing HMRC administration found strong levels of support for an online version of the R40. This should be a smart form like the SA return which, by asking questions about types of income, guides the taxpayer to relevant sections and makes it easier for people to skip sections of income which are not relevant. Where a taxpayer is registered for self assessment, submission of a tax return generates an automatic repayment and they will not need to submit an R40.

**4.59** We recommend that as part of the Government’s “Digital by Default” strategy, HMRC should provide the facility for people in PAYE to submit the R40 form electronically. The paper R40 should also be revised with clearer headings and explanations and should be tested with pensioner groups.

**4.60** We acknowledge that HMRC has concerns about fraud risks if the R40 is made available for online submission. However, the efficiency gain is considerable and the online R40 needs to be pushed forward.

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<sup>18</sup> [www.hmrc.gov.uk/forms/r40.PDF](http://www.hmrc.gov.uk/forms/r40.PDF)



# 5

## Policy recommendations

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**5.1** The interim report highlighted a range of legislative complexities for further exploration. As mentioned in Chapter 3, there are a number of fundamental changes taking place in the way the state supports its citizens at vulnerable times of their lives, the most significant changes being the introduction of Universal Credit, Personal Independence Payments and the flat-rate State Pension.

**5.2** Another major policy initiative of the present Government has been the increase in personal allowances as mentioned in Chapter 3. This coupled with previous above inflation increases in the age allowance (though frozen in Budget 2012) and the popularity of tax free savings such as Individual Savings Accounts (ISAs) have reduced many pensioners' income and savings tax liabilities. One consequence is to limit the effectiveness of allowances such as the 10 per cent savings rate, the blind person's allowance and the married couple's allowance.

**5.3** Our interim report highlighted a number of complex allowances and reliefs for further review. The allowances and reliefs discussed in this chapter are often poorly targeted and complex and in many cases do not benefit the most vulnerable. Where we propose the removal of such allowances and reliefs it is both to simplify the legislation and to allow the savings made to be invested in improvements to improve the process for all pensioners – see Chapter 4 for our administrative recommendations.

**5.4** As highlighted in the Executive Summary, no further review has been made of the age allowance proposals in this report as the Chancellor has already decided to freeze, and eventually abolish, the separate allowances consequent upon the announced increases in general personal allowances. As this should eventually achieve simplification the OTS has concentrated on the other policy areas in the interim report.

**5.5** In summary, the key legislative areas for consideration in the final phase of the review are as follows:

- married couple's allowance;
- blind person's allowance;
- 10 per cent savings rate; and
- MIRAS (Mortgage Interest Relief At Source).

### A. Married couple's allowance

**5.6** This allowance was highlighted by the interim report as one which is highly complex and is only retained for a diminishing group of older taxpayers. The interim report noted that this was a legacy of pre-independent taxation (derived from the wife's earnings election) and it reduced in value throughout the 1990s, with the rate it was given at reducing from 20 per cent to 15 per cent then to 10 per cent. Married couple's allowance was abolished for all non-pensioner couples

in 1999; they were in part compensated through changes to the tax credit and benefits system. The allowance was retained for pensioners only and since 6 April 2000 is only now available to those born before April 1935, therefore the youngest recipients are now in their 78<sup>th</sup> year.<sup>1</sup>

**5.7** The interim report highlighted a range of complexities surrounding the allowance but the main ones relate to the system of abatement where the allowance is reduced by £1 for every £2 the income is over £25,400 after first calculating any abatement of the age related allowance (for the 2012-13 tax year). The other key complexity is that the allowance is given at 10 per cent rather than the basic rate of tax and for higher rate taxpayers and those on middle to high incomes the withdrawal taper or abatement applies. This produces a reduction of the pensioner's tax liability rather than a deduction from income and as such it has further complications – or confusion – compared with those given as allowances against income. It also means it only has value for pensioners with enough income to generate a tax liability.

#### **Box 5.A: Married couple's allowance worked example**

Bertram is a married pensioner. He has a small occupational pension of £100 per month and savings income of £400 a year paid gross as well as his state retirement pension of £8,936. Bertram's personal allowance is £10,660 because he is 80. Bertram's total income is £10,536, which is less than his personal allowance. His wife is a non-taxpayer.

Consequently, the additional married couple's allowance available of £7,705 which is given as a tax credit of £770.50 has no value or benefit, as no tax has been paid.

**5.8** If the allowance is to be given as a deduction against income, there is some logic in it generating a repayment for people such as Bertram in the example, but there is no provision for a repayment in the legislation.

**5.9** The interim report also highlighted some peculiarities in the system, including a divide between couples who married before and after 5 December 2005. Couples married before this date have the allowance paid to the husband; if they married or entered into a civil partnership on or after this date they can elect to have it paid to the higher earner as the allowance is transferable between spouses. Consequently the allowance is challenging to claim, and the system of abatements and obscure rules make it confusing to calculate and understand. It is a prime source of confusion and error in tax codes.

**5.10** Due to the claimant criteria the numbers claiming it are inevitably falling each year. The maximum value is £770.50 and the minimum is £296.00 (from £14.81 down to £5.69 per week). HMRC's internal analysis<sup>2</sup> estimates that the number of claims has been falling steadily and is likely to be no more than 500,000 with an average claim of £575 a year. The allowance is projected to cost £290 million in 2014-15.

**5.11** We conclude that married couple's allowance is overly complex, lacks a clear current policy rationale and is unfair to pensioners under 78 and non pensioners of any age. **Logic and simplification would suggest that the allowance should be abolished and equivalent support given to relevant older pensioners through alternative methods such as pensions credit instead. That might be achieved through a sunset clause which would set a definite date in the future e.g. Finance Bill 2018 for its abolition and the removal of all legislation.**

<sup>1</sup> Though as the allowance is transferable between spouses a partner of any age could receive the allowance.

<sup>2</sup> The information provided by HMRC for this costing for 2014-15 is based on 2009-10 Survey of Personal Incomes using economic assumptions consistent with the OBR's March 2012 economic and fiscal outlook.

**5.12** Against this, there is the argument that the married couple's allowance for all its complexity, is at least well-established and reasonably well understood (in principle, if not in detail). It also has something of a built in sunset clause in that it only applies to those born before 6 April 1935.<sup>3</sup>

**5.13** Because of this, we conclude that it would be difficult to abolish the allowance. Instead, **the OTS recommends simplifying the married couple's allowance by turning the allowance into what it really is – a deduction against tax bills. The current value is a maximum of £770.50 so we would suggest an amount similar to this.**

**5.14** Giving a flat allowance in this way would clearly benefit a few wealthier pensioner couples who currently receive a rebated allowance (possibly the minimum £296) but the payback for the Government would be in terms of much simpler administration.

**5.15** The allowance should also be made freely transferable between couples, eliminating the oddities around marriages and civil partnerships referred to above.

**5.16** We have considered whether the allowance should be made into a repayable credit. That would clearly add considerably to the cost (though the cost could be managed by reducing the amount of course). It also would add administrative complexity as many more couples would be drawn into making tax reclaims. Although it may be possible for pensioners in PAYE to have a refund generated through the reconciliation process. We therefore simply note it as a possibility but do not recommend it.

## **B. 10 per cent savings rate**

**5.17** The 10 per cent savings rate was highlighted as an area of complexity by the interim report. The savings rate offers a band of up to £2,710 savings interest a year which can be taxed at 10 per cent rather than the basic 20 per cent. The amount of the £2,710 rate available at 10 per cent is reduced by £1 for every pound of income earned above the personal allowance. This rate was left on the statute after the removal of the 10 per cent income tax starting rate in 2008 and the explanatory document said this was "to continue to encourage savings".

**5.18** It is available to all taxpayers who are eligible under the income limit although as the limit for income is fairly low at current interest rate levels it appears to benefit people with low levels of earned income and high levels of savings (given low current interest rates, any meaningful benefit from the 10 per cent rate would have to be underpinned by significant amounts of capital).

**5.19** The rationale for the tax treatment of this group of savers is unclear as taxpayers on low incomes are able to use their Individual Savings Account (ISA) or their personal allowance to reduce the tax paid on savings. An extra band of lower tax on savings appears to incentivise only the very wealthy with modest earned income but large sums of savings income.

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<sup>3</sup> Though as the allowance is transferable between spouses a partner of any age could receive the allowance.

### Box 5.B: An example of the 10 per cent savings rate

Fernando has earnings from employment of £7,000 and savings income of £4,000 as well as his pension of £5,587. Fernando's personal allowance is £10,500 because he is 70. Fernando's taxable income is £6,087. The calculation below shows how this is worked out.

Total income £16,587  
Less personal allowance £10,500  
Taxable income £6,087

Fernando's personal allowance is first used against his earnings of £7,000 and pension of £5,587 so only £2,087 (£12,587 - £10,500) is taxable. The rest of the starting rate limit for savings (£2,710 - £2,087 = £623) can be used against savings income. The calculation below shows how this is worked out. Fernando's earnings are taxable before his savings income.

Earnings £2,087 x 20% = £417.40  
Savings £623 x 10% = £62.30  
Savings £3,377 (£4,000 - 623) x 20% = £675.40  
Total tax = £1,155.10

Fernando's employer has deducted £416.20 income tax from his earnings through Pay as You Earn with a manual payroll (and using Table A, etc). Fernando's bank will have taken tax off all of his interest at 20 per cent so they will have taken off £800 (£4,000 x 20% = £800). So Fernando has paid a total of £1,216.20 tax at source (£416.20 + £800). But Fernando is only due to pay £1,155.10 tax. This means he can claim a repayment of tax from HM Revenue & Customs of £61.10 (£1,216.20 - £1,155.10).

**5.20** The 10 per cent savings rate can be claimed in two ways:

- either through the SA system which will automatically claim the rate on a taxpayer's behalf via their tax assessment. Many of those who benefit from the rate may be unaware that they receive it; and
- those in PAYE must first become aware of the rate, understand how to calculate and estimate their likely claim and submit an R40 form to reclaim the 10 per cent rate. HM Revenue & Customs' (HMRC) internal analysis estimates that very few people in PAYE access the 10 per cent savings rate, creating significant unfairness.

**5.21** In order to explore the complexity of the rate and how easily it is understood by pensioners OTS and HMRC research tested a simplified example of the concept.<sup>4</sup> The pensioners in our research sample found it extremely difficult to understand and struggled to assess their eligibility as these quotations demonstrate.

<sup>4</sup> <http://www.hmrc.gov.uk/research/reports.htm>



**Box 5.C: A sample of pensioner responses to 10 per cent savings rate from the OTS and HMRC commissioned research:**

"I don't entirely understand the 10 per cent 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 pensioner from the south of England**

"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." **Female pre-pensioner from the north of England**

**5.22** Many of the pensioners did not understand interest from savings as 'income' so struggled to understand the eligibility criteria. Many pensioners in our research sample struggled with who would have enough savings to generate the levels of savings income discussed while having such a low income. In the research, even with a very simplified example, this caused considerable exasperation. Given the levels of confusion and the low level of take up, we would argue that this rate is not an effective incentive to save.

**5.23** One interim solution would be to mount a further publicity campaign to encourage those eligible for the rate to claim; this could be targeted through analysis of HMRC data to identify those with earnings around the level of the personal allowance. However, this would be a significant burden for HMRC for little real impact and wider advertising campaigns are likely to generate as much confusion as solution, given the involved nature of eligibility of the rate. We do not think this would be cost-effective and in any event does not really pass our simplification aim.

**5.24** We feel that any savings incentives should be focused around Individual Savings Accounts (ISAs) as they have high levels of brand recognition and awareness and are already in place. We would advise against any changes to the savings tax regime which involve complicated eligibility calculations or a reclaim process both of which are key barriers to take up of the 10 per cent savings rate.

**5.25** The OTS therefore recommends that the 10 per cent savings rate is removed, as awareness and claim levels are so low that it is ineffective in incentivising savings. Money saved could be used to make a pragmatic above-inflation increase in the ISA limit.

**5.26** The OTS recognises that this recommendation affects people outside the remit of this review which is focused on pensioners. However, we cannot see that our conclusions are likely to be altered by a study of wider age groups: the evidence we have seen from our researches is likely to be replicated for other age groups. We think our recommendation is therefore valid as something that will simplify the system for all taxpayers.

**5.27** HMRC estimates<sup>5</sup> that there are 525,000 current recipients of the 10 per cent savings rate. The rate is estimated to cost approximately £50 million with an average claim of £90 a year. The current maximum rebate claimable under the 10 per cent rate is £271.00 (10 per cent of the £2,710 rate.) HMRC estimates that the rate will cost £50 million in 2014-15.

**5.28** Removing the 10 per cent savings rate would be a significant simplification, but would not be revenue neutral. There are a number of options the Government could consider if it wanted

<sup>5</sup> The information provided by HMRC for this costing for 2014-15 is based on 2009-10 Survey of Personal Incomes using economic assumptions consistent with the OBR's March 2012 economic and fiscal outlook.

to make a broadly cost neutral change. As noted above, one suggestion would be to introduce a one-off increase in the ISA allowance for pensioners, to allow them to move savings that would otherwise be taxed at 20 per cent into a tax free vehicle. The one-off increase in the ISA limit could be calculated to give a tax saving roughly equal to the tax raised by abolishing the 10 per cent savings rate. However, as the current rate is open to all taxpayers a one off increase for pensioners only would be unfair to other taxpayers who would lose the rate and would cause considerable complexity for HMRC, banks and savers in what is currently a simple savings product. Therefore a general increase in the ISA allowance for all savers would be a simple and effective way to compensate savers who lose the 10 per cent rate.

## C. Blind person's allowance

**5.29** The OTS's review of tax reliefs<sup>6</sup> considered the blind person's allowance. Our conclusion at the time was that it was poorly targeted, had patchy take up and was ineffective as a fair way of helping blind or severely sight impaired people. We recommended that the allowance should be abolished and the monies potentially available by way of tax relief (were all to claim it) used to give direct grants to blind/severely sight impaired people.

**5.30** Our recommendation was not followed by the Government. As we explained in our interim pensioner report, we felt we had to re-examine this allowance as it was something that was regularly cited to us as a source of complexity and confusion.

**5.31** This allowance is not pensioner-specific but has been included in the review as the incidence of sight loss increases with age, and it affects many pensioners. The allowance was introduced as a late amendment to the 1961 Finance Bill and was intended to help blind people in work who were considered to have a reduced earning capability compared to sighted people.

**5.32** As blind person's allowance is a tax allowance rather than a benefit, it is effectively restricted to those with income above their personal allowance rather than those on the lowest incomes. On average, people registered blind have very modest incomes, and often struggle to access employment opportunities. Pensioners who were blind during their working life may not have been able to build up a private or occupational pension, and often their only taxable income is the state retirement pension, topped up by non-taxable benefits, such as pension credit. If the aim of the allowance is to recognise the additional demands being blind places on them over and above many other disabilities then the current allowance appears poorly targeted. It is worth noting that a substantial proportion of people with visual impairment also experience a number of other disabilities as identified by the NHS report on the Registered Blind and Partially Sighted People.<sup>7</sup>

**5.33** We spoke to several charities for blind and partially sighted people about the complexity of claiming the allowance. The current system in England and Wales<sup>8</sup> means that a blind person needs to be initially certified as blind through their hospital consultant, then the hospital informs their local authority and once registered and in receipt of official evidence they can then contact HMRC to claim the allowance. Registration is also a passport to other forms of local authority support. Although the blind person's allowance claim itself can be started by phone; charities for blind people have indicated that the process of registration can be a barrier to take up.

**5.34** There are approximately 180,000 people registered blind according to RNIB and HMRC data. Despite the efforts of RNIB and other similar groups, the take up of blind person's

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<sup>6</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)

<sup>7</sup> <http://www.ic.nhs.uk/pubs/blindpartiallysighted11>

<sup>8</sup> The eligibility criteria are different in Scotland and Northern Ireland where the criteria include being unable to perform any work for which eyesight is essential see <https://www.gov.uk/blind-persons-allowance/overview>

allowance remains patchy. Based on internal HMRC figures<sup>9</sup> on the current level of claimants there are approximately 37,000 blind person's allowance claimants, of which 27,000 are pensioners. This leaves 143,000 people who are registered blind but not receiving any support from the allowance.

**5.35** The allowance is currently £2,100 and is estimated to cost the Exchequer £15 million in 2014-15. The average claim is worth £440 a year. The allowance can be transferred to a (non-blind) spouse; a couple where both are registered as blind can receive two allowances.

**5.36** The blind person's allowance (BPA) is currently £2,100, and if it was replaced by a grant (recognising that most recipients of the allowance have tax rates of 0 per cent and 20 per cent) the only group significantly disadvantaged would be higher rate taxpayers, who are likely to be few in number. It is currently worth £840 to higher rate taxpayers, but nothing to non taxpayers.

#### **Box 5.D: Blind person's allowance worked examples**

Agnes is single and registered blind. She has a small occupational pension of £250 per month and savings income of £1,800 paid gross as well as her state retirement pension of £5,587. Agnes's personal allowance is £10,500 because she is 70. Agnes's total income is £10,387, which is less than her personal allowance.

Consequently, the additional allowance available of £2,100 as a blind person has no value or benefit.

Algernon is 58, and registered blind with his local authority. He has an annual salary of £12,000. So taking the personal allowance of £8,105, and adding the blind person's allowance of £2,100, he only needs to pay tax on £1,795 (£12,000 less the sum of £8,105 and £2,100).

**5.37** The Government's introduction of Personal Independence Payments (PIP's) in April 2013 will replace Disability Living Allowance and target help at people who need additional support due to illness or disability. These payments are based on the level of need rather than targeted at particular illnesses or disabilities so the Department for Work and Pensions (DWP) is unlikely to be able to administer a benefit for blind people through this scheme.

**5.38** The OTS remains of the view that the blind person's allowance is ineffective in helping the general population of blind people and that it would be better if it were abolished and the funds potentially available for tax relief used to provide direct grants and support to blind people. It has also been suggested that this could involve grants to buy equipment to enable younger blind people to enter employment or increased support to access digital government services.

**5.39** If the abolition/grant route is not taken up, **we recommend that the process of claiming the allowance needs to be simplified.** There needs to be a one off exercise to contact all those registered as blind/severely sight impaired and ensure they are aware of the allowance and encouraged to claim it if they have sufficient income. This would be a good example of 'joined-up government' in action. Going forward, **we agree with RNIB's proposal that a medical diagnosis of blindness should trigger an automatic notification to local authorities and HMRC.** This could be administered through the electronic certification of visual impairment (ECVI)

<sup>9</sup> The information provided by HMRC for this costing for 2014-15 is based on 2009-10 Survey of Personal Incomes using economic assumptions consistent with the OBR's March 2012 economic and fiscal outlook.

system which has been developed by Moorfields Eye Hospital.<sup>10</sup> After notification the onus should be on HMRC to help the newly-blind person by giving all necessary assistance to ensure they have the tax relief if they have the income. This would include ensuring claimants explore the possibility of their spouse/civil partner making use of the allowance.

## D. Mortgage Interest Relief at Source scheme (MIRAS)

**5.40** Tax legislation relating to mortgage interest relief was introduced in 1969. The OTS interim report on pensioner taxation highlighted the complex MIRAS legislation, which was retained when the remainder of tax relief on interest was abolished in 1988.

**5.41** MIRAS relief was abolished for most people in April 2000 but an obscure relief remains for pensioners who took out a loan to purchase a life annuity before 1999. Relief for new loans to purchase a life annuity (normally referred to as home income plans) was withdrawn from 9 March 1999. Existing plans at that time continue to qualify for relief. This means that the youngest recipients will currently be 79. The rationale for its retention is that a pensioner who had already taken out a life annuity when the rules changed could not reverse this decision so without this protection could end up having used up some of the value of their home while receiving little or even no benefit from this. The end of MIRAS in effect meant the end of this type of scheme.

**5.42** Although some taxpayers still benefit, it does seem that their continuing benefit is something of an anomaly. Arguably they have had some 14 years' additional benefit compared with those buying houses.

**5.43** According to HMRC's figures, the numbers of claims are declining year by year. The latest figures from HMRC show that £2.25 million of relief was paid in 2003-04 and this had fallen to £424,000 in 2011-12. Additionally, the value of the benefit is restricted by statute, and with the best rates charged typically at around no more than 5.9 per cent given the Bank of England base rate of 0.5 per cent, it is worth little more than £354 per year (£6.80 per week). Based on the maximum loan limit of £30,000.00 and assuming (based on the highest current rates charged) interest at 7.6 per cent, it is worth a maximum of £456.00 p.a., or £8.76 per week. Most claimants probably receive a much smaller tax subsidy.

**5.44** OTS research suggests that there is little administrative burden in maintaining the relief simply because it is well-established. In fact the OTS has had difficulty in locating anyone who benefits and indeed anyone in banking, or the tax advisory profession, who knows of the relief.

**5.45** Abolishing this allowance would allow the final repeal of considerable amounts of legislation dealing with MIRAS. **The OTS therefore recommends that it is abolished, either through immediate removal (presumably from April 2014) or that a sunset clause is added ending the relief and thus removing this relief and all remaining MIRAS legislation at a specified point in time e.g. 2017.**

**5.46** Consultation prior to abolition should seek out more information on who actually benefits from the relief and whether a pragmatic one-off adjustment to interest amounts could be given to offer compensation for the loss of the relief.

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<sup>10</sup> <http://ecvi.moorfields.nhs.uk/>

# A Interim report – priorities and suggestions

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This section includes:

**A.1** A table detailing the list of areas for further investigation and suggestions for short-term improvements from the OTS interim report, including formal HMRC response.

**A.2** HMRC and DWP's update paper on their communication strategy.

**Table A.1 – Priorities list and suggestions for short term improvements from the interim report with HMRC’s revised formal responses from January 2013.**

Issue	Priority rating for second stage of the OTS pensioner review		Suggestions for short term improvements or matters to consider immediately	HMRC Response
	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.	HMRC does not hold enough information about PAYE customers’ incomes (e.g. interest they receive on investments) to accurately identify people who are eligible for age-related allowances. The alternative would be to write to all customers but as many would not be entitled, HMRC believes this would cause unnecessary concern and confusion.
<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.	
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.	The notes on MCA have been reviewed with input from OTS consultative committee members. IT change timescales mean HMRC will introduce the revised notes by the end of 2012. This will ensure that all P2 notes are updated prior to next year’s annual recoding exercise.

Issue	Priority rating for second stage of the OTS pensioner review		Suggestions for short term improvements or matters to consider immediately	HMRC Response
	Policy reform/ legislative change	Administrative		
<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 per cent 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			

Issue	Priority rating for second stage of the OTS pensioner review		Suggestions for short term improvements or matters to consider immediately	HMRC Response
	Policy reform/ legislative change	Administrative		
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.	HMRC is working with DWP to provide joined-up information for bereaved customers and pensioners. Revised information on taxation, including the R85, will be introduced in an updated booklet which will carry the same title and a reference code DWP 011. This booklet should be available from December 2012. It will be available online and printed copies can be requested from DWP.
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	HMRC Response
	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.	<p>DWP and HMRC has introduced a new data feed process which electronically transfers details of all new State pension claims and updates the record automatically with the amount in payment. This is designed to reduce the number of requests for information issued to customers and allows updates to tax codes to be made more quickly and accurately.</p> <p>The data feed also provides details of any amendments to the amount of State pension a customer receives and the uprated amounts each year.</p> <p>Receiving this information during the year and applying the changes automatically to tax codes should negate the need for final review after the end of the year.</p>
F.2 PAYE and the state pension	High			
F.3 Information from the DWP about the state pension – considering a 'P60 Benefits'		High		

Issue	Priority rating for second stage of the OTS pensioner review		Suggestions for short term improvements or matters to consider immediately	HMRC Response
	Policy reform/ legislative change	Administrative		
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.	HMRC is actively reviewing the way in which it communicates with those approaching retirement age. In particular, HMRC is simplifying guidance and liaising with DWP to identify the most appropriate channels for delivering this guidance.
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'.	A separate report 'Review of HMRC & DWP tax-related communications for pensioners' is attached

Issue	Priority rating for second stage of the OTS pensioner review		Suggestions for short term improvements or matters to consider immediately	HMRC Response
	Policy reform/ legislative change	Administrative		
<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.	<p>HMRC has a project to improve the R43 form and guidance and will take on board these comments. An April 2013 update is planned.</p> <p>HMRC is also reviewing the P53 form which customers use to claim a tax repayment following trivial commutation.</p> <p>This will improve the quality of guidance HMRC gives to pension scheme members, redesign the form and simplify the associated process for claiming repayment.</p> <p>On 16 November draft legislative changes for comment were published in respect of 'Tax code applied to certain commuted pension payments from registered pension schemes', There is an 11 January closing date for comments.</p>
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.	On 16 November draft legislative changes for comment were published in respect of 'Tax code applied to certain commuted pension payments from registered pension schemes', There is an 11 January closing date for comments.

Issue	Priority rating for second stage of the OTS pensioner review		Suggestions for short term improvements or matters to consider immediately	HMRC Response
	Policy reform/ legislative change	Administrative		
<b>I. Overseas pensions paid to UK resident pensioners</b>				
I.1 The 10 per cent 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.	<p>Since the interim report was published HMRC and OTS have discussed this in more detail and agreed that the information on exchange rate fluctuations is an area outside of HMRC's control.</p> <p>HMRC's review of communications and guidance will include the remaining issues.</p>
<b>J. Collecting tax – PAYE</b>				
J.1 Eliminate any errors remaining in NPS		High		<ul style="list-style-type: none"> <li>• HMRC is on track to clear all PAYE arrears by the end of 2012-13.</li> <li>• On the basis of the information HMRC holds, tax codes are now over 98 per cent accurate.</li> <li>• PAYE gets things right in year for 85 per cent of customers.</li> <li>• The DWP State pension data feed and the information supplied from employers and pension providers, especially with the introduction of Real Time Information (RTI), will mean that HMRC gets more recent and accurate information on which to base tax codes.</li> </ul>

Issue	Priority rating for second stage of the OTS pensioner review		Suggestions for short term improvements or matters to consider immediately	HMRC Response
	Policy reform/ legislative change	Administrative		
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.	HMRC will continue to review the P2 process generally to identify and review improvements.  HMRC's intention is to carry out a cost/benefit analysis in 2013 to assess the viability of the introduction of a 'statement' to replace multiple P2 Coding Notices.
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.	The DWP State pension data feed and the information supplied from employers and pension providers will mean that we get more timely and accurate data on which to base tax codes.  The automated state pension data feed includes a daily update to HMRC of amounts paid to new state pension recipients and changes to amounts in payment by DWP. DWP also send an annual file of the following year's amount for each recipient of state pension to enable an accurate tax code to be calculated for the next tax year. Both the daily and annual updates will trigger automated tax code calculations.  The introduction of RTI provides an opportunity to build on this in the future.

Issue	Priority rating for second stage of the OTS pensioner review		Suggestions for short term improvements or matters to consider immediately	HMRC Response
	Policy reform/ legislative change	Administrative		
				The PAYE Regulations have been amended to provide for RTI, and occupational pension payers will have to deduct PAYE under RTI in the same way that they do now.
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'.	<ul style="list-style-type: none"> <li>• HMRC continues to look at potential changes to the process.</li> <li>• HMRC are considering changes to the P800 form. The changes based on feedback from customers are designed to present information in a clearer, more simpler way.</li> <li>• This year HMRC started the reconciliation process for the tax year ended April 2012 two months earlier than previous years so that many customers will get their money back quicker. This also provides certainty sooner for those who have additional tax to pay.</li> <li>• Where tax is underpaid, HMRC usually recovers the underpayment automatically in 12 monthly instalments over the subsequent tax year through the customer's annual tax code. Where this causes financial difficulty, people may be able to spread the payments over a longer period (up to 3 years).</li> </ul>

Issue	Priority rating for second stage of the OTS pensioner review		Suggestions for short term improvements or matters to consider immediately	HMRC Response
	Policy reform/ legislative change	Administrative		
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.	HMRC does not have the data necessary to carry out this review.
J.7 Determining pensioners' PAYE codes and form P161		High		HMRC has recently reviewed the purpose of the form P161 and changed this into an Age Allowance request, as HMRC now receives information about State pension and occupational pension from elsewhere. The new version of the form was developed in consultation with customers and is now available.
<b>K. Collecting tax – self assessment</b>				
K.1 Self assessment – operational improvements		High		HMRC wants to try to ensure that Self Assessment (SA) only includes customers who need to be in it and that the SA criteria remain relevant and up to date. This year, under a new initiative, HMRC has invited people who don't think they should be in SA to contact them – as a result, over 330,000 customers have been taken out of SA.  The pre-population of SA returns is something HMRC is interested in exploring. Further analysis of the costs and benefits is required.

Issue	Priority rating for second stage of the OTS pensioner review		Suggestions for short term improvements or matters to consider immediately	HMRC Response
	Policy reform/ legislative change	Administrative		
<b>L. Support for bereaved taxpayers</b>				
L. Support for bereaved taxpayers		Low (but we endorse ongoing work).		<p>HMRC has worked closely with tax agents, tax charities and listened to customers to introduce a series of improvements to enhance customers' end-to-end experience of dealing with HMRC. The improvements include:</p> <ul style="list-style-type: none"> <li>• a priority telephone service for bereaved customers</li> <li>• a single Post Office Box address for people on PAYE and SA matters relating</li> <li>• a dedicated team which is responsible for processing the main form which customers use to finalise a person's estate to bereavement</li> <li>• a redesigned bereavement form with supporting notes which is easier for customers</li> <li>• updated standard letters for customers following bereavement with improved style, tone and clarity</li> <li>• an online bereavement guide so customers can now answer a series of questions relating to the person who has died and receive tailored information about what they have to do</li> </ul>



Issue	Priority rating for second stage of the OTS pensioner review		Suggestions for short term improvements or matters to consider immediately	HMRC Response
	Policy reform/ legislative change	Administrative		
				<ul style="list-style-type: none"> <li>an improved process to speed up the agent authorisation process</li> <li>early (in year) settlement for Self Assessment customers</li> </ul> <p>HMRC is continuing work in this area on improvements in the quality of our call handling; increasing the efficiency of our processes; and joining up relevant services across HMRC.</p>
<b>M. National Insurance Contributions</b>				
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		Recent research commissioned by HMRC has given a much better understanding of customers who could do with more help if they are to get their tax right and claim their entitlements. That understanding is being used to help design a better service for those customers that more closely reflects their needs.

Issue	Priority rating for second stage of the OTS pensioner review		Suggestions for short term improvements or matters to consider immediately	HMRC Response
	Policy reform/ legislative change	Administrative		
N.2 Digital exclusion		High		Government's "Digital by Default" Strategy means ensuring all new services are designed from the outset to be delivered digitally, and re-designing existing services in the same way, when the opportunity arises. HMRC is looking at the support needs of people who are less able or unable to use online services and will factor this into the design of services for customers with the greatest need.
<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			

Issue	Priority rating for second stage of the OTS pensioner review		Suggestions for short term improvements or matters to consider immediately	HMRC Response
	Policy reform/ legislative change	Administrative		
<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  Inability to use free online filing software to submit Residency pages  Navigation and simplification of guidance		Low (but we would welcome further submissions as regards problem areas).	HMRC should review the problems noted in the report to see if any improvements can be delivered.	The associated costs mean HMRC does not plan to introduce a facility to permit non-UK residents to file online.  Receiving this information during the year and applying the changes automatically to tax codes should negate the need for final review after the end of the year.  HMRC is exploring this as part of the general consideration of communications and guidance.

# Review of HMRC & DWP tax- related communications for pensioners

## Introduction

In the Interim Report of their Review of Pensioner Taxation, the Office of Tax Simplification (OTS) suggested that HMRC and the DWP should review the current information provided to pensioners, and noted the benefit that would be gained from more coordinated working. HMRC and DWP responded by identifying key individuals with the appropriate policy, strategic and operational knowledge to participate in a review of communications. They formed a steering group to review pensioner communications and report back to OTS. This report sets out the outcomes of this work.

The Pensioner Tax Communications Closer Working Group first met in September 2012 with a remit to review, discuss, agree and co-ordinate communications by HMRC and DWP which relate to tax for pensioners and pre-pensioners. The aim was to ensure consistency of approach by both departments and to deliver improved clarity of understanding for customers. The Group accepted an ongoing role to facilitate continued joint engagement beyond the OTS review.

## What we did

Between September and November 2012 HMRC and DWP carried out a review of the tax messages provided for pensioners. The review sought to consider the extent to which communications carried appropriate messages about tax, and to look at any amendments or improvements to provide more effective messages for customers. The review specifically considered:

- DWP leaflets and forms
- DWP's web content hosted by gov.uk
- HMRC's web content aimed at pensioners on both HMRC's website and gov.uk.

It did not look at HMRC forms as key forms were being considered separately. HMRC do not currently provide any leaflets specifically for pensioners, although a web version of IR121 (Approaching retirement – A guide to tax and National Insurance contributions) currently exists. That was considered alongside other web content.

## DWP leaflets and products

The review considered the products, leaflets and website material relating to tax for pension age people provided by DWP. Starting from the customer perspective, DWP and HMRC staff worked together to identify the relevant contact points within State Pensioners' customer journeys. They considered the various channels and media that customers use and the key communications products that they encounter.

A working group then reviewed the existing information and made recommendations for improvements in signposting and in raising the profile of tax messages. The aim was to present changes which could be considered at the next point of review for each of the products, and could, wherever possible, be accommodated within existing budgets as business as usual.

Internal stakeholders in both departments were consulted before a final list of possible amendments was produced. DWP have provided a timetable for review of this literature. The actual text will be subject to further review as part of the process for agreeing changes in line with this agreed schedule. The majority of changes should be delivered by April 2013.

A key product considered as part of the review was the State Pension annual uprating letter and supporting notes. The review identified opportunities to improve the prominence and

wording of the tax messages carried in the supporting notes, which DWP are currently progressing with the Office of Tax Simplification.

Alongside this work, HMRC and DWP worked together to review literature relating to bereavement. DWP's leaflet DWP 1027 (What to do after a death in England or Wales) was revised and a new leaflet with the same title (reference: DWP 011) will be published in December and printed versions are available on demand.

Our wider review of customer journeys confirmed that DWP's products do carry relevant tax messages and signposting to HMRC - from the point where a customer requests a State Pension Statement (formerly forecast) through to a State Pension/Pension Credit claim closure. In some products, though, these messages were difficult to find. The recommendations therefore included moving tax messages to earlier points in key documents.

One leaflet, SPD1 (State Pension Deferral – your guide) was not reviewed in full. It was agreed that there was scope for a more fundamental review and this will be considered in the next business year.

### **gov.uk**

The review co-incided with the introduction of [gov.uk](http://gov.uk) on 17 October 2012. [gov.uk](http://gov.uk) replaced directgov and is the sole website for DWP related content for pensioners. Reviewers were able to work with DWP and [gov.uk](http://gov.uk) to enable key tax messages and links in the area of the site relating to pensions and benefits. These pages now contain a clear statement that State Pension is taxable and links across to the HMRC pages which relate to pensioners and tax.

[gov.uk](http://gov.uk) also contains a limited amount of HMRC material – HMRC's website is due to migrate as part of a later phase. The review looked at this material and has made suggestions to correct factual errors (e.g. in understanding how State Pension is taxed) and to improve the messages so that they more closely meet customer needs. Work continues to refine the pensioners and tax information provided on the [gov.uk](http://gov.uk) website.

### **HMRC's website**

The review provided input into HMRC's annual review of their pensioner website pages. Revisions and suggested amendments have been passed to HMRC's digital communications team to be reviewed and where appropriate, incorporated. However the HMRC site is due to move to [gov.uk](http://gov.uk) in December 2013 and so the focus for significant work in the months ahead will be in simplifying the content and providing clear briefing to the [gov.uk](http://gov.uk) web authors.

### **Recommendations**

Specific recommendations for wording changes have been taken forward by each department to evaluate and determine whether they can be implemented as part of:

- business as usual changes or
- future planned change programme activities

These include changes to the HMRC website and gov.uk pages - changes to the [gov.uk](http://gov.uk) pages relating to DWP material have already been implemented.

The review also identified several specific issues that require further consideration by the relevant department:

- HMRC will need to consider how it can meet demand for printable information on tax for pensioners – either by updating the pdf booklet IR121 or creating clearly printable web pages for each topic.

- Consideration of HMRC providing additional communication around the taxation of the State Pension. Although the review found that tax messages were being included, awareness remains low, suggesting that alternative routes for providing this information could usefully be explored. We know many pensioners do not actively seek this information so need to consider innovative ways to get information to individuals when it is most relevant.
- Looking at whether there is scope to improve links with the voluntary sector – including Tax help for Older People and Tax Advice for Pensioners Service.
- The need to continue work to simplify HMRC's online pensioner material to enable a smoother transition to [gov.uk](http://gov.uk) in due course.

### **Conclusion**

Recommendations for improved messages are being taken forward by HMRC and DWP. The changes will mean that customers have relevant tax messages at appropriate points as they begin considering claiming State Pension, making a claim, and receiving updates and statements.

Effective links have been developed between HMRC and DWP which enabled the review to be carried out in a very short timescale.

HMRC and DWP will continue to use the key links and governance arrangements created for this review to support ongoing dialogue so that the benefits of a joined up approach are not lost. The Group will continue to meet to review progress and scan for new issues.

Pensioner Tax Communications Closer Working Group  
26 November 2012

# B

## Analysis and provisional costing assessments from HMRC and the DWP

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This section includes:

- B.1** HMRC's internal analysis paper on the numbers of state pensioners in self assessment.
- B.2** HMRC estimate paper on the costs of OTS policy recommendations.
- B.3** DWP internal analysis paper on the potential impact of taxing the State Pension at source.
- B.4** DWP internal analysis paper on the potential impact of producing a DWP60.

## 'Pensioners in SA'

### Introduction

This note examines emerging HMRC KAI analysis on 'Pensioners in SA' i.e.

"People receiving the State Pension who file an SA return" (in this case, in 2010-11).

So it will include people who have declared a State Pension income who are either, non-taxpayers, liable to tax, or taxpayers claiming a repayment of excessive tax deductions.

And exclude people who are due a state pension in 2010-11, but have opted to defer the payment of that pension until a later tax year.

We investigate the reasons for which these individuals are filing an SA return.

It is important to note that once a single reason to file is identified, a complete SA return must be filed covering all income sources. This can lead to relatively small amounts of income being declared, which considered under their own criteria would not need to be. A widespread example of this is bank and building society interest.

### Data

For this analysis we have used the full data extract of SA returns as stored on HMRC's administrative systems. At the date of extract, the 2010-11 SA returns were estimated to be 93% complete so we make an adjustment to take into account those yet to file a return. We assume that there is no significant difference between those already filing and those yet to file so apply a simple grossing factor (effectively  $1/0.93$ ) across all cases.



## Results

There are, as far as we can identify, 15 reasons for being in SA. They are as follows:

1. **Tapered Age Allowances**
2. Ministers of Religion
3. Self-Employed
4. Partner
5. Lloyds Underwriter
6. Land and Property
7. Foreign Income
8. Trust Income
9. Capital Gains Tax
10. Residence and Domicile
11. Additional Information
12. Savings and Investments
13. Directorships
14. Expenses and Reliefs in employment
15. Total Income over £100,000

Table 1 (overleaf) shows a breakdown of the reasons for filing an SA return.

**Table 1: People receiving State Pension in SA 2010-11: Why are they on SA?**

Reason for being in SA	Number of criteria met for being in SA						
	None	1	2	3	4	5 or more	All
Tapered Age Allowances	-	305,092	271,231	164,678	79,193	59,780	879,974
Ministers of Religion	-	1,716	1,352	564	159	57	3,848
Self Employed	-	173,132	107,054	42,225	16,695	13,761	352,868
Partner	-	70,194	57,656	30,046	13,618	12,587	184,100
Lloyds Underwriter	-	58	197	271	315	1,523	2,365
Land and Property	-	92,884	90,660	59,751	29,592	25,618	298,505
Foreign Incomes	-	39,028	67,982	70,113	46,156	46,689	269,968
Trust Income	-	2,977	5,625	5,970	4,717	7,153	26,442
Capital Gains Tax	-	14,980	31,620	36,804	31,443	40,349	155,196
Residence and Domicile	-	6,789	8,298	4,393	2,113	1,955	23,548
Additional Information	-	50,828	149,871	93,891	49,027	45,057	388,674
Savings and Investments	-	23,729	52,102	54,516	37,489	41,464	209,299
Directorships	-	22,179	27,470	34,251	20,874	18,929	123,703
Expenses and Reliefs	-	727	1,461	1,316	1,516	2,137	7,156
Total Income over 100k	-	3	3,839	8,721	10,567	22,962	46,093
<b>Totals</b>	<b>411,280</b>	<b>804,314</b>	<b>438,209</b>	<b>202,504</b>	<b>85,869</b>	<b>60,889</b>	<b>2,003,065</b>

N.B. the columns will not sum to the column totals. This is because individuals are counted twice if they meet two criteria, four times if they meet four criteria. The row totals are definitive numbers of individuals.

As seen in table 1, there are approximately 2 million 'pensioners in SA' of which **411,000 meet none of the criteria for being in SA**. These are candidates for simplifying their affairs and we will come back to these later.

Of the remaining 1.59 million, around 51%, or 804,000 have just one reason for being in SA; the other **788,000 have multiple reasons for which there is little prospect of their being able to leave SA**.

So looking at the 804,000 with only one reason for being in SA, **just 305,000 are in SA solely because of the tapered age allowances**. Everybody else in the group claiming age related allowances has at least one other reason for being in SA and therefore not likely candidates for removal from SA.

**So from 2 million pensioners in SA, we are left with:**

- **411,000 with no statutory reason to be in SA**
- **305,000 who are in SA solely because of the Tapered Age Related Allowances**

These individuals do not satisfy any of the criteria we think cover everyone that should be in SA. Early indications show that there are a number of reasons this group exists:

1. Some are using the SA system as a means of recovering overpayments (i.e., a simpler, more comfortable substitute for the Claims system)
2. Some have been filing SA returns for years and continue to do so even beyond the stage that they are required to do so.

The majority of this group – 279,000 (305,000-26,000) are subject to the tapered Aged Personal Allowance acting on net incomes above £22,900.

There is also a small group of around 26,000 that are subject to the Married Couple's Allowance taper that currently extends upward from the point that the Age Related Personal Allowance runs out (£29,230 for 2010-11). **This group will not be removed by the changes to the Personal Allowance, but it will slowly reduce over time due to mortality and there should be very few new claimants for MCA.**

## **HMRC Response to OTS's policy suggestions on costs of suggested recommendations.**

Information on the costs/ benefits of the OTS's policy proposals on:

1. Blind Persons Allowance (BPA)
2. Married Couples Allowance (MCA)
3. 10p Starting rate for savings

### **Customer and yield impact analysis**

Information is for 2014-15 for all individuals. This is based on the 2009-10 Survey of Personal Incomes using economic assumptions consistent with the OBR's March 2012 economic and fiscal outlook.

1. Abolition of BPA is estimated to yield around £15m (rounded) in 2014-15. This would affect 37,000 individuals, each with an average loss of £440.
2. Abolition of MCA is estimated to yield around £290m (rounded) in 2014-15. This would affect 500,000 individuals, each with an average loss of £575.
3. Increasing the starting rate for savings from 10p to 20p would yield an estimated £50m (rounded) in 2014-15. This would affect 525,000 individuals, each with an average loss of £90. Please note that the majority of taxpayers in contact with HMRC only via NPS (National PAYE System) are assumed to be unaffected as they do not currently make a claim for the differential between the 20p TDSI (tax deduction scheme for interest) and the current 10p starting rate for savings and so are not included in the estimate above.

### **Administrative costs**

On the basis of the high level analysis we have been able to conduct, all three changes would carry costs up-front to HMRC to change our IT and forms (in particular the paper and online self assessment return). We would also need resource to respond to contact from individuals affected by the changes. Pensioners are the customer group most likely to contact us in response to a communication and we believe this would be particularly true amongst the older group who would be affected by the removal of Married Couple's Allowance. There would be small savings over the longer term from each change through a reduction in processing, calls and letters. However our funding arrangements would not allow us to offset these savings against any investment in IT change.

We have also looked further at the implications of DWP introducing a P60 style document and, again given the propensity of the pensioner population to contact us by telephone for confirmation and re-assurance; this change would result in a cost to HMRC rather than a saving. We would anticipate that call volumes would decline if the P60 document became a regularly issued

mailing but remain generally higher amongst pensioners than for other customer groups.

### **MIRAS (Mortgage Interest Relief at Source)**

The table below represents repayments to MIRAS providers - home owners get relief at source when they make payments and the providers claim the tax back. The details below do not give the numbers of pensioners involved but show the steady reduction in relief.

Year	No. of claims	Total amount repaid
03/04	102	£2.25m
04/05	114	£2.5m
05/06	Can't find the numbers	
06/07	90	£1.5m
07/08	89	£1.7m
08/09	83	£922k
09/10	86	£612k
10/11	83	£630k
11/12	80	£424k

## Outcome note on taxing State Pensions at source for the Office for Tax Simplification

### Operational costs and risks

The Department for Work and Pensions has explored the impacts of taxing State Pensions at source and has concluded that this would be a major change with considerable implications for the Department. The costs of operating tax at source are substantial, largely due to the operational costs of processing and enquiries, as well as the need to amend a number of IT systems to enable taxation functionality.

The DWP is already committed to a significant programme of reform and introducing tax at source would place considerable strain on its capacity to deliver these commitments. HMRC has expressed concern over the scale and complexity of taxing State Pensions at source, particularly with regard to tax codes, and believe there would be a high risk of error. This would be detrimental to pensioners and pose a reputational risk to the DWP. In addition, the RTI data link between DWP and HMRC would be unable to cope with the volume of data transfers required to tax State Pensions at source.

There are questions about whether introducing tax at source would risk disturbing the position of the majority of state pensioners who are largely content with the current system of deducting tax from their private pension, or indeed who prefer to submit a tax return via self assessment.

### Policy Implications

In addition to the costs and risks above we have reservations that taxing State Pension at source would be cost effective because of changes to State Pension policy which shifts the responsibility of earnings related pensions from the state to the individual. Outcomes from the state are set to decline over time in line with a long term overall reduction in pension income from the state. This is attributable to three main factors:

- State Additional Pension is falling in real terms because of the reduction of accrual rates in SERPS and S2P and the removal of earnings relation in State Second Pension – to the point that in an unreformed system earnings relation would be withdrawn entirely by the 2030s. Changes such as this happen only slowly for instance the maximum theoretical amount of Additional Pension at State Pension age now is £162<sup>1</sup>, by 2030 this amount will be £140. But we estimate that the average amount of net State Pension (basic State Pension and Additional Pension less any contracted out rights) will be around £129 in 2015, £134 by 2025 and £139 by 2030 – below the current personal tax limit of £155<sup>2</sup> a week.
- The Government is preparing a White Paper for publication on the single-tier State Pension which would replace the current two tier system. Although no decisions have been made regarding the level of the single-tier pension the objective for the policy is to provide an almost universal flat-rate pension above the level of the weekly means test. The single-tier pension will mean that in future most pensioners would reach State Pension age with State Pension incomes within the current personal tax allowance.
- The number of people reaching State Pension age with **net** State Pension above the current personal tax allowance will reduce in the next 20 years as the cohorts who contracted out of

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<sup>1</sup> This assumes that contributor had earned at the Upper Earnings Limit (Upper Accrual Point from 2008) for each year in their working life from age 16 to State Pension age.

<sup>2</sup> In this paper we have used a Personal Allowance of £8,105

Additional Pension work themselves through the system (the numbers are not likely to peak until the early 2030s and it should be noted that by that time the majority of people, over 80%, will have a reduced State Pension because of contracting out provision).

### **Pension Credit and the tax system**

Paragraph 3.106 of the OTS interim report describes an issue concerning the calculation of Pension Credit. In brief the Pension Credit means test calculation takes into account income net of tax. However, Pension Credit claimants who have a tax liability and who have this collected through self assessment will not be able to provide a net income amount at the point of claim. As a result their income will be overstated and they will receive less Pension Credit than their entitlement.

Following representations from the Low Incomes Tax Reform Group, DWP now alerts customers through leaflets, claims packs and DirectGov to provide their annual tax liability as part of the claims process and this would be included in the overall weekly Pension Credit assessment. Any adjustments to take account of revised liability can be made should the claimant report a change.

The Guarantee Credit of £142.70 for single people (£217.90 for couples) is within a Personal Allowance of £155 and in straightforward claims it seems unlikely that pensioners with a tax liability would also be entitled to Guarantee Credit. However, Pension Credit has a series of premiums (for carers and people with disabilities and for people with certain housing costs) which can lift the applicable amount in Pension Credit above the income tax Personal Allowance. In addition, people may be entitled to the Savings Credit element of Pension Credit (where the current taper end point is around £190). Some taxpayers may well be brought into Pension Credit entitlement through a combination Savings Credit and premiums. It is difficult to accurately assess whether these particular issues will continue into the long term. For instance, the DWP Green Paper on the single-tier pension proposed that the Savings Credit should be withdrawn for people who retire into the single tier and a key objective of the single tier is to ensure that as many people as possible retire on an income above the Guarantee Credit. We are not aware that the current arrangements are presenting difficulties and it may be useful (if possible) for external stakeholders involved in the OTS work to inform HMRC of examples where customers have been disadvantaged because of their tax arrangements.

### **Annex**

1. Three of the Department's IT systems and two interfaces would require substantial amendments to enable tax functionality and future IT platforms would require additional functionality.
2. DWP would also be required to produce an end of year statement for every state pensioner at substantial cost.

## Outcome note on DWP issuing a DWP P60 (equivalent) to State Pensioners for the Office for Tax Simplification

### Scope

The Department for Work and Pensions has explored a number of options to develop a DWP P60 (equivalent) statement that would provide State Pension customers with details of the amount of taxable benefits they were entitled to during the tax year. As part of the scope for this work DWP considered the requirement to trigger statements, both at the end of the tax year and/or following an award closure.

The options explored to address these requirements are as follows:

1. Paper statement issued automatically to all State Pension customers.
2. Paper statement issued only on request from a customer or representative.
3. An electronic statement that the customer could access and view on-line.
4. Utilising existing products. For example, the State Pension uprating letter.<sup>1</sup>

### Summary of Operational Implications

The DWP considered the impacts of each of the options to develop a DWP P60 (equivalent) statement and has concluded that this would be a major change with considerable implications for the Department. All options included fixed set up costs to establish and maintain records for all 12million pensioners.

The costs of developing the DWP P60 (equivalent) statement are substantial. This is largely due to the changes required to a number of IT systems; increased operational processing costs where full automation cannot be achieved, and additional customer enquiries generated on receipt of the statement.

- For each of the 4 options above, three of the Department's IT systems, one interface and future IT platforms would require substantial development work to introduce functionality to enable an accurate statement of taxable benefits to be produced.
- The Department's experience is that pensioner customer groups will contact the originator of the letter, even when advised no action is required or signposting messages are incorporated. The Department expects millions of customer enquiries as a result of placing a greater administrative burden on DWP Operations. As DWP are not specialists in the tax system there is a significant risk the volume and complexity of additional enquiries could have a detrimental effect on the overall service provided to all pensioners, disproportionate to those pensioners requiring the P60 (equivalent) information for self assessment purposes.

Additionally, HMRC have advised that it would expect to see a proportion of queries to be received into HMRC call centres. Based on historical data, correspondence to pensioners that includes new information about a change involving tax can generate up to 20% of calls based on the total number of letters sent.

Although no timescales have been indicated for the introduction of the P60 (equivalent) statement, the Department is already committed to a significant programme of reform and developing a new notification of this scale and complexity would suggest any delivery date would be no earlier than 2017.

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<sup>1</sup> uprating letter that is issued to all State Pension customers annually advising them of their State Pension entitlement from April for the year ahead



## Policy Implications

Our note on DWP operating PAYE at source described how State Pension incomes over time will become increasingly flat rate. This is happening at the moment because earnings relation is gradually being withdrawn in State Second Pension – and the Government intends to publish a White Paper in the autumn setting out its plans for single-tier pension set at fixed amount above the level of the Standard Guarantee Credit.

While State Pension outcomes will increasingly be below the annual personal allowance, and the numbers self assessing purely because they have little other income apart from State Pension will decrease, people will still need accessible information about their taxable State Pension. While the costs of automatic notifications described above may not be proportionate we will want to look for opportunities, especially as we change systems to make way for the single tier pension, to improve customer accessibility.

## Next Steps

Whilst the DWP concluded that development of DWP P60 (equivalent) would be prohibitively expensive to introduce on existing IT systems and place a greater administrative burden on its operations, it has not ruled out that there are opportunities to explore and identify customer service improvements. We would continue to work with HMRC and OTS to improve our existing processes and products, looking to enhance the quality of information and service provided to State Pension customers.





# The OTS review of pensioner taxation

**Table C.1: Members of the review of pensioner taxation – Consultative Committee**

<b>Committee member</b>	<b>Organisation</b>
Ciaran Arthurs	Advice NI
Malcolm Booth (appointed in Oct 2012)	National Federation of Occupational Pensioners
Sally Ferguson	Tax practitioner
Bob Harris	ICAS and McLellan Harris & Co
Peter Holland	HM Revenue & Customs
Camilla Metcalf	HM Treasury
Patrick Millard MBE	LITRG and Tax Help for Older People
Jane Moore	ICAEW
Mary Pattison	Department for Work and Pensions
Graham Sherburn	Tax Help for Older People
Matthew Stephens	Prudential
Kelly Sizer	Low Incomes Tax Reform Group
Roger Turner (retired in Oct 2012)	National Federation of Occupational Pensioners
Karen Thomson	Chartered Institute of Payroll Professionals
Mike Warburton	Grant Thornton
Sally West	Age UK
Angela Williams	Tax practitioner and ex-OTS

**Table C.2: 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.

### **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:

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