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

General Features

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LITRG, CIOT and ATT respond to the HMT consultation

LITRG, ATT and CIOT responded to the Treasury's consultation on the future of pensions tax relief.

LITRG noted that the low opt-out figures for the recent auto-enrolment scheme for employees' pensions has been encouraging but the small sums involved from both employer and the individual suggest people are still not saving enough for retirement. The loss of top-up to the state pension with the abolition of contracted-in or contracted-out additions leave future pensioners having to make greater provision for themselves.

Pension savings are accrued in the long term and must therefore offer stability in order to engage the trust of the savers. LITRG makes a plea that rules and systems should be changed in future only if this is necessary to ensure improvement.

The LITRG response noted the importance of education in what is needed to provide an adequate income in retirement and how much must be contributed to produce this, especially among those on low incomes who have little 'spare' income and often have a more tenuous grasp of financial affairs. Savers must be encouraged to start early, bearing in mind the conflicting pressures of low starting salaries, paying off student loans, saving deposits for a house, starting a family and other more immediate demands on their limited income.

LITRG therefore proposed a standard rate of relief for all of 33.3% to incentivise those on low incomes in particular to set aside money for later years and possibly a top-up at age 30 to encourage an early start to the savings habit. LITRG also said a flat-rate tax relief on contributions would best meet the objectives of fairness to all and control of public expenditure.

ATT put forward the view that so many changes to the pensions system in recent years have created uncertainty and people have lost confidence in pension savings. The ATT urged the government and all parties to work towards a sustainable system that will remain unchanged for a significant period to rebuild confidence and incentivise people to become more engaged with pensions.

The ATT also mentioned that affordability is a large barrier to incentivising younger people to save towards retirement. Many in the main catchment group of 20- to 30-year-olds have other commitments on their incomes which is difficult for the government to address. The introduction of Auto Enrolment has helped, but only a little. Like LITRG, the ATT said education would be key in turning around people's perceptions of pensions. ATT suggested that a new advertising campaign promoting the benefits of saving towards retirement, similar to the one carried out in the 1980s, was needed to counteract the mainly negative press coverage of pensions.

The ATT did not believe that a change to a tax-exempt-exempt system would be an improvement. It might initially boost the Exchequer with tax on contributions, in the longer term this system would result in many pensioners drawing a tax-free pension and not contributing anything to the tax system. In addition, the ATT did not believe that taxing contributions up front would encourage people to save more, especially given the current affordability issues.

The CIOT thought that a comprehensive study, similar to that which preceded the reforms introduced by FA 2004, should form a key part of any reforms. The ideal would be that pensions saving remains attractive, that the underlying legislation is clear and certain, and that the regime is straightforward.

The CIOT recognised that a large proportion of contributions are made by employers and felt that considerable weight should therefore be given to their views before a decision to reform pensions tax relief is made.

The CIOT added that, if individuals are to be encouraged to save into pension schemes, there must be a confidence that government will not then substantially change the rules to the detriment of the individual. For example, year-on-year changes have undermined confidence in the longevity of the system. Required is a stable, trusted and sustainable system of pensions' taxation.

Finally, the CIOT said that, should the government decide not to undertake a wholesale reform of pensions tax relief, the current system of pensions taxation should be subject to a thorough review to restore the simplicity intended by the FA 2004 reforms. This is a point that we have made previously.

The government is now considering the responses to the consultation and the options for reform. It intends to publish its response at Budget 2016.

The LITRG submission is available on the LITRG website.