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Pensions, savings and business taxation

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Pensions lifetime allowance

- Reduce the lifetime limit from £1.25m to £1m from April 2016
- Uprate it with CPI inflation from April 2018
- Raises £0.6bn per year by 2019-20
- Cut to £1m is one of Labour's three proposed pension tax increases
  - Better than reducing annual allowance: why does timing matter?
  - Much better than restricting the rate of relief: tax relief (at marginal rate) on contributions is the logical counterpart to tax (at marginal rate) on pension income
- But there are better ways to raise revenue from taxation of pensions
  - Revisit 25% tax-free lump sum and lack of NICs on employer contributions
- Uprating is sensible
  - So why not until 2018? And why not uprate annual limit too?

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Selling DC annuities in payment

- Penalty for selling annuity income to a relevant institution removed from April 2016
  - Instead, income tax charged at the seller's marginal rate when they draw on the sale receipt
- Government to consult on number of issues, including:
  - details of how the secondary market for annuities should operate
  - advice and guidance that should be provided
- 6 million annuities paid out a total of £13.3 billion to an estimated 5 million individuals in 2013

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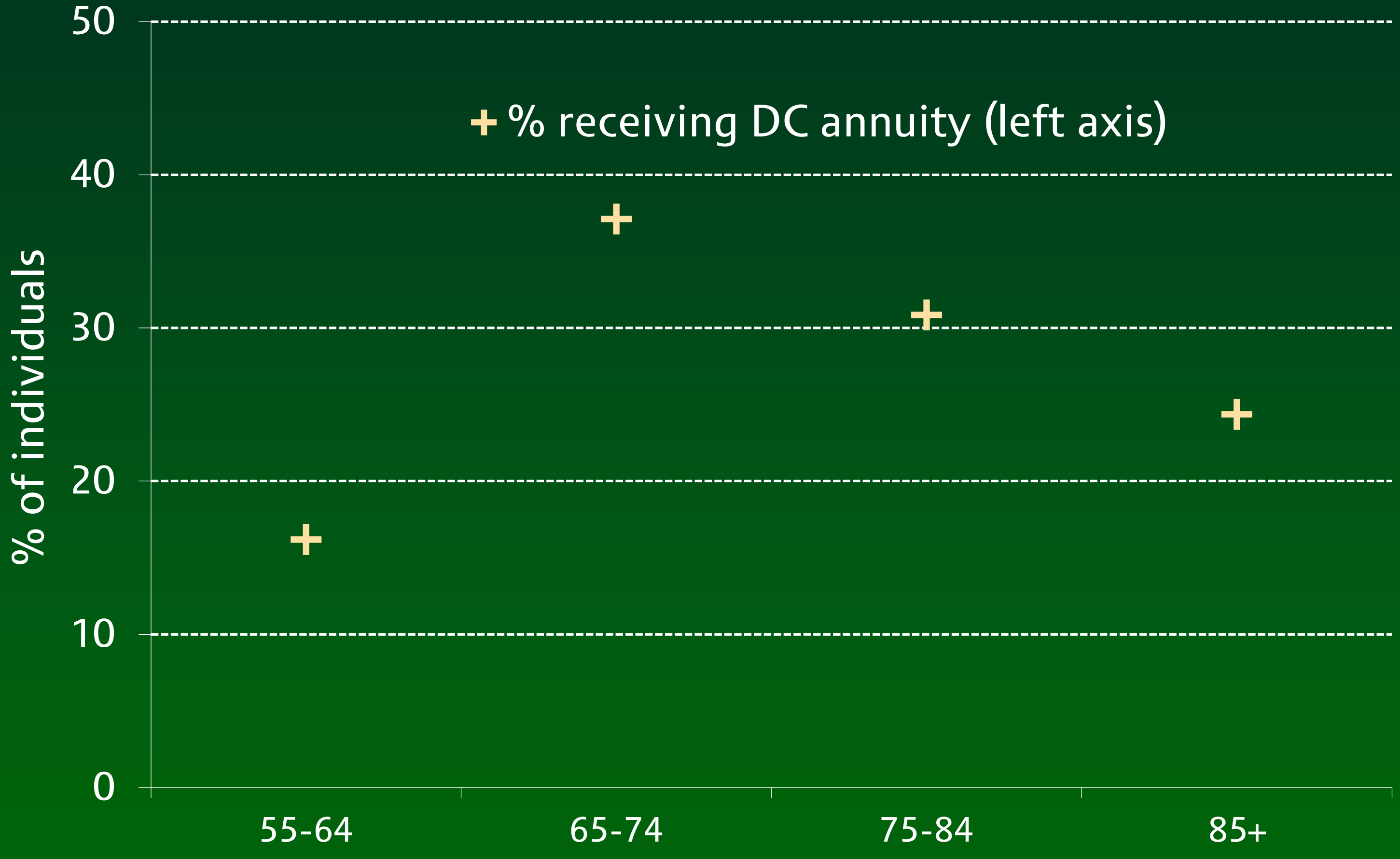
DC annuity holdings in England by age, 2012-13



Source: Calculations by Gemma Tetlow using data from the English Longitudinal Study of Ageing.

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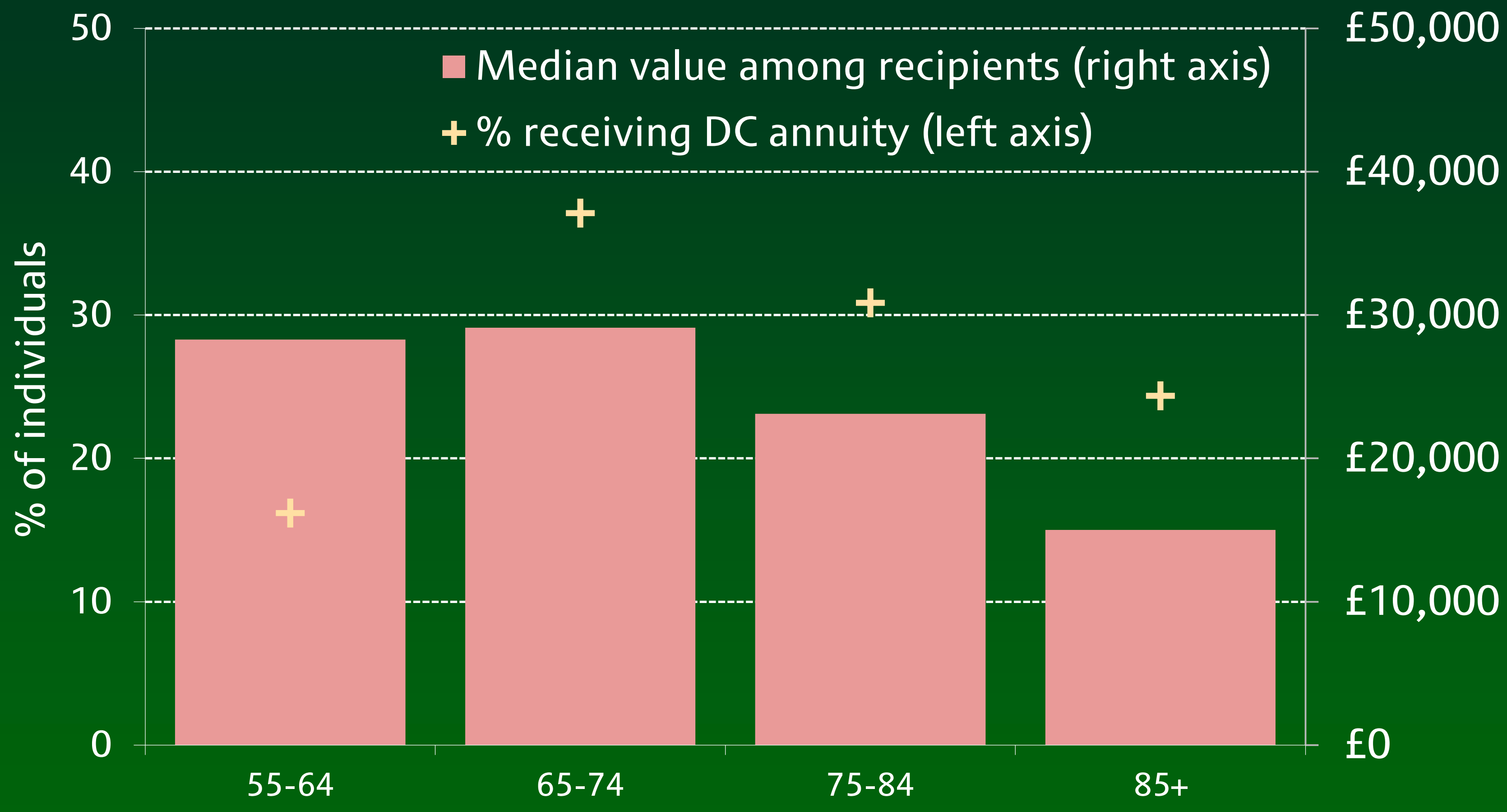

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Selling DC annuities in payment: pros and cons

- Advantage: welcome flexibility for some…
  - Logical counterpart to new flexibility in use of DC pension pots
- …though adverse selection means that secondary market in annuities might be limited or struggle to emerge at all
  - If many of those looking to sell an annuity are those who have good reasons to believe they might die soon…
  - …and those buying the annuity cannot reflect this in the price…
  - …then prices on offer will *assume* that those looking to sell their annuity will be likely to die soon…
  - …and these prices will be unattractive to most – especially women
- Disadvantage: some people might make bad decisions
  - Important to get the advice and guidance right
  - Oldest individuals might be least well placed to make complex and important financial decisions

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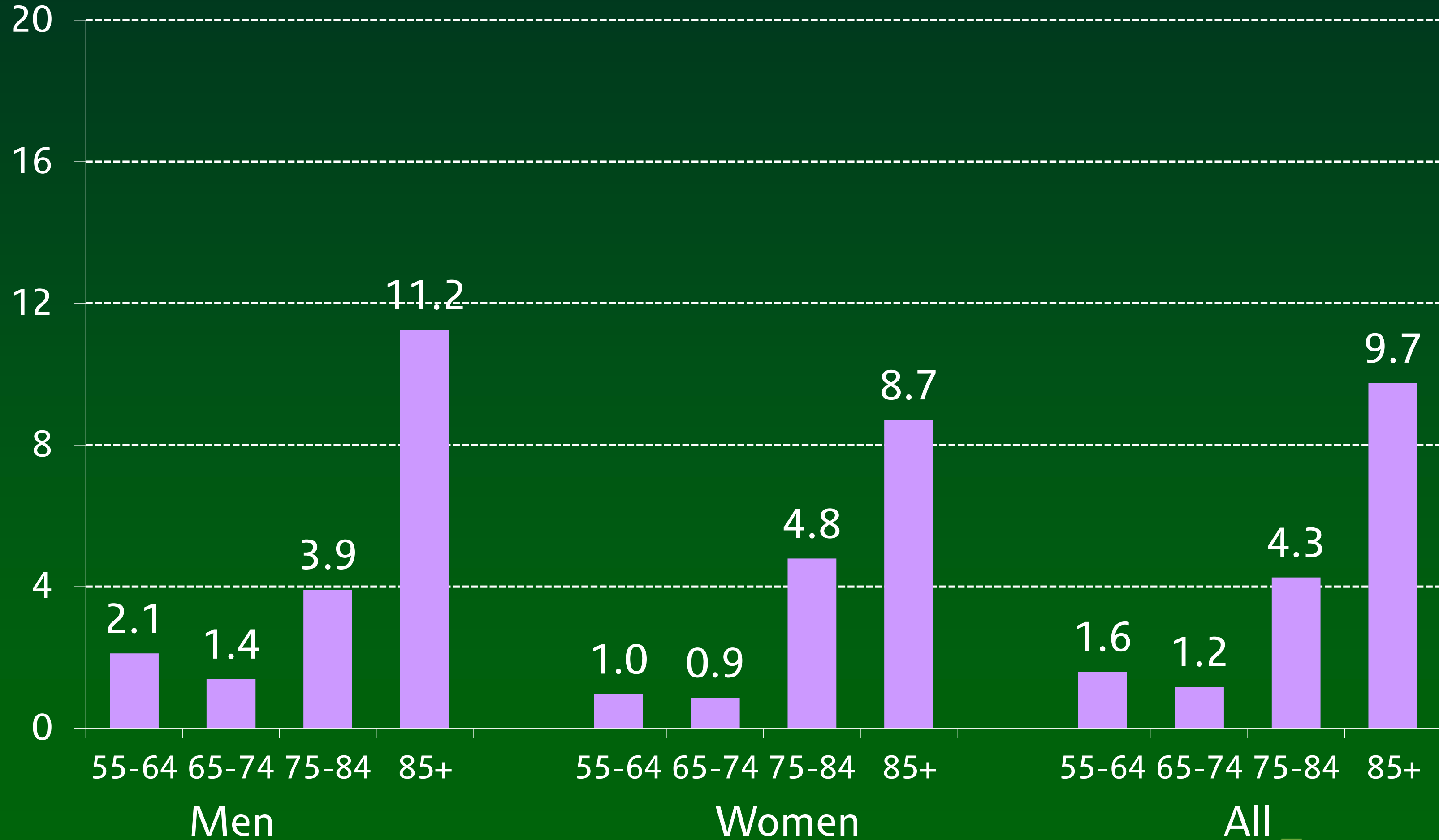
% of those with a DC annuity who say they have problems managing their money, 2012-13



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Personal savings allowance (1/2)

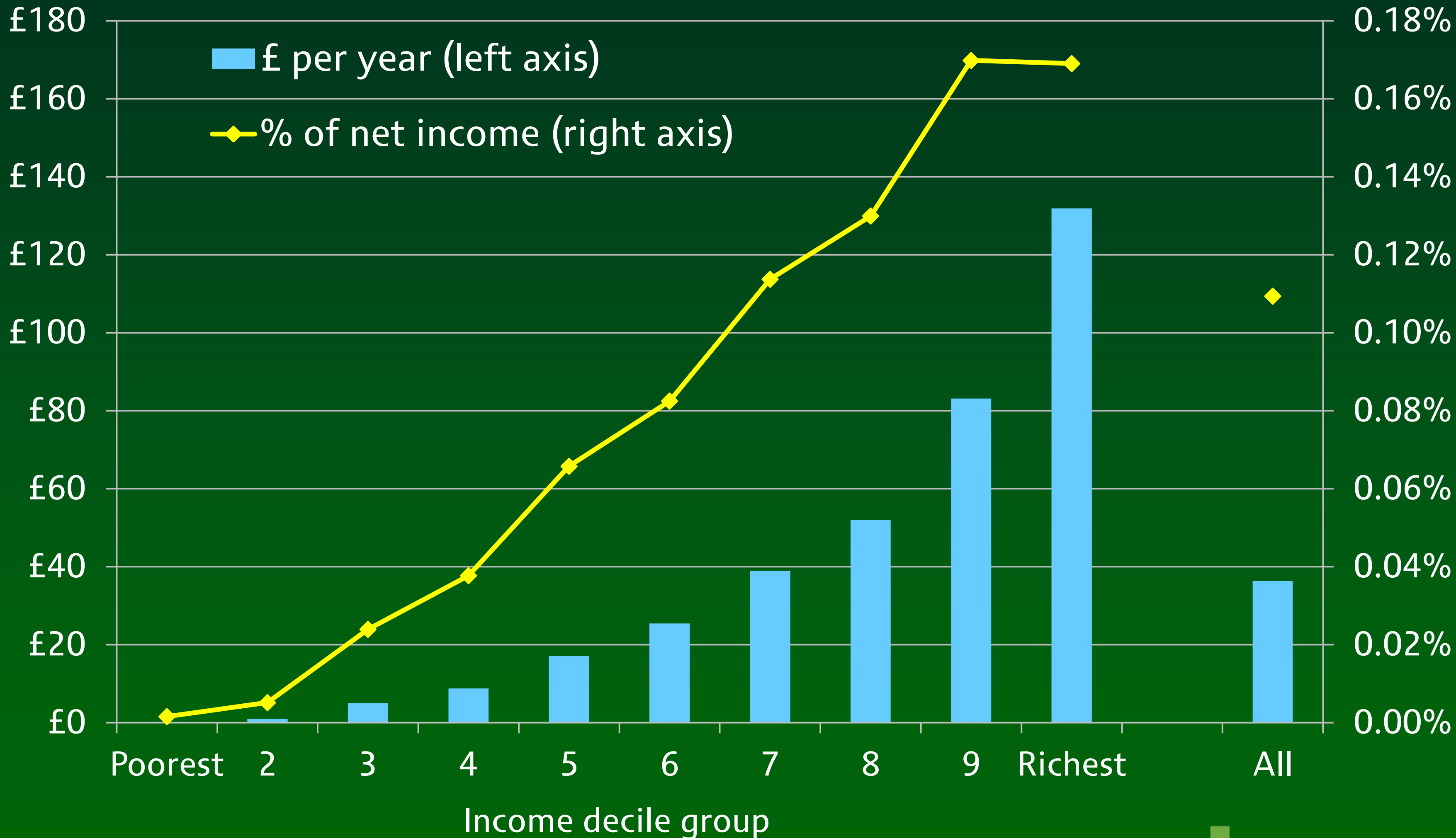
- Additional income tax allowance for savings income from 2016-17
  - £1,000 for basic-rate taxpayers, £500 higher-rate, £0 additional-rate
  - Worth up to £200 for basic- and higher-rate taxpayers
  - Some people will be up to £200 worse off by increasing their gross income

- On top of 0% rate for savings income in first £5,060 of taxable income
  - Already no tax due on savings income if total income <£15,860 in 2016-17
  - Reform means not tax if total income <£16,860
  - But many such people are taxed, incorrectly – reform will end that

- Government estimates no tax on savings income for 95% of taxpayers

- Cost unknown – not shown separately from ISA change
  - Combined cost £0.8bn in 2019-20

Distributional impact of personal savings allowance



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Personal savings allowance (2/2)

- Additional-rate taxpayers don't gain, but otherwise regressive
  - Those with income <£15,860 already not liable (though many taxed anyway)
  - Worth more to those with more savings income (albeit subject to a cap) – generally better off
  - Two-income couples gain twice – generally better off
- A big simplification
- Welcome removal of a disincentive to save for many people
- Better to tax high earners than to tax those who save their earnings
  - Budget did not do that so made system more efficient but more regressive

ISA limit reforms

- Can withdraw and replace funds within overall annual contribution limit
  - In effect, replaces gross limit on annual contributions with a net limit

- Welcome increase in flexibility
  - No obvious rationale for the restriction

Pension and savings taxation under the coalition

	Before coalition reforms	After coalition reforms
Bank interest	Fully taxed except in small 10% band	Not taxed unless very high savings or total income
ISAs		
Pensions		

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ISAs	Separate cash & equity ISAs £10,200 gross contribution limit	Unified ISA £15,240 net contribution limit
Pensions	£255,000 annual limit £1.8m lifetime limit Neither limit uprated Less flexible use of funds	£40,000 annual limit £1m lifetime limit Lifetime limit uprated More flexible use of funds

- Pensions more flexible but can save less in them
- Much more scope for tax-free saving elsewhere

Help to Buy ISAs (1/3)

- 4-year window to open an account, starting autumn 2015
- Can pay in up to £1,000 on opening account, £200 per month thereafter
  - Investment returns within fund tax-free like other ISAs
  - Can't pay into another ISA in the same year as a Help to Buy ISA
- When funds used to buy a first home, government will add 25% to up to £12,000 of contributions (so govt contributes up to £3,000)
  - If purchase price below £450,000 in London or £250,000 elsewhere
  - To pay in £12,000 takes at least 4½ years

Help to Buy ISAs (2/3)

- Very attractive offer for potential first-time buyers
  - If pay in £12,000 over 4½ years, top-up equivalent to an average annual interest rate on contributions of 20%
- Many will pay in amounts they would have saved anyway
  - But some will save up to £12,000 more, to benefit from the top-up
  - And some will save up to £3,000 less, as need less to buy same home
- Those who find it easiest to qualify for the maximum £3,000 top-up will include those who have already saved £12,000 and those with wealthy parents
- Government estimates annual cost climbing to £835m by 2019–20
  - Assumes 60% of first-time buyers take it up

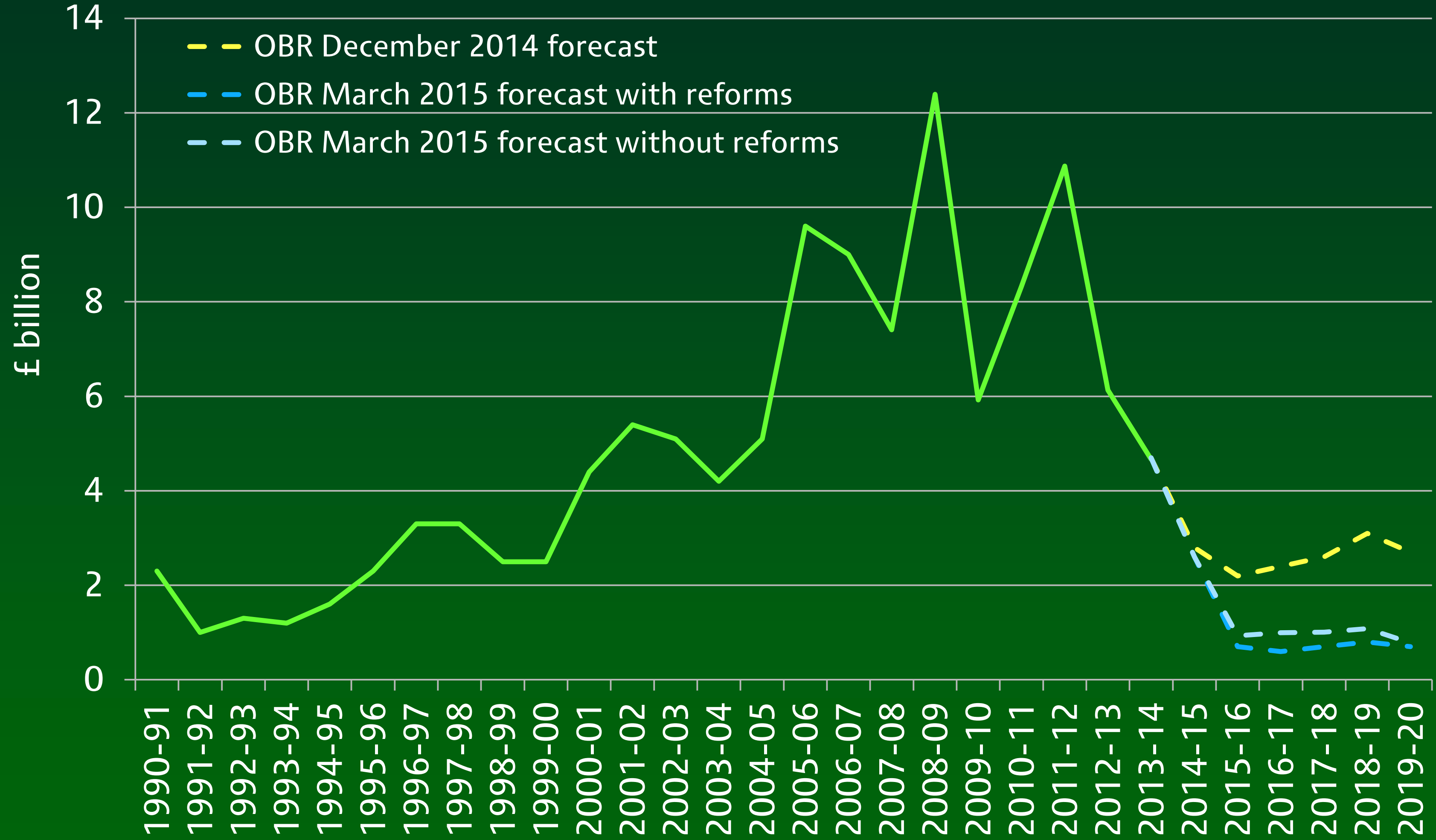
Help to Buy ISAs (3/3)

- Policy motivated by concern that some struggle to buy first home, especially if don't get assistance from friends or family
  - home ownership rate at age 25 has fallen from 45% for those born in the mid-1960s to 20% for those born in the mid-1980s
- But increased demand will bid up house prices
- If no extra supply, overall affordability cannot increase
  - Though first-time buyers can still gain
  - Others looking to buy a more expensive home find it harder
- So benefits shared between first-time buyers and existing owners
- Policy will affect timing and size of first-time purchases
  - Some might delay until 2020 in order to qualify for maximum top-up

North Sea taxation reduced

- Supplementary corporation tax cut from 30% to 20% from Jan 2015
  - Overall corporation tax rate reduced from 60% to 50%
- Petroleum revenue tax reduced from 50% to 35% from Jan 2016
  - Overall marginal rate cut from 80% to 67.5% for (the few) pre-1993 fields
- Single investment allowance replaces field allowances from Apr 2015
  - Simplification
  - Not clear what justifies a large subsidy for offshore investment
- Total cost £0.4bn in 2016-17, £0.1bn in 2019-20

North Sea tax revenues



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Bank taxation increased

- Bank levy increased from 0.156% to 0.210% from April 2015
  - Raising £0.9bn
  - The 9th different rate that has been due to apply from April 2015
- Compensation payments no longer a tax-deductible business expense
  - Revenue peaks at £0.3bn in 2016-17

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Business rates in England reformed

- Business rates 100% retention pilots
  - Councils now keep 25-50% of revenue from new developments until 2020
  - Pilot areas will instead be able to keep 100%
  - Stronger incentive to encourage development, but favours the fortunate
- Wider policy review launched last week
  - See IFS Green Budget 2014 for a discussion of business rates policy

Summary

- Tax cuts for the oil industry, tax rises for banks, more upheaval for both
- Lifetime pension limit cut (bad) then uprated (good)
- Savings tax simplified and unwelcome disincentive to save removed
- More flexibility for savers – welcome if used wisely
- Dubious policy to help first-time buyers and inflate house prices

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