



Institute for Fiscal Studies

Taxation of private pensions explained

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Private pensions are tax-favoured relative to most other forms of saving. The extent of the tax advantages varies between people.

Pension contributions are exempt from income tax, as are investment returns within a pension fund. When a pension is accessed, 25% can be taken free of tax, with the remainder being subject to income tax. Individuals' pension contributions are made out of income that has been subject to National Insurance contributions (NICs), but no NICs are charged on pension income. Employer pension contributions, however, do not incur NICs at any point – and will not incur the new health and social care levy – and are therefore especially tax-advantaged. There are additional tax advantages for pension pots bequeathed at death. There are lifetime and annual limits on the amount that can be saved free of income tax in a pension, both of which have been reduced significantly since 2011.

Private pensions in the UK fall into two broad categories: defined-benefit (DB, also termed salary-related) and defined-contribution (DC, also known as money-purchase). Pension contributions can be made by individual savers or by others on their behalf: the majority are made by employers on their employees' behalf.

A primer on UK private pensions

In a money-purchase or defined-contribution (DC) pension, each individual has their own pension pot, in which the amount accrued is determined by the size of the contributions paid into the pot and the returns achieved on the investments made (usually predominantly in shares but also in bonds and other assets). Once they reach a minimum age (currently 55 but set to rise), individuals now have considerable flexibility in what they do with their DC pension savings. They can leave the money in the pension fund, withdraw money from it as and when they wish ('lump sums' and 'drawdown'), and/or use it to buy an annuity, which provides a guaranteed regular income until they die. If a person dies with money in a

pension pot (i.e. that has not been withdrawn or used to buy an annuity), the pension pot can be bequeathed.

In a salary-related or defined-benefit (DB) pension, the level of retirement benefits is determined by the scheme rules. In general, they provide for an optional one-off lump sum (up to a cap) on retirement and a regular income from then until death (some DB pensions also provide for payments to continue, at a lower rate, to designated surviving dependants after the individual's death). The regular income is calculated using a formula, which varies between schemes but normally takes into account the number of years spent in the pension scheme and the salary earned (historically this was a measure of final salary earned but increasingly it is the salary earned in each year of scheme membership). The age from which DB pension income can be drawn is also set by the scheme rules, with earlier access sometimes being allowed with reduced benefits (though, as with DC schemes, this must still be above a minimum age, which is currently 55).

Contributions to a pension can be made by individual savers or by others on their behalf; the majority are made by employers on their employees' behalf. Employees' individual contributions ('employee contributions') are usually administered through their employer's payroll processes, but are still distinct from employer contributions: employer contributions are a part of remuneration that is in addition to gross earnings, while employee contributions are made out of earnings. As explained below, employer and employee/individual pension contributions are treated differently by the tax system.

Contributions to DC pensions are easy to measure as the amount paid into the individual's pension pot. For DB pensions, employee contributions are easily measurable as the amount the individual has to contribute (according to the scheme rules) in exchange for accruing pension benefits. Employer contributions made on behalf of each individual scheme member, however, are harder to measure, as employers do not make a separate, measurable contribution in respect of each employee: instead the employer makes whatever aggregate contribution to the scheme is needed (over and above aggregate employee contributions and investment returns) for the scheme as a whole to be able to meet its future obligations to all scheme members. Since the DB scheme rules determine the amount of pension income someone will receive in retirement, the employer contribution for any individual is implicitly the difference between the value of the additional benefit they accrue for working that year and the contribution that they themselves made. However, this calculation is not normally made in practice, and in principle it will depend on factors such as how that individual's life expectancy – and that of a potentially surviving dependant – has changed

over the year. This makes it challenging to apply personal taxes to employer contributions to DB pensions.

Pensions and income tax

Broadly speaking:

- income that is paid into a private pension is exempt from income tax;
- income earned from investments within the pension fund is also exempt (and capital gains are exempt from capital gains tax);
- money received from the pension is taxed.

This is often referred to as ‘exempt-exempt-taxed’ or ‘EET’ treatment.

In effect, income tax on earnings paid into a pension is deferred from the time the contribution is made until the time the earnings (along with any returns accrued in the meantime) are withdrawn from the pension. It is as if individuals, rather than receiving their earnings in full now, agree to get part of their earnings in future instead, and income tax is levied when that deferred remuneration is actually received.

If someone faces a lower (higher) income tax rate when they receive their pension income than when the pension contributions were made, then they will pay less (more) income tax as a result of deferring their income in a pension. For example, many people who are higher-rate taxpayers when making contributions (and therefore receive 40% income tax relief on their pension contributions) will be basic-rate taxpayers in retirement (and therefore pay only 20% income tax on their pension income).

More about facing different tax rates on pension contributions and pension income

Some people get income tax relief on their pension contributions at a different rate from the one they pay on their pension income. Most commonly, this is because they are higher-rate taxpayers while contributing but basic-rate taxpayers in retirement or because they are basic-rate taxpayers while contributing but pay no income tax in retirement. The opposite case (being in a higher income tax band in retirement than when working) is much less common.

The pattern is more complicated if we account for means-tested social security benefits (such as universal credit, pension credit, housing benefit and council tax support) as well as income tax. Pension contributions are partly or wholly deducted from income for means tests, while pension income is included. Thus people can get high effective rates of up-front relief if they are able to make pension contributions while subject to a means test. That is because putting more into a pension makes their assessed income lower and therefore their benefit entitlement higher. Conversely, people can face high effective rates of tax on their pension income if they receive means-tested benefits in retirement because the pension income reduces their benefit entitlement. Whether people face higher or lower effective tax rates when contributing to a pension than when receiving pension income therefore depends on their specific circumstances at different times of life.

People can also face different tax rates in work and retirement because of policy changes: income tax rates and thresholds (not to mention means-tested benefits) are now rather different from what they were when many of the current generation of pensioners were building up their pensions, and will be different again by the time the current generation of savers reaches retirement.

There are two exceptions to this EET treatment. The main one is that people can choose to take 25% of their pension free of income tax. This means that 25% of the income saved in a pension never incurs income tax, either on the way in or on the way out. (This is known as ‘exempt-exempt-exempt’ or ‘EEE’ treatment.) The vast majority of pension savers will take 25% of their pension free of income tax. This is one of the main ways in which pensions are tax-advantaged relative to other forms of remuneration and savings. The second exception to EET treatment is that pensions bequeathed before the age of 75 are entirely exempt from income tax in the hands of the recipient (and therefore also EEE). The gradual shift that is taking place from DB to DC pensions and the introduction of ‘pension freedoms’ in 2015 (giving people more flexibility to use their DC pension savings in ways that result in the pension pot being bequeathed) mean that this exemption will become more important over time.

There are two ways that income tax relief on individuals’ pension contributions is administered: a ‘net pay’ arrangement, where pension contributions are made out of earnings before income tax is paid (so that the pension contribution is excluded from taxable income), and a ‘relief at source’ arrangement, where individuals’ pension contributions are made out of after-tax income and income tax is reclaimed

from HMRC. For most pension savers, which arrangement is used does not affect the amount of income tax relief received, but the different arrangements do have different implications for non-taxpayers and for some Scottish taxpayers.

More about ‘net pay’ and ‘relief at source’ arrangements

All DB pensions and most DC pensions that are run by employers for their employees (‘occupational pensions’) operate under a ‘net pay’ arrangement. Notable exceptions include some of the large schemes that have been set up in recent years to provide employers with pensions complying with [automatic enrolment](#) – including the National Employment Savings Trust (NEST) – which operate on a ‘relief at source’ basis. Personal pensions, in which the individual contracts directly with a pension provider such as a bank, building society or insurance company (though employers are usually involved in making and administering contributions), all operate on a ‘relief at source’ basis.

If a pension scheme operates on a ‘net pay’ basis then individuals’ contributions are deducted from gross earnings before income tax is calculated. Individuals thus automatically receive relief from income tax up front, in most cases at the correct rate for their income level.

If a pension operates on a ‘relief at source’ basis then individuals’ contributions are deducted from net earnings (i.e. after income tax has been paid), and the pension provider receives an additional contribution from HMRC. This top-up from HMRC is equal to 25% of the contributions made (and therefore 20% of the contribution including the top-up itself), and provides the correct amount of tax relief only for basic-rate taxpayers (who pay 20% income tax). Those who pay higher- or additional-rate income tax have to claim an additional income tax rebate from HMRC, which would be received as cash or deducted from other tax liabilities, rather than being added to their pension; but if they add the amount of the rebate to their pension contribution themselves, they end up with the same amount in their pension pot and the same amount available to spend as they would under a ‘net pay’ arrangement (see the example of Susan below). Those who do not pay income tax because their incomes are too low still receive the top-up from HMRC, even though they did not pay any income tax on their earnings.

For most people, saving through a ‘net pay’ or ‘relief at source’ pension yields the same amount of up-front relief from income tax for the same amount going into a pension: the difference is purely an administrative one. There are two groups for whom this is not true, however.

- The first is non-taxpayers, for whom saving in a ‘relief at source’ pension is substantially better than saving in a ‘net pay’ scheme because doing so yields a 25% greater pension for the same level of gross contributions. This is sometimes referred to as the ‘net pay anomaly’ or ‘relief at source anomaly’.
- The second is some taxpayers in Scotland. Income tax rates in Scotland [are slightly different](#) from those in the rest of the UK. People in ‘net pay’ pension schemes automatically receive relief at the appropriate Scottish rate of income tax. But for those in ‘relief at source’ pensions, the top-up made into the pension fund from HMRC remains at 20%. For those facing the 19% starter rate of income tax in Scotland, HMRC does not recover the 1% difference, so they benefit from a slightly higher rate of relief in a ‘relief at source’ pension than a ‘net pay’ pension (much like non-taxpayers do, but to a much lesser degree). Those facing rates of tax above 20% can claim the additional tax relief from HMRC in the same way as higher- and additional-rate taxpayers everywhere in the UK, and therefore reach the same outcome as under a ‘net pay’ arrangement, though for those facing the 21% intermediate rate of tax this might involve significant extra hassle for relatively little extra money.

A few worked examples are illustrated below:

Suppose Brian is a basic-rate taxpayer:

- In a ‘net pay’ scheme: he can directly contribute £1 of gross pay and will get £1 in his pension. He therefore does not pay 20p of income tax on that pension contribution, ending up with £1 in his pension rather than the 80p of after-tax salary he would receive if he did not make the contribution.
- In a ‘relief at source’ scheme: for £1 of gross salary he will pay 20p income tax and can contribute the remaining 80p to his pension. HMRC will top up that contribution by 25% (=20p) so he will have £1 in total in his pension (80p that is his own contribution and 20p from HMRC). Overall, as in the ‘net pay’ scheme, he has paid no tax on his £1 gross salary (he paid 20p tax but got 20p tax relief paid into his pension) and ended up with £1 in his pension.

Suppose Susan is a higher-rate taxpayer:

- In a ‘net pay’ scheme: she can directly contribute £1 of gross pay and will get £1 in her pension. She therefore does not pay 40p income tax on that pension contribution, forgoing only 60p of net income to have £1 in her pension pot.

- In a ‘relief at source’ scheme: for £1 of gross salary she will initially pay 40p income tax, leaving her with 60p. If she nonetheless contributes 80p to her pension from her net income, HMRC will top up that contribution by 25% (=20p) so she will have £1 in total placed in her pension. In addition, she can reclaim 20p directly from HMRC (the difference between the 40p total higher-rate income tax on the £1 of salary and the 20p basic-rate relief already paid into the pension), recouping the difference between the 60p of after-tax salary she initially received and the 80p she had to contribute to get £1 in her pension once basic-rate relief had been added. Overall, she has paid no tax on her £1 gross salary, ending up – exactly as with the ‘net pay’ scheme – forgoing 60p of net income to have £1 in her pension pot.

Suppose Andrew does not earn enough to pay income tax:

- In a ‘net pay’ scheme: he can directly contribute £1 of gross salary and will get £1 in his pension. He will pay no income tax whether or not he makes a pension contribution.
- In a ‘relief at source’ scheme: for £1 of gross salary he will pay no income tax and have £1 of net salary available. If he contributes 80p of that to his pension, HMRC will top up that contribution by 25% (=20p), so he will have £1 in total in his pension (80p that is his own contribution and 20p from HMRC) and still have 20p of net salary left over (which he would not have under a ‘net pay’ arrangement).

Tax on pension income is [collected as tax on employment income](#): pension providers deduct income tax through the Pay-As-You-Earn (PAYE) system before making pension payments, but many pensioners have to fill in a tax return each year to ensure that the correct amount of tax is paid.

Pensions and NICs

National Insurance contributions are never levied on income from savings and investments, and that includes pensions. Thus, like income tax and capital gains tax, NICs are not levied on investment returns within pension funds. Unlike income tax, NICs are not charged on any income received from the pension either (in effect, pension income is treated as savings income rather than deferred earnings for NICs purposes).

Whether pension contributions are subject to NICs depends on the type of pension contribution.

Private pension contributions made by an employee or self-employed person cannot be deducted from earnings for NICs purposes: that is, individuals' pension contributions are made out of their after-NICs income. This treatment is consistent with the fact that future pension income is not subject to NICs. Individuals' pension contributions are thus taxed up front but not thereafter: they have 'TEE' treatment.

In contrast, employer pension contributions are not included in earnings for NICs purposes. This means that remuneration in the form of employer pension contributions escapes NICs altogether: there are no NICs on the earnings paid into the pension, and no NICs when the money is received from the pension either (they have 'EEE' treatment). In overall revenue terms, this is by far the biggest tax break for pensions. The new health and social care levy will work in the same way, further increasing the tax break provided for employer pension contributions.

The fact that NICs treat employer pension contributions more generously than employee contributions goes some way to explaining why the majority of private pension contributions are made by employers. Indeed, in some cases, employees and employers explicitly agree to take advantage of the opportunity: if their employer is willing, employees can enter a 'salary sacrifice' arrangement, where they reduce their gross salary in exchange for higher employer pension contributions. This means someone with the same overall gross remuneration and the same total pension contribution can reduce how much they (and their employer) pay in NICs by reducing their employee pension contributions and increasing their employer pension contributions.

Salary sacrifice: worked example

Suppose Emma earns £500 per week before tax. In 2021–22 she will pay £37.92 per week in employee NICs (12% of earnings above the primary threshold of £184 per week), and her employer will pay £45.54 (13.8% of earnings above the secondary threshold of £170 per week). If she pays £25 as an employee contribution into her pension, this will not affect her NICs liability or her employer's.

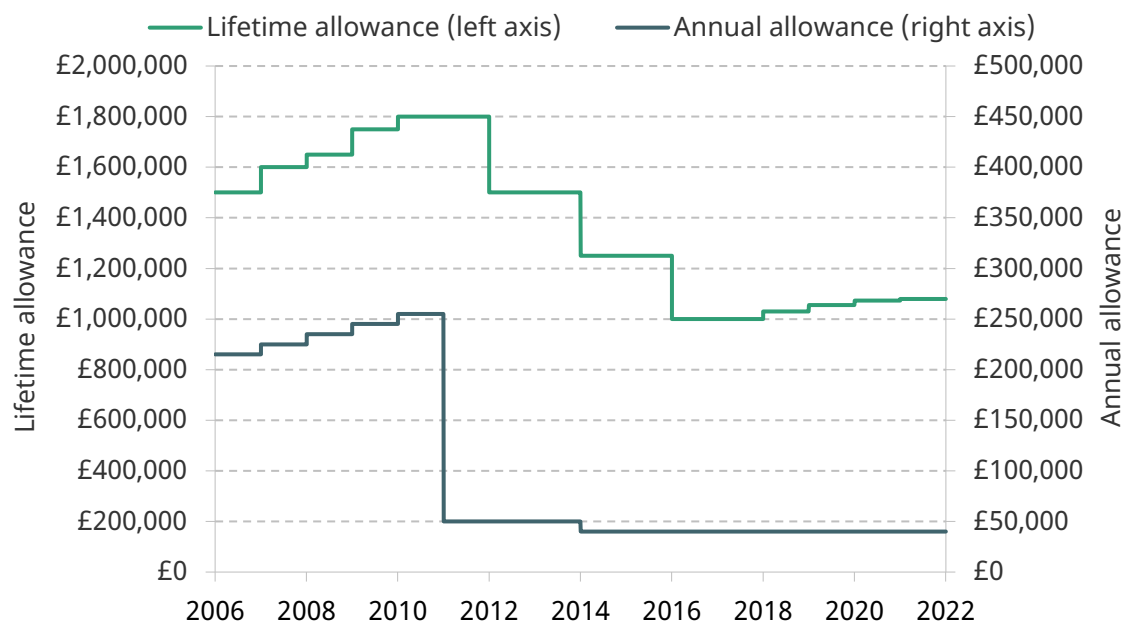
Now suppose instead Emma enters a salary sacrifice arrangement with her employer, and reduces her gross salary by £25 in exchange for her employer paying £25 into her pension.

Now her gross salary is only £475 per week, and she pays £34.92 per week in NICs while her employer pays £42.09. By having the same £25 of gross earnings go into her pension as an employer contribution, rather than as an employee contribution, Emma has reduced the total amount of NICs the government receives on her earnings by £6.45 (equivalent to over a quarter of the £25 gross pension contribution). Emma's NICs bill is £3 per week lower and her employer's NICs bill is £3.45 per week lower.

Annual and lifetime allowances

There are annual and lifetime caps on the amount that can be saved in a pension free of income tax. These were introduced in 2006 (replacing a swathe of more complicated arrangements) and have been greatly reduced since 2010.

Pension allowances over time



Note: Years refer to financial years, so, for example, '2020' refers to 2020–21.

For most people, the annual allowance limits tax-free contributions to £40,000 (or the greater of £3,600 and 100% of earnings if that is lower than £40,000) per year.

But the annual allowance is lower for the highest-income individuals and for those who have already taken money from their pension in certain ways.

More about the annual allowance

The annual allowance (AA) limits tax-free pension contributions to £40,000 per year (or 100% of earnings, if lower, though with a minimum of £3,600). But the allowance is reduced for the highest-income individuals. Specifically, if someone's income *excluding* pension contributions exceeds £200,000, the annual allowance is reduced by £1 for every £2 by which the individual's income *including* pension contributions exceeds £240,000, until it reaches a minimum level of £4,000 for those whose income including pension contributions exceeds £312,000. This is shown in the chart below.

The pensions annual allowance for high-income individuals, 2021–22



Note: The reduction in the allowance for those with high incomes applies only if their income *excluding* pension contributions exceeds £200,000; otherwise it remains at £40,000.

If someone does not use all of their annual allowance in a year then they are allowed to carry forward the unused allowance for up to three tax years.

If someone starts withdrawing money from a DC pension in certain ways, they [may trigger](#) the Money Purchase Annual Allowance, which limits the amount that can be paid into a pension each year to £4,000.

Contributions in excess of the annual allowance are subject to income tax when they are made, as well as being taxed again when the person receives their pension. This makes contributing above the annual allowance very unattractive.

For those in DC schemes, the pension contribution that is assessed against the annual allowance (AA) is simply the sum of individual and employer gross contributions made in the year. For those in a DB pension, the assessment is more complicated, as employers do not make a separate, measurable contribution in respect of each scheme member. The amount contributed to the pension for each individual is instead viewed as the increase in the total value (in today's prices) of the stream of pension income they would receive in future if they left the scheme at the end of the year compared with its value if they left at the start of the year. This is estimated (rather roughly) by:

- (i) calculating the annual pension income that the person would have been entitled to had they left the scheme at the start of the tax year, multiplying that by 16 (to approximate the lump-sum value of a stream of annual payments until death), and adding any lump sum they would also have been entitled to;
- (ii) increasing that amount in line with inflation over the year, as measured by the Consumer Prices Index (CPI);
- (iii) calculating the annual pension income that the person is entitled to at the end of the tax year, multiplying that by 16, and adding the value of any lump-sum entitlement.

It is the difference between the results of (ii) and (iii) that is compared with the AA.

The way some DB pensions work means that the assessed value of the contribution can sometimes be very high. This has combined with the reduced AA for high earners to [cause significant problems](#) – including large (often unexpected) tax bills and strong disincentives to work – for some public sector workers, such as senior doctors, who are in DB pension schemes that are both generous and inflexible. But the problem affects far fewer people since 2020–21, when the threshold above which the AA is reduced was increased from £110,000 to £200,000.

In addition to the annual cap on contributions, there is a lifetime allowance – £1,073,100 in 2021–22 – which the total value of an individual's private pensions cannot exceed without attracting extremely high tax rates.

More about the lifetime allowance

The lifetime allowance (LTA) of £1,073,100 applies to the total value of all of an individual's private pensions. For DC pensions, the value is simply the value of the pension funds. For DB pensions, the value is (usually) taken to be 20 times the pension income that will be received in the first year plus any tax-free lump sum – which, in practice, results in a much more generous LTA for DB pensions than for DC pensions.

The value of someone's pensions is only tested against the LTA at certain times. The main ones are when any pension is first accessed and at age 75 (if they have any pension savings not converted to an annuity) or when the person dies (if before age 75 and they still have unaccessed pensions). If pension benefits are taken in stages – for example, different pensions start to be accessed at different ages – then on each occasion that a pension starts to be accessed a proportion of the LTA (according to the value of that pension) is used up. For pensions in drawdown, when someone reaches age 75 the value of the remaining fund is assessed again, and any increase in value over the amount that was in the fund when drawdown started will be tested against the remaining unused proportion of the LTA.

Any excess pension value above the LTA incurs an LTA charge. This is a one-off tax of either 55% if the excess funds are taken as an (otherwise tax-free) lump sum or 25% if the excess funds are taken as income (since this income will also be subject to income tax).

When the LTA has been reduced, however, [transitional protection](#) has been introduced to ensure that those whose pensions already exceeded the new LTA (but not the old, higher one) are not penalised retrospectively for it, provided they do not build up their pension further. Such protections are justifiable but significantly complicate the system.

Because the LTA applies to the value of a person's pensions rather than to the amount contributed, it is possible for someone to stop contributing before their pension reaches the LTA but still breach the LTA by the time it is tested because of investment returns subsequently earned within the fund. This means people approaching the LTA must assess when to stop contributing, how to invest their pension fund and/or when to start withdrawing money from their pension, in order to avoid accidentally breaching the LTA.

Tax treatment of pensions on death

When someone dies, what happens to their pension depends on the type of pension scheme.

- DB schemes often pay some benefits to a surviving partner or other dependants. These payments are liable to income tax at the recipient's tax rate.
- For DC pensions where there is still a balance of funds (i.e. not an annuity), the person inheriting the pension pot can choose when and how to draw the funds out of the pension (e.g. as a lump sum or gradually). If the individual was 75 or older when they died then the payments to the beneficiary are liable to income tax at the recipient's tax rate whenever they choose to take the money. But if the individual died before age 75 then such withdrawals are entirely free of income tax.

Pensions that are bequeathed are effectively exempt from inheritance tax: they are not included as part of deceased individuals' estates when inheritance tax assessments are made (except in special, easily avoidable, circumstances).

What are the tax advantages of pensions?

When thinking of the tax advantages of saving in a pension, many people's first thought is of income tax relief on pension contributions. But much of this up-front relief will be offset by the income tax eventually charged on pension income. These two elements should be considered together. There is tax relief on pension contributions precisely because the resulting income is taxed; it would be absurd to tax both income paid into a pension fund *and* income received from it. The income tax on earnings contributed to a pension is merely deferred until the money (along with any returns earned in the meantime) is received from a pension.

In some cases, deferring income tax until retirement makes no difference to the value of the tax ultimately paid by taxpayers and received by the government. In other cases, deferring tax until the pension is received means that people pay tax at a lower (or higher) rate in retirement than they would have faced if taxed up front on the earnings contributed to a pension.

It is debatable whether those people who face a lower tax rate in retirement than in working life should be regarded as receiving ‘tax relief’; this depends on the benchmark against which the current system is judged. They are certainly paying less tax than they would if tax were levied up front on earnings contributed to a pension. But there is a [good case for](#) only applying tax when money is available to spend, and against this benchmark the fact that their tax rate would have been higher if tax were levied earlier would not be viewed as tax relief.

The second tax ‘advantage’ often attributed to pensions is that there is no income tax or capital gains tax levied on investment returns within pension funds (tax is only paid when the money is withdrawn). Again, that is a tax relief compared with a benchmark system in which all income is taxed when it accrues, but it is debatable whether that is the most appropriate benchmark. In practice, the returns accruing on most other assets (notably including owner-occupied housing and Individual Savings Accounts (ISAs)) are not taxed (or not taxed in full) either.

Four other features of the current system provide tax breaks for pension savings (and these are tax breaks regardless of which benchmark the current system is compared with):

- (i) No NICs are levied on employer pension contributions (either when the contribution is made or when the money is withdrawn from the pension).
- (ii) 25% of a pension can be withdrawn free of income tax, and thus never incurs any income tax.
- (iii) There is no income tax charged on inherited DC pensions if the pension holder dies before age 75.
- (iv) There is no inheritance tax payable on bequeathed pension wealth.

In revenue terms, the lack of any NICs on employer pension contributions is by far the biggest tax advantage for pension saving. It has also grown as NICs rates have increased.

How much does pension tax relief cost?

HMRC publishes widely cited [estimates of the cost of pension tax relief](#). HMRC highlights that this is not the tax yield that would be expected from withdrawing tax relief or changing the tax treatment of pensions, as there would be significant

changes in behaviour. However, even with that caveat, these figures are easily misinterpreted and should be used with care.

The cost of NICs relief ((i) above) is relatively straightforward, at least assuming a fixed level of pension contributions. HMRC estimates that in 2019–20 the government gave up nearly £20 billion that it would have collected if the employer pension contributions made in that year had been subject to employer and employee NICs.

Income tax is more complicated. HMRC estimates that in 2019–20:

- income tax relief on pension contributions was £34 billion;
- income tax relief on investment returns within pension funds was £7 billion;
- income tax collected on pension income was £19 billion.

HMRC concludes that net income tax relief for pensions that year was £22 billion ($34 + 7 - 19$); coming on top of £20 billion NICs relief, that makes a total of £42 billion. However, there are a number of caveats and limitations which ultimately make that £22 billion figure more misleading than enlightening.

First, the HMRC figures compare the income tax relief given to today's savers with the income tax levied on today's pensioners. That provides an estimate of how much income tax revenue the government is forgoing in a particular year, but it is not a good estimate of how generous the system is to either the current generation of savers or the current generation of pensioners. Ideally one would want to calculate, for each individual, the total amount of tax they would pay on their pension saving over their entire lifetime given the current tax system, and compare that with how much they would pay under an alternative (benchmark) system. By instead comparing tax relief for current savers with tax from current pensioners, the HMRC figures ignore the fact that the number of people in each cohort, the size of their pension funds and the tax policies in place at different times in their lives are very different. If pension income will be higher in future (e.g. because there will be more pensioners than there are today), these figures will overstate the cost of pension tax relief.

Second, the HMRC figures compare the current income tax treatment of pensions with one particular alternative. Specifically, they are calculated compared with a system in which tax is levied on earnings paid into a pension and on investment

returns within a pension, but not on pension income ('TTE' treatment). That is one reasonable benchmark, albeit a benchmark system that would actively discourage saving and is harsher than the treatment applied to most other savings. But, as we have noted above, there are other reasonable benchmarks (e.g. one could compare with a system in which income was only taxed when it was available to be spent (an 'EET' system) or one in which earnings were taxed but the return to savings not (a 'TEE' system)). Different comparisons would yield very different estimates. The HMRC figures do not disentangle the cost of allowing 25% of a pension to be accessed tax-free or of the income tax exemption for pensions inherited from under-75s ((ii) and (iii) above, both of which would be counted as reliefs against any alternative benchmark).

Third, £7 billion is an underestimate of the tax forgone on investment returns within pension funds. It is calculated assuming income tax relief at the basic rate of tax, while in reality many of the returns will accrue to higher-rate taxpayers. It also does not include capital gains tax relief on capital gains made within pension funds; that is a big part of the relief on investment returns, but the government produces no estimate of it.

Finally, note that the government does not publish estimates of the cost of exempting bequeathed pension pots from inheritance tax ((iv) above). The cost of that will be small at the moment, as most of those now dying either have DB pensions or had already used their DC pension pot to buy an annuity before the introduction of '[pension freedoms](#)' in 2015 removed the requirement to do so. But as this new and tax-advantaged option grows in popularity, its cost is likely to rise rapidly.