

Tax After Coronavirus (TACs) : Restricting pension tax ...

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Tax After
Coronavirus

Wealth taxes

The reasons why wealth needs to be subject to additional taxation has been discussed in another [Tax After Coronavirus \(TACs\) post](#), with all links being supplied there and so it will not be repeated here.

What was also discussed [in that post](#) was that the necessary short term changes to wealth taxation fall into three groups. They are, firstly, to equalise tax rates on equivalent sources of income or allowances. Second, it is by reconsidering those things that should be taxed that are not but might be if the goal of greater equality is to be achieved, and vice versa. In other words, those parts of available tax bases subject to exemptions and reliefs need to be reviewed. Third, it is about creating a more progressive tax system by changing tax rates without challenging, as far as possible, the first objective.

Restricting pension tax reliefs

In a [recent academic paper](#) co-authored with Prof Andrew Baker of the University of Sheffield we explored issues relating to wealth in the UK and the impact of tax upon it. As we noted, wealth is held as follows, based on the [most recently available data](#) at the time we were writing (it's since been updated but with little consequence for the argument made here):

| | £ billion | | Percentage Change |
|---|------------------------|------------------------|-------------------|
| | July 2012 to June 2014 | July 2014 to June 2016 | |
| Property Wealth (net) | 3,806 | 4,516 | 19 |
| Financial Wealth (net) | 1,564 | 1,630 | 4 |
| Physical Wealth | 1,130 | 1,230 | 9 |
| Private Pension Wealth | 4,385 | 5,354 | 22 |
| Total Wealth (including Private Pension Wealth) | 10,886 | 12,730 | 17 |
| Total Wealth (excluding Private Pension Wealth) | 6,500 | 7,376 | 13 |

Of that total wealth we noted that most property wealth (in the forms of people's homes), all pension wealth, and about a third of financial wealth at that time, in the form of ISAs, was tax subsidised. As we noted, also drawing attention to an analysis we had prepared on the costs of various tax reliefs in that same paper:

In total, therefore, it is likely that 81 per cent of UK personal wealth is held in heavily tax incentivised assets. The tax system — which incentivises these assets at a cost of more than £86n a year — is not neutral in the process. This analysis suggests that about 20 per cent of tax reliefs might be used in ways that promote inequality in the UK.

The figures can be open to minor reinterpretation, and will change slightly over time, but however we think this analysis is undertaken the same broad conclusion will be reached. In that case if the issue of wealth inequality is to be tackled then so too must tax reliefs be reformed.

The most egregious of these reliefs is that for pension contributions. The rules in this area are complex, most especially when they are tapered and partially withdrawn in various ways for those who are on the highest incomes (which has, overall, been a welcome step taken in recent years). However, the cost of this relief remains high. This [data comes from HM Revenue & Customs:](#)

Table 6 Cost of Pension Tax and NICs Relief

£ million

| | 2012-13 ¹ | 2013-14 ¹ | 2014-15 ¹ | 2015-16 ¹ | 2016-17 ¹ | 2017-18 ² |
|--|----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|
| Income tax relief on:- | | | | | | |
| Occupational Scheme Contributions | | | | | | |
| By Employees | 3,800 | 4,000 | 4,100 | 4,100 | 4,000 | 4,200 |
| By Employers | 18,100 | 17,100 | 16,700 | 19,300 | 18,200 | 18,600 |
| Personal Pension Scheme Contributions | | | | | | |
| By Employees | 1,800 | 1,900 | 1,900 | 2,000 | 1,800 | 1,600 |
| By Employers | 3,600 | 4,200 | 4,600 | 5,600 | 5,600 | 5,600 |
| Contribution to pensions by self employed | 600 | 600 | 600 | 600 | 500 | 500 |
| Investment income of pension funds ¹ | 5,800 | 5,900 | 6,100 | 6,800 | 6,500 | 6,700 |
| Pension tax relief | 33,700 | 33,700 | 33,900 | 38,300 | 36,700 | 37,200 |
| Less income tax liable on | | | | | | |
| Payments from pension schemes ² | 14,400 | 15,500 | 16,000 | 17,600 | 17,800 | 18,300 |
| Pension tax relief (net of tax received on pension income)³ | 19,200 | 18,200 | 17,900 | 20,700 | 18,900 | 19,000 |
| National Insurance Contributions (NICs) relief for employer pension contributions⁴:- | | | | | | |
| Employee NICs relief on employer pension contributions | 4,300 | 4,200 | 4,300 | 4,800 | 4,800 | 5,300 |
| Employer NICs relief on employer pension contributions | 9,500 | 9,400 | 9,500 | 11,000 | 10,700 | 11,200 |
| Pension NICs relief | 13,900 | 13,600 | 13,800 | 15,900 | 15,500 | 16,500 |
| Pension tax and NICs relief (net of tax received on pension income)⁵ | 33,100 | 31,800 | 31,700 | 36,600 | 34,400 | 35,400 |

p = mixture of provisional outcome and projections; r = revised

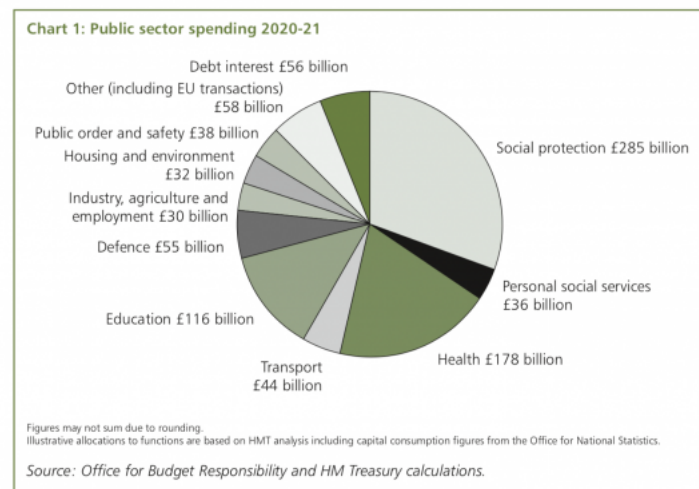
Updated September 2019

It is important to note that HM Revenue & Customs like to suggest that tax paid on pensions can be offset against the current cost of pension tax relief, but doing so breaches all the rules of accounting. The tax paid on pensions enjoyed in the current year relates to the tax reliefs given in earlier years, and not those of the current year. As such they cannot be offset. Items must relate to the same year to be offset.

The result is that the most recent estimate of the cost of pension tax reliefs is £37.2 billion for tax plus £16.5 billion of national insurance, or about £53.7 billion a year. That is almost exactly the same as current defence spending:

Government spending and revenue

Chart 1 shows public spending by main function. Total Managed Expenditure (TME) is expected to be around £928 billion in 2020-2021.



There is an argument as a result that this relief should be abolished altogether as a cost that cannot be afforded.

That is not suggested here, although it has been proposed that the relief should be made conditional on the use made of at least some of the money invested in pension funds.

Instead the issue that is of concern is that it is still the case that a great many people paying higher rate taxes (who represent approximately 12% of the taxpaying population) enjoy tax relief at 40% on the contributions that they make to pensions when about 88% of the UK population receive tax relief at 20%.

In other words, those who are the highest earners get at least double the tax relief for each pound that they contribute to their pension pot compared to most people, and this is bound to increase wealth inequality in the UK.

This is very obviously inappropriate: subsidising those already best off more than those who are not is contrary to the principle of seeking to reduce inequality that should be inherent in the UK tax system.

The solution is quite simple: no contribution to a pensions fund should enjoy tax relief at a rate greater than the basic rate of UK income tax. Higher rate pension tax relief should be abolished.