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SPP Special Evening Meeting

Responding to HM Treasury Consultation on Pension Taxation Relief

Strengthening the incentive to save: a consultation on pension tax relief

17 August 2015

Duncan Buchanan
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Consultation on Pensions Tax Relief

Structure of session:

- Overview and political influences
- SPP’s 10 guiding principles
- Effect of moving from EET to TEE
- Discussion on alternatives

- Assumption of working knowledge of pension taxation *“we will not propose any further changes to the [pensions] system during the next Parliament”*

Conservatives, 12 April 2015

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Overview

– Budget announcement
  - Has the Treasury made up its mind already
  - “Strengthening the incentive to save” consultation
  - HMT figures are very suspect
– SPP will respond to the consultation – 10 points of principle
– Purpose of the meeting is to get feedback from members

SPPs 10 points of principle

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1. People need an incentive to save for retirement
2. "Dry" tax charges on employer contributions will be unwelcome and reduce take home pay
3. Fairness between DB and DC schemes
4. Double taxes must be limited or avoided
5. Simplicity is needed to ensure engagement
6. Must not undermine automatic enrolment
7. Lack of trust in system not being changed by future governments
8. Fairness as between younger/older savers
9. Any cap on total pension tax relief should be transparent
10. Intergenerational unfairness

Is the existing system too complex?

- For most (particularly in DC) the system is simple – although unfairness between relief at source and net pay for low earners
- System not understood by savers
- System favours those who pay no tax
- Only 300,000 people account for 25% of all income tax
- There is tax leakage – 25% PCLS and shift to lower tax bands in old age – Employer NIC
- How big is that "leakage" – £50bn, £21bn or less –
- HMRC Pen 6 data:-
  - costs are subject to large revisions and have a particularly wide margin of error.
  - the ratio of pensioners to contributors may be expected to increase significantly which would tend to reduce the cost in net present value terms
- Included deficit repair contributions to DB – accounts for about £6bn of tax relief (inc NIC)

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"For the truth is Britain isn't saving enough and that's something we need to fix in our economy too.

I am open to further radical change.

Pensions could be taxed like ISAs.

You pay in from taxed income – and its tax free when you take it out. And in-between it receives a top-up from the government.

…

Our goal is clear: we want to move from an economy built on debt to an economy built on the more secure and productive foundations of saving and long term investment."

George Osborne, Summer Budget Speech, 8 July 2015

Effect of moving from EET to TEE

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Basic-rate taxpayer – DC pension

Exempt, Exempt, Taxed

- £23,660 – average basic earnings without bonus
- 5% employer contribution
- 3% member contribution
- Costs worker £567.84 for £1,892.80 total pension contribution
- 25% tax-free PCLS
- 75% marginal rate tax

Taxed, Exempt, Exempt

Member costs (p.a.)

- £141.96 extra NICs
- £236.60 extra income tax
- £141.96 extra contributions in lieu of basic rate relief
- £520.52 total

Employer costs (p.a.)

- £163.25 extra NICs

Benefits tax free

Higher-rate taxpayer – DC pension

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Exempt, Exempt, Taxed

- £68,000 – managerial
- 5% employer contribution
- 3% member contribution
- Costs worker £1,632 for £5,440 total pension contribution
- 25% tax-free PCLS
- 75% marginal rate tax

Taxed, Exempt, Exempt

Member costs (p.a.)

- £68 extra NICs
- £1,360 extra income tax
- £408 no basic rate relief
- £408 higher rate relief lost
- £2,244 total

Employer costs (p.a.)

- £469.20 extra NICs

Benefits tax free

Final salary pension

1/80th for each year of service with 30 years' service at the start of the tax year

Inflation	Salary increase	TEE reduction in take-home pay compared with current EET basis
2.5%	1%	£3,013.37
1%	1%	£5,558.32
2%	4.5%	£9,657.87

Pensionable earnings are all £68,000 at the end of the tax year

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Final salary pension

1/80th for each year of service with 30 years' service at the start of the tax year

Scenario	**1% pay increase**	**10% promotion**
Gross salary increases to	£62,436.18	£68,000.00
EET take-home pay (after pay increase)	£39,305.51	£42,155.30
EET take-home pay (before pay increase)	£38,988.88	
EET change in take-home pay	+£ 316.63	+£ 3,166.42

Pensionable earnings are all £61,818 at the start of the tax year

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Final salary pension

1/80th for each year of service with 30 years' service at the start of the tax year

Scenario	1% pay increase	10% promotion
Gross salary increases to	£62,436.18	£68,000.00
TEE take-home pay (after pay increase)	£35,759.79	£24,134.43
TEE take-home pay (before pay increase)	£35,478.27	
TEE change in take-home pay	+£ 281.52	-£11,343.84
Effect on take-home pay of change to TEE	-£3,545.72	-£18,020.87

Pensionable earnings are all £61,818 at the start of the tax year

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INTRODUCING THE LIFETIME

MICHAEL JOHNSON

SUMMARY

- The UK's debt accumulation, and lack of a savings culture, potentially places the nation on a conveyor belt to fiscal calamity.
- Currently the UK relies on imported capital to bridge the gap between its addiction to debt and the absence of a savings culture.
- Under-35s are so disengaged from private pensions that the industry's next cohort of customers will be very thin. One could conclude that, in the long term, the private pensions business is finished.
- Generation Y[1] is, however, embracing ISAs, perhaps the last trusted brand amongst savings products.
- This paper proposes a solution to boost UK savings in the form of a new savings product: the Lifetime ISA. This improved ISA should appeal to under-35s, and re-engage them with retirement saving. The Lifetime ISA would be a savings chameleon: incorporating both ISA-like and pension-like features.
- Introducing the Lifetime ISA would involve assimilating today's two Junior ISAs with the two forthcoming New Lifetime ISA.
- Crucially, the Lifetime I for a Treasury incentive up to an annual allow described in a sister April 2014.[2]
- In addition, the Lifetime degree of ready acce simultaneously justify incentive, which d commitment to saving. hold cash and inves savers from the cradle signalling the emerge savings agenda (as opp
- Establishing the Lifetim bring the ISA brand savings arena, as well marked simplification landscape.
- This paper advances reform, as summarised

[1] The generation born in the 1980s and 1990s.

[2] *Retirement saving incentive and a new beginning*, Miche

Centre for Policy Studies

3 July 2015

Briefing Note

THE WORKPLACE ISA AND THE ISA PENSION

MICHAEL JOHNSON

1. INTRODUCTION

Replacing current support for occupational pensions with a Workplace ISA would have the following benefits:

- A radical simplification of the UK savings landscape.
- Clearly in line with what people want from savings products.
- An opportunity to make a significant reduction in the deficit, perhaps by up to £10 billion.

Last year the Centre for Policy Studies published proposals to abolish all Income Tax and employer NICs relief on pension contributions, to be replaced by a redistributive 50p incentive per £1 saved, paid irrespective of tax-paying status.[1] In contrast, the Conservative Party's 2015 manifesto

[1] See *Retirement saving incentives: the end of tax relief, and a new beginning*, Michael Johnson, CPS, April 2014.

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IREMENT SAVING INCENTIVES

THE END OF TAX RELIEF AND A NEW BEGINNING

MICHAEL JOHNSON

SUMMARY

proposes the scrapping of all relief on pension contributions, with a simpler incentive.

Budget annuity reforms highlight to scrutinise the purpose and ss of today's pension-saving traditionally provided to e for pension products'

x-based incentives for pension expensive, totalling over £54 012-13, primarily in the form of relief (£28 billion) and NICs relief on, predominately paid to . They are inequitably distributed of earners receive 30% of all tax have failed to stimulate a broad- ement savings culture.

lief makes the Treasury the fund nt industry's largest client. Since has injected, through people's ts, £270 billion, on which charges e levied.

- International evidence shows that default policies are far more effective for broadening retirement savings across those who are least prepared for retirement, i.e. lower-income workers, in particular.
- The reforms proposed here aim to improve boost the efficacy of the Treasury spend; to achieve a much broader distribution of retirement savings; and to increase the size of the nation's pool of savings.
- Eight proposals for reform are summarised overleaf. They include:
  - replacing today's complex framework of retirement saving with a Treasury contribution of 50p for every £1 saved for retirement, paid irrespective of the saver's taxpaying status;
  - combining annual ISA contributions and pensions allowances to £30,000; and,
  - allowing people to bequeath unused pension pot assets to third parties' pensions pots, free of Inheritance Tax (perhaps limited to £100,000).

NISA, LISA and PISA

"The pensions industry is supported by a huge state subsidy, in the form of an ineffective framework of regressive tax-based retirement savings incentives"

Michael Johnson, Centre for Policy Studies

Retirement Savings Incentives – The end of tax relief and a new beginning

LISA and the HMT incentive

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- One wrapper, two taxation bases
- Incentive – 50p from HM Treasury for every £1 saved
- Capped at £4,000 for £8,000 saving (April 2014/August 2014)

LISA and the HMT incentive

- One wrapper, two taxation bases
- Incentive – 50p from HM Treasury for every £1 saved
- ~~Capped at £4,000 for £8,000 saving (April 2014/August 2014)~~
- Capped at £2,000 for £4,000 saving (3 July 2015)
- Extra money is normal ISA basis without incentive
- £30,000 overall saving cap

LISA and the HMT incentive

- One wrapper, two taxation bases
- Incentive – 50p from HM Treasury for every £1 saved
- Capped at £2,000 for £4,000/£4,000 for £8,000 saving
- Extra money is normal ISA basis without incentive
- £30,000 overall saving cap
- LISA would be a AE qualifying scheme
- Employer contributions taxed per TEE but incentivised
- Default fund would meet quality criteria with cost cap
- Transparency and disclosure requirements

LISA – access to savings

Order of withdrawals	Before age 60 (pre-50 savings)	After age 60 (pre-50 savings)	Post-50 savings
1. Non-incentivised savings principal	Yes, with no tax deductions	Yes, with no tax deductions	Yes, with no tax deductions
2. Incentivised savings principal*	Yes, but repay HMT's incentive	Yes, but taxed at marginal rate	No, not until 10 years have passed
3. Accumulated income and capital growth from 1 & 2*	No access	Yes, but taxed at marginal rate	No, until age 60 Yes, from age 60

* Treat employer contributions as 2 or 3?

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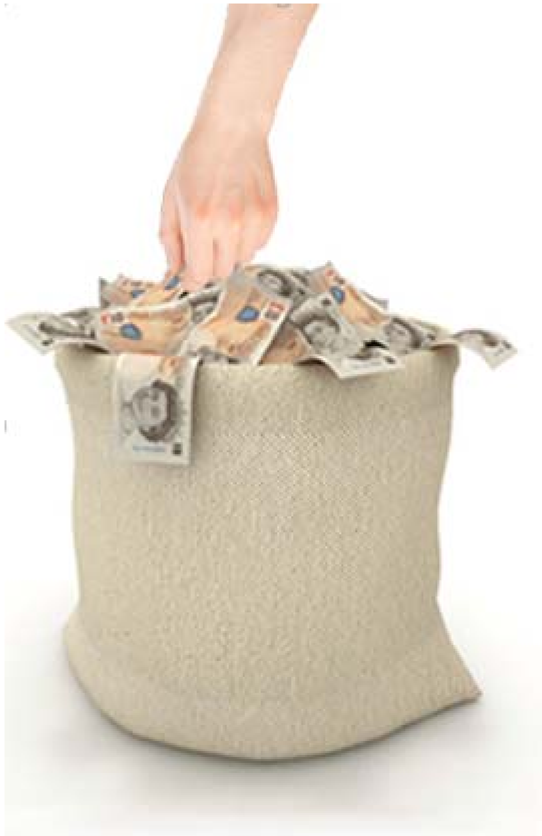
Conversions / Transfers to a PISA?

- £3.4 trillion ONS estimate of UK households' pension wealth
- Transfer and pay a 20% tax charge for access?
- 20% x 75% x £3.4 trillion = £510 billion



“the Government is interested in views on fundamental reform of the system (TEE) to less radical changes (retain current system and altering lifetime and annual allowance)… as well as options in between”

Current system

Change LTA/AA factors for DB

Fixed rate relief (e.g. 30%)

Lifetime ISA

TEE with no top-up

Reduce LTA/AA

No PCLS

Abolish salary sacrifice

TEE with top-up

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TEE

Pros	*Cons*
Revenue raising for HMT	Complex transitional arrangements/ One-off tax charge
Incentivise savings?	Could discourage saving if employer contribution subject to tax and NI
	Could diminish "retirement" savings and long-term investment
	Could undermine business models of some providers/master trusts
	Risk that TEE would become TET
	May undermine social cohesion

Lifetime ISA

Pros	Cons
Revenue raising for HMT	Impact on existing pension saving vehicles
Incentivise savings?	Could discourage saving if employer contribution subject to tax and NI
	Could diminish "retirement" savings and long-term investment
	No fiduciary oversight of ISAs
	Risk that TEE would become TET
	Potential impact on means-tested benefits and tax credits
	May undermine social cohesion/ Intergenerational unfairness
	Risk that savings would be accessible to Trustee in Bankruptcy

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No change

Pros	Cons
No disruption	Not Revenue raising for HMT
Focus can be on improving existing system (value, adequacy, better communications etc)	Doesn’t address perceived unfairness of existing system

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"the Government is interested in views on fundamental reform of the system (TEE) to less radical changes (retain current system and altering lifetime and annual allowance)... as well as options in between"

Current system

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TEE with top-up

TEE with no top-up

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Final thoughts

Consequences of a move to TEE:

1. Increase in tax take not as big as expected
2. Lower take home pay for employees
3. Disincentive to save for retirement
4. Lower long term investment for UK plc
5. ISA governance and charging structures

Don’t forget the c£3 trillion of private sector existing pension savings.

Please email any further feedback and comments to:

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