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CIOT/IFS debate

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@TheIFS

How should the tax system treat pension saving?

abrdn
Financial Fairness Trust

When to tax pensions?

IFS

- Some argue for taxing up-front or restricting relief on contributions
- We might want a system that:
  - taxes large returns
  - delivers revenue when demands on public spending greater
  - is straightforward to apply even when employers contribute to defined benefit pensions
  - allows individuals to smooth their taxable income
- Deferring income tax until income is drawn achieves all these

Income tax

IFS

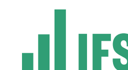
- Largely based on taxing income when it is drawn
- 25% can be taken as tax-free lump sum
  - subsidises pensions saving among those with £1m pension pots
  - more generous to higher-rate tax paying retirees, remember 45% of pensioners don't pay income tax
- Restricted by annual allowance and lifetime allowance, both reduced substantially in recent years
  - 7.5 times more people exceed annual allowance than in 2015
  - 6.7 times more people exceed lifetime allowance than in 2011
- A better system would
  - limit total tax-free lump sum, for example, to 25% of £400,000
  - give same rate of relief to all
  - relax annual and lifetime allowances

National Insurance

IFS

- Treatment varies by whether employer or employee contributing
  - employee contributions subject to employer and employee NICs
  - employer contributions escape NICs entirely
- £20 billion a year subsidy to pension saving which is
  - opaque
  - unintendedly increasing over time
  - poorly targeted
- A better system
  - apply employer NICs to employer contributions; apply employee NICs on pension income, aligning with income tax
  - maybe introduce with new and more rational subsidy on employer contributions

Conclusions



- Taxing income when received is a good basis for the tax treatment of pension saving
- Deviations should be well targeted at those otherwise at risk of under-saving for retirement
- Plenty of scope to improve design of
  - tax-free lump sum
  - National Insurance treatment of employer contributions
  - (treatment of pensions at death)