Reforming the conditions attached to pension tax relief...

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I have this morning published the latest note in my series that will make up the Taxing Wealth Report 2024.

This latest note refers to a proposed change in the conditions to be attached to pension tax relief. Doing so it updates previous proposals I have made on this issue and complements the proposals made recently on ISA reform.

Pension saving publis

The summary of this note says:

Brief Summary

This note proposes that in exchange for the tax relief given on qualifying pension contributions made to a UK pension fund that one-quarter of the contributions made should be invested in investments that would fund:

* The required climate transition if net-zero goals are to be achieved.
* New social housing.
* Other new social infrastructure.
* Related training, education and support services.

A further object of this exercise is to provide the opportunity for UK pension funds, which now have a marked preference for bond investment, to do so in a way that permits active choice by the funds and their members in the activities in which they would wish such savings to be used when at present very few bond saving opportunities make any link between funds saved and activity in the real economy.

Given that more than 77 per cent of the UK's financial wealth is saved in pension funds and at least 85 per cent is saved in tax-incentivised assets it is thought unlikely that there will be any significant adverse behavioural response to this proposal.

The proposal does not apply to any past sums invested.

It is thought that this proposal would release at least £35 billion per annum for investment in the activities noted, saving the government from having to do so as a result and providing it with a positive return on its own contribution to pension savings as a consequence. Without any other measure of the impact of this proposal being available, this sum is used for that purpose since it releases an equivalent amount for spending on alternative UK government budgets as a result.

Discussion

In a previous note in this series[1]**, it was suggested that the cost of pension tax relief to the UK Exchequer is about £65 billion per annum. Suggestions were made as result to restrict that relief in the case of higher rate taxpayers and to save more than £14 billion of that cost a year as a consequence.**

In another note in the series[2], it was noted that the cost of tax relief given to those who save in ISA accounts did not give rise to a commensurate economic benefit to the government in exchange for the tax relief given. As a consequence, it was suggested that the tax relief given on ISA accounts should be made conditional upon the funds saved in such accounts being used for appropriate social purposes.

In this note, those two observations are combined to make suggestion that in addition to pension tax relief being restricted to the basic rate of tax, irrespective of the income tax rate paid by the person making the contribution, the receipt of pension tax relief on contributions made by a person to a pension fund should be conditional upon at least part of the contribution that they make being made available to fund investment for social and economic programmes consistent with the objectives of the government granting such relief. In this way, the exceptional cost of pension tax relief (which is at present almost exactly equivalent to the current spending on schools in England[3]) could, at least, give rise to a commensurate return for the sum expended.

There is another reason for suggesting this reform. It is already Labour and Conservative Party policy to encourage greater direct investment by UK pension funds in the UK economy, both having noted how little direct engagement between pension funds and the underlying economy that there is. This is not least because of the marked preference of most pension funds for bond-based investment, little of which can be directly related to investment activity in the real economy, which is an issue that needs to be addressed.

This proposal could be achieved if pension funds invested in:

*** UK government green saving bonds of the type now issued through NS&I, which is the government's own savings bank. The use of these funds is noted by the government in occasional reports**

*** Green gilts issued by the UK government which are now becoming more commonplace.**

*** Bonds issued by a UK government-owned national investment bank that had as its purpose investment in the above-noted categories of assets, on which returns could be paid by their users.**

*** Private sector funds meeting the above-noted required specification for investment could be used for this purpose. A very clear taxonomy requiring strong evidence of the actual investment of funds raised for green purposes would be required for any company to qualify to raise funds in this way.**

It is stressed that the majority of UK financial savings are held in pension arrangements. It is likely that in 2020, when the most recent data with regard to this issue was published, that seventy-seven per cent of all UK financial assets were represented by pension savings. If ISAs are taken into account, it is likely that at the same date approximately eighty-five per cent of all financial assets were held in some form of tax-incentivised savings arrangement. It is therefore very unlikely that there would be a significant behavioural reaction to this proposal with people withdrawing their savings from pension arrangements as a result of it.

Cumulative value of recommendations made

The **recommendations now made as part of the Taxing Wealth Report 2024** **would, taking this latest proposal into account, raise total additional tax revenues or (in the case of this proposal) release sums available for alternative spending of approximately £150.1 billion per annum.**

Footnotes

[1]
https://www.taxresearch.org.uk/Blog/wp-content/uploads/2023/09/Restricting-pension-tax-relief-published-1.pdf

[2]
https://www.taxresearch.org.uk/Blog/wp-content/uploads/2023/11/The-use-of-ISAs-published.pdf

[3] **Based on data here:**
https://www.gov.uk/government/publications/autumn-statement-2023/autumn-statement-2023-html