Paying for Dilnot

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January 23, 2013

Paying for the Dilnot commission proposals

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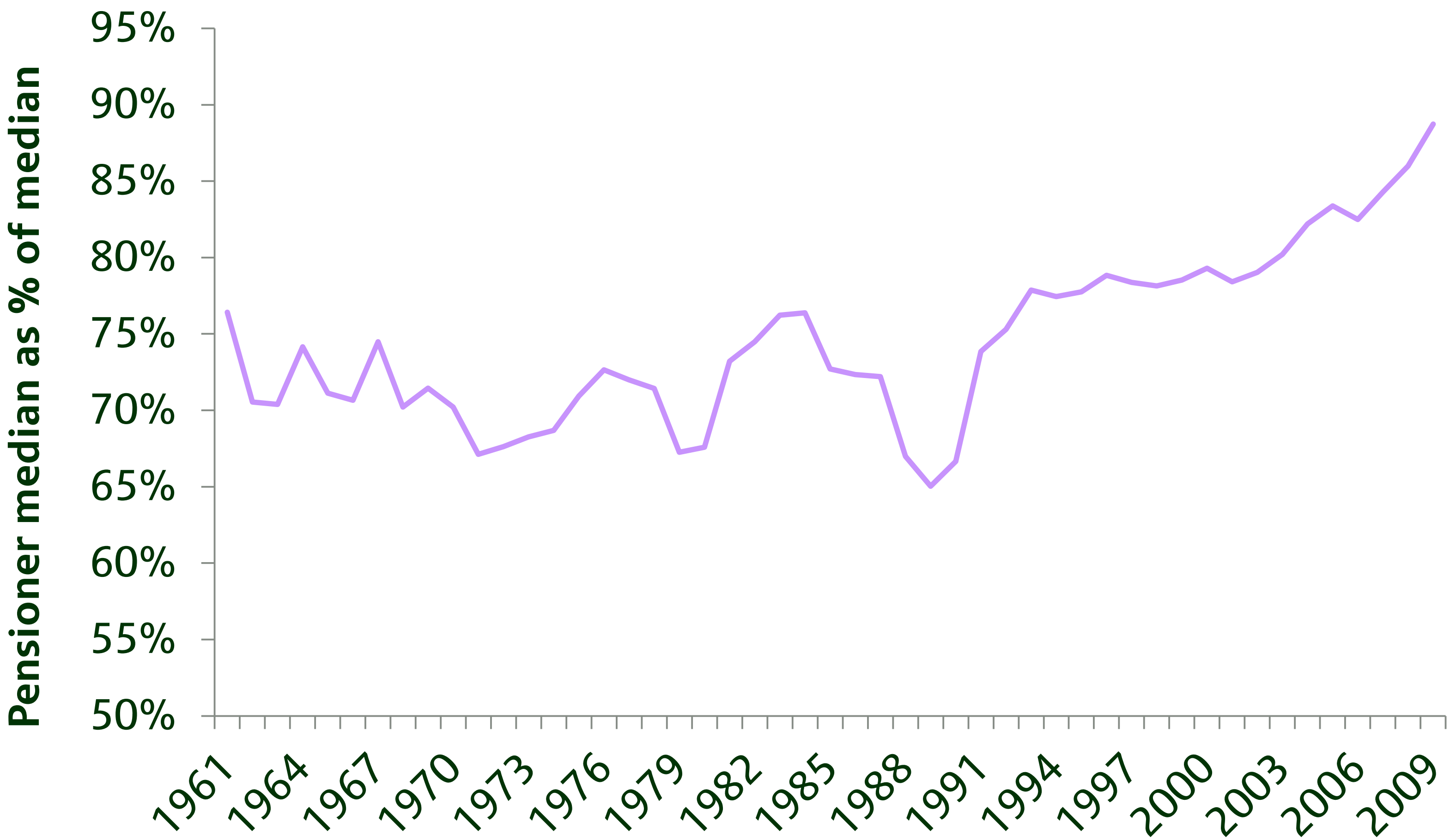
  - Could raise taxes or cut spending very slightly across the board…
  - …or go for approach that is distributionally neutral by increasing taxes or cutting benefits for those who would gain from proposals

Background: pensioners have become a relatively richer group over time



Paying for the Dilnot commission proposals

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  - Could raise taxes or cut spending very slightly across the board…
  - …or go for approach that is distributionally neutral by increasing taxes or cutting benefits for those who would gain from proposals
- Focus on second of these. Key question:
  - Are there coherent ways of ensuring that better off pensioners as a group pay for more generous social care funding?
- Need to consider tax and benefit system as a whole:
  - What elements of the current tax and benefit system look less than coherent?
  - And how could they be reformed to raise money while enhancing coherence?

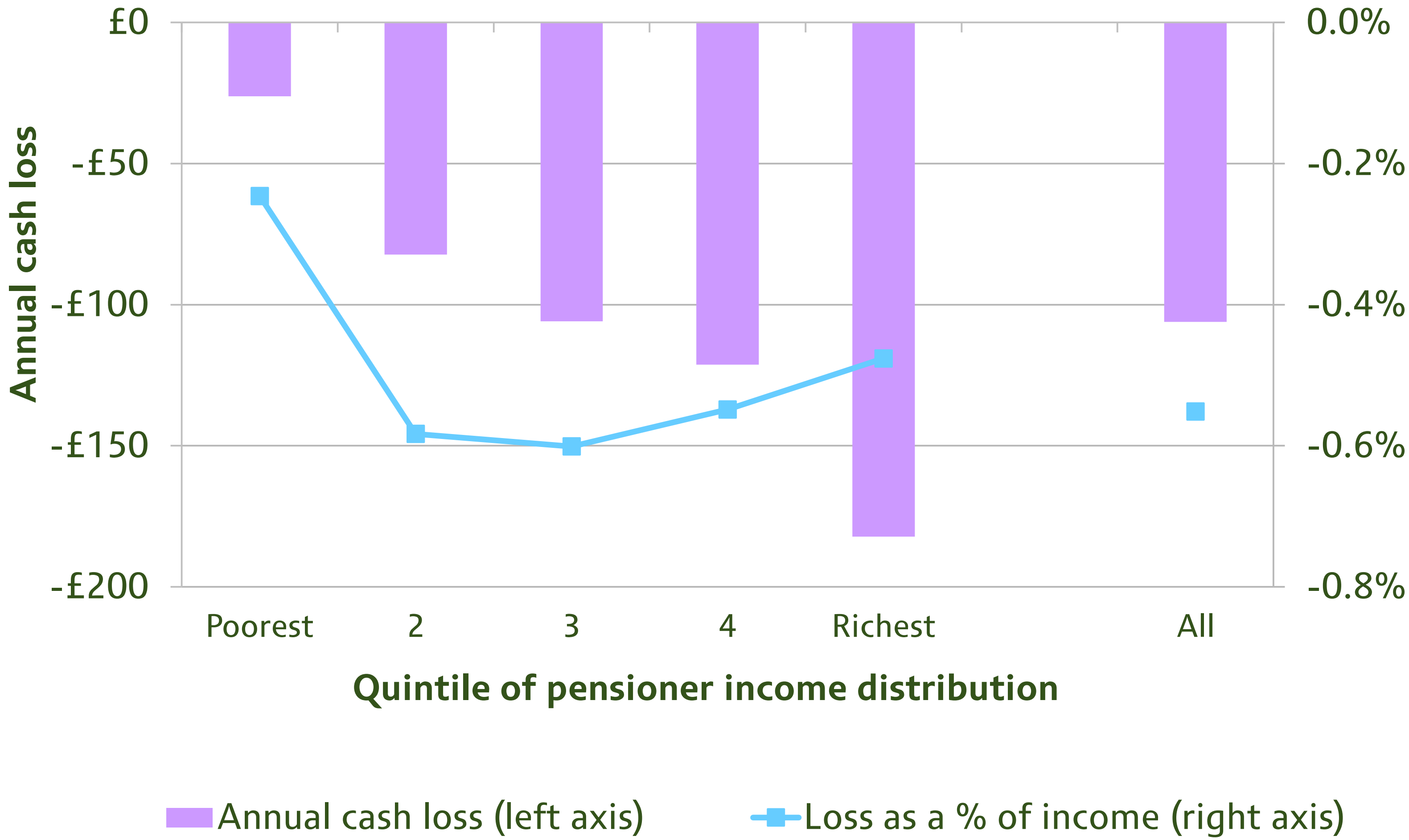
Principles for reform

- Look for where the current system deviates from a coherent structure for supporting pensioners
- Basic and earnings related pensions and pension credit represent a coherent system of support by themselves
- Other additional benefits and tax reliefs need to be justified

Additional benefits

- Winter fuel allowance and free TV licences
  - Go to all pensioners, not taxed or means-tested
  - Cost: £2.1 billion for WFPs and £0.6 billion for free TV licences
  - Just giving them to those on Pension Credit could save £1.5–£2 billion
  - Richer households lose, though biggest in percentage terms for those with incomes just above the cutoff for Pension Credit

Distributional impact among pensioners of means-testing Winter Fuel Payments



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- Pros:
  - Why have separate benefit in the first place?
  - Those who benefit from Dilnot proposals pay
- Cons:
  - IFS research has shown giving pensioners Winter Fuel Payments does increase their spending on fuel. If pensioners would otherwise spend a less than socially-optimal amount on fuel, may want to keep them
  - More means-testing: weakens incentive to save for retirement, increases complexity, take-up of Pension Credit fairly low

Also look at coherence of the tax system

- No NICs on earnings after state pension age – cost £800 million
  - Imposing NICs would take money away from higher income pensioners
  - But might want lower tax rates for older workers as more responsive to incentives
- Higher income tax personal allowances
  - Being phased out
- Single person discount for Council Tax
  - Particularly valuable to pensioners
- CGT is forgiven at death – cost £600 million
  - No justification for this: encourages people to hold onto assets when could be more profitably reinvested elsewhere
  - And IHT is probably in need of reform

Taxation of pensions

- Tax neutral treatment of saving generally appropriate
  - Though probably want more generous treatment for pensions
- Tax neutrality implies not taxing returns to saving, and either taxing contributions or pension income in retirement
- In the UK pensions are treated in the following way:

	Income Tax	National Insurance
Employee contributions	Exempt	Taxed
Employer contributions	Exempt	Exempt
Returns	Exempt	Exempt
Withdrawals	Taxed, apart from 25% tax-free lump sum	Exempt

- Two divergences from neutrality: tax free lump sum, and employer contributions escaping NICs altogether

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Potential reforms to taxation of pensions

- Tax free lump sum costs £2.5 billion
  - Can get up to £312,500 tax free: limiting to higher rate threshold could save £500 million
- Employer pension contributions not subject to NI at any point
  - Which is both distorting/unfair to those whose employer does not contribute and extraordinarily generous
- Imposing NI *on private pensions* in payment could raise £350 million per 1p
  - Any such change would need to be phased in: would mean past employee contributions faced NICs on the way in and on the way out
  - Would also want offsetting NICs relief on employee contributions: overall cost in short run
  - Higher-income pensioners would lose the most from this…

Distributional effect of imposing full employee NI rate on private pension income

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Conclusions

- The "Dilnot reforms" would benefit better off pensioners
- As a group, pensioners have done relatively well in recent years
  - Though their incomes are still below those of working age on average
- The current tax and benefit system is not wholly rational in its treatment of pensioners
  - If one wanted to find money from better off pensioners to fund the Dilnot proposals one could, and improve coherence of system at the same time
- Universal benefits like winter fuel allowances and free TV licences could be means-tested, abolished, or consolidated into the Basic State Pension or Pension Credit
- CGT at death, NICs and tax treatment of pensions could all be reformed in ways that raise money and increase coherence