

Press Release

Millions to be taken out of the savings tax net, but taxes and charges continue to make decisions hard for savers

Savers face a complex and changing array of different tax treatments. These differences are big and can make the cost of choosing the ‘wrong’ savings vehicle very large. In addition apparently small differences in fees and charges can outweigh the effects of different tax treatments. Meanwhile pension auto-enrolment arrangements, which compel matching contributions from employers, will make saving through pensions auto-enrolment much more attractive than almost any other option with the same underlying return.

These are among the main findings of new work by IFS researchers on how taxes and charges can affect the attractiveness of different forms of savings. The research also highlights how recently announced changes will take the returns to many people’s savings out of tax altogether. That is a welcome simplification. It also means that, from April, those who can arrange their affairs so as to take up to £1,000 of interest income, £5,000 of dividend income and £11,000 of capital gains in any year could, if they can also use their income tax personal allowance, take up to £28,000 in returns to savings entirely free of tax, compared with £11,000 for those who can use only the personal allowance.

On differences between savings vehicles the report finds:

- Pensions remain the most tax-efficient major form of saving. Employer contributions to pensions are especially strongly favoured because of generous treatment in the National Insurance system. For a basic-rate taxpayer a contribution to a pension by their employer with a net cost of £70 is worth the same as a £100 contribution to an ISA.
- Investment in owner-occupied housing is significantly more tax-advantaged than investment in property to let, even before recently announced changes to the treatment of mortgage interest for landlords;
- Additions to ISA limits and taking some dividend and interest income out of tax means that savers can now save substantial amounts in bank accounts and shares tax-free.

Even where underlying returns are the same, it is not just different tax treatments for different savings vehicles that matter. People in different positions can face very different incentives to save in the same vehicles, while charges and matching contributions from employers may matter more than any tax differences:

Embargo

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- The new universal credit (UC) system will create huge disincentives to have more than £6,000 of savings in cash or shares for the seven million families affected. On the other hand those facing withdrawal of UC as their earnings rise will have a very big incentive to put money in a pension.
- The introduction of auto-enrolment obliges employers to contribute to most employees' pensions if the employees do. Under the default scheme employees will get a pension 60% bigger than without the match.
- An annual charge of 1% on funds can have an effect broadly comparable to charging basic-rate income tax on returns. For similar reasons, a low-charge ISA can offer a better return than a high-charge pension despite the tax advantage associated with the latter.

Stuart Adam, one of the report's authors said: "The last few years have seen radical changes announced to the taxation of savings. These will take millions of people's savings out of the tax net altogether. Ideally people might make savings decisions based on the underlying risks and returns of different assets. But taxes and charges can significantly change the relative attractiveness of different savings options. If people are unsure about how taxes and charges might change, their decisions become even harder."

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Notes to Editors:

1. For embargoed copies of the full report, "The Effects of Taxes and Charges on Saving Incentives in the UK," or other queries, contact: Bonnie Brimstone or at IFS: 020 7291 4800 / 07730 667013, bonnie_b@ifs.org.uk,
2. This report will be launched on the morning of Tuesday 16 February 2016, 10am-11.30 at the IFS, 7 Ridgmount Street, London WC1E 7AE. Please contact IFS events (020 7291 4800 or events@ifs.org.uk) for details if you would like to register to attend. <http://www.ifs.org.uk/events/1269>.

