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Lifetime ISAs

Stuart Adam

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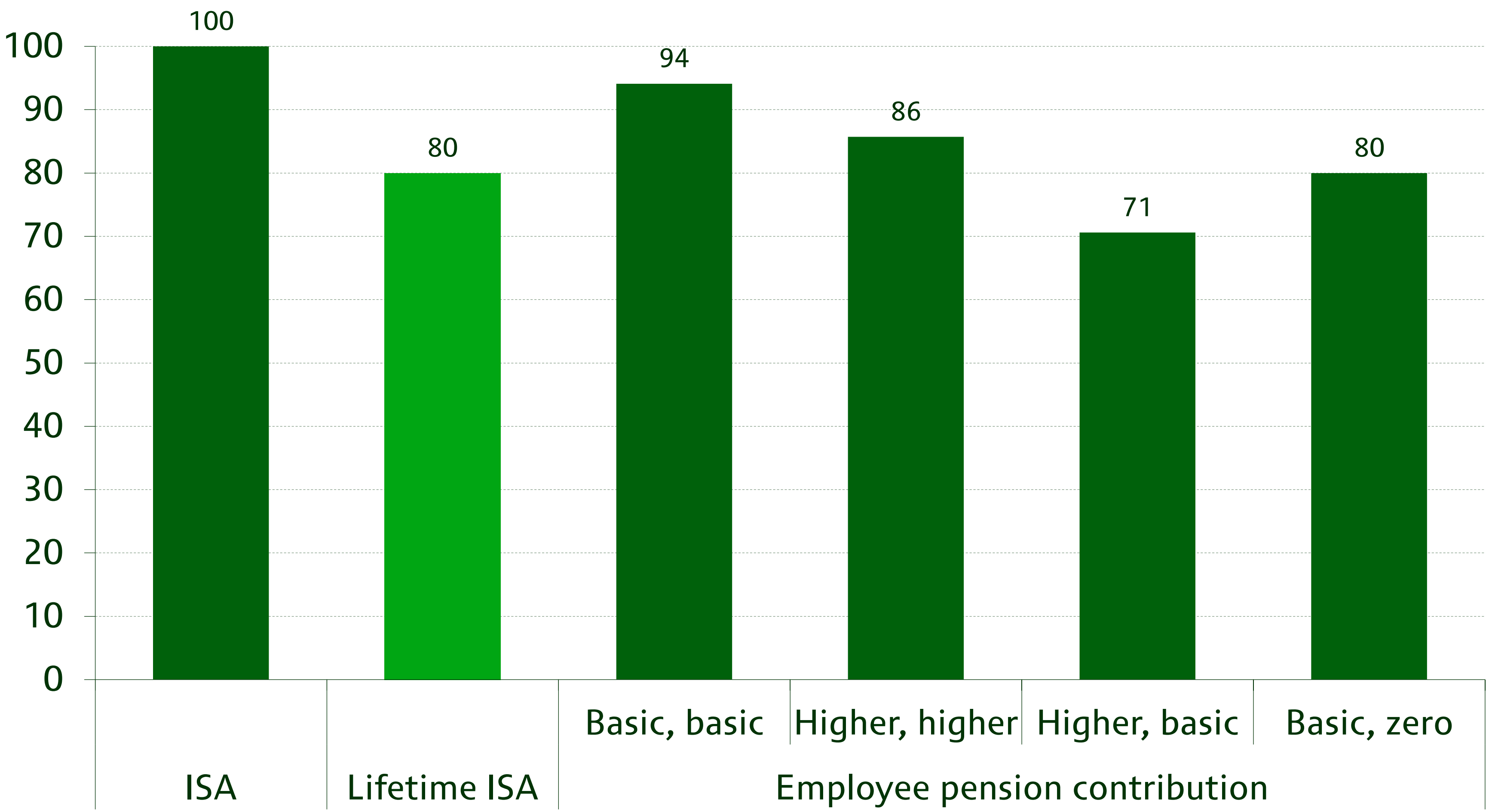
Lifetime ISA

- Accounts can be opened by 18-40-year-olds from April 2017
- Contributions count towards ISA limit; like ISAs, no tax on returns
- While aged 18-50, government will add 25% to up to £4,000 of contributions each year
  - So over 32 years, max £32,000 top-up on £128,000 of contributions
- Can withdraw from age 60, or earlier to buy 1st home for <£450,000
  - If withdraw earlier for other purposes, 5% charge + lose the top-up

Contribution required to match 100 saved in ISA

By marginal tax rate in work and in retirement



Note: Effect of taxes only, holding all else constant

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LISAs vs. pensions

- Employee pension contributions lower-tax option than LISAs only for higher-rate taxpayers who expect to pay basic rate in retirement
- Employer pension contributions still more favourably treated
  - Thanks to generous National Insurance regime
- Employer match also strong incentive to make employee contribution
  - But not to put *additional* savings in pension rather than LISA
- Differential returns or charges could be more important than tax
- Can gradually shift money from LISA to pension from age 60
  - Benefit from LISA top-up *and* pension tax-free lump sum

What might we expect?

- Evidence unclear how much incentives affect level of saving
- Evidence clear that incentives do affect where savings are held
- So expect lots of shifting of existing savings into LISAs
  - In 2013, 3.2m under-45s had more than £3,000 in ISAs
- Big winners: basic-rate taxpayers who can transfer existing savings
  - And higher-rate taxpayers saving for 1st home

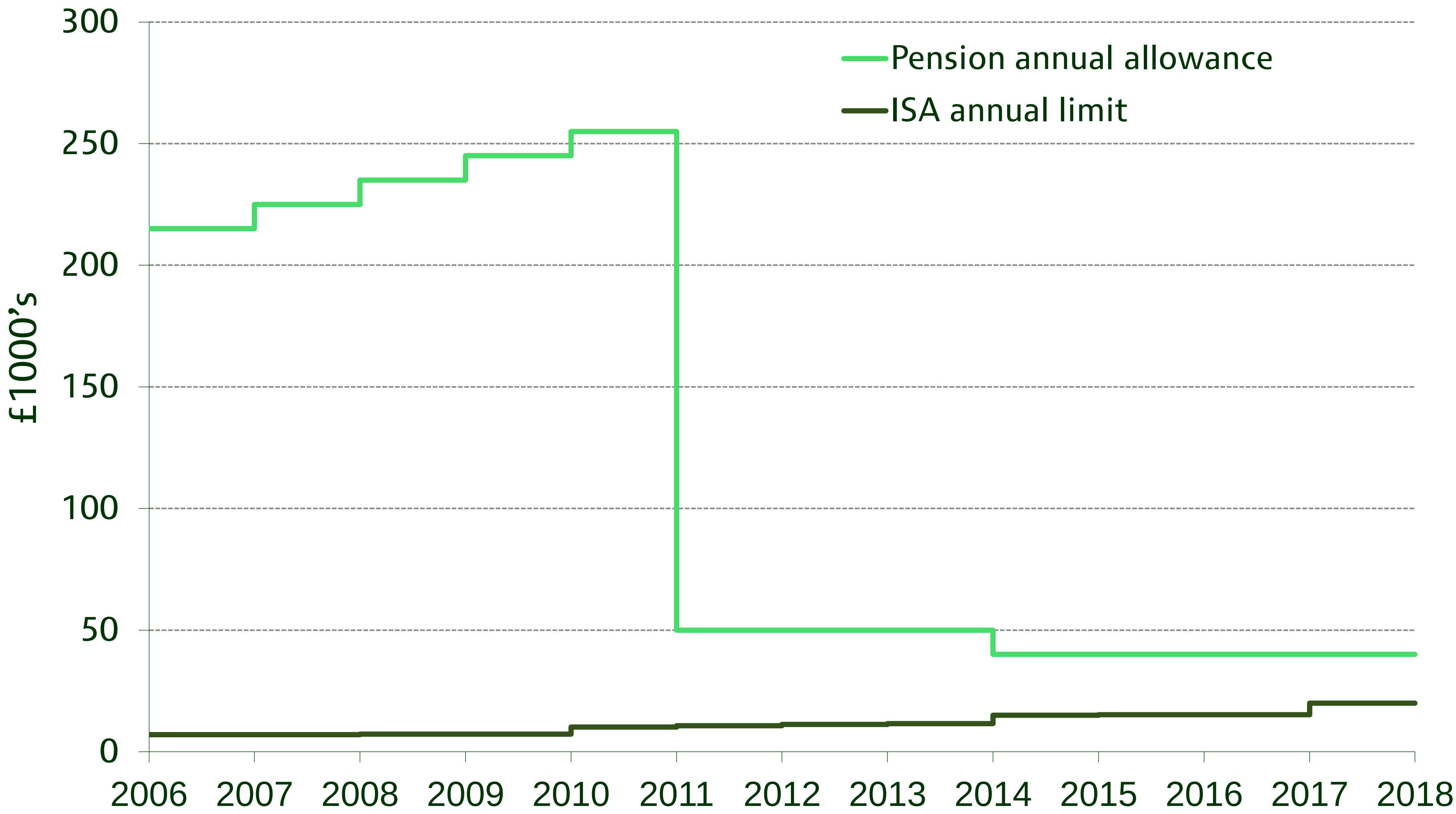
What does the government expect?

- Gov’t has published shockingly little information: no estimates of
  - Number of LISAs expected to be opened
  - Average balance in each account
  - Extent to which this is expected to represent new saving or shifting existing funds, and shifting from where
- Expects introduction of LISAs to cost £830m in 2020–21
  - Suggests that government expects low take-up
  - Policy could be much more expensive if take-up is high

A move in the right direction?

- ‘Bang for buck’ depends how much LISA saving is additional vs. shifting
- But is paying people to save more a good idea anyway?
- Clear rationale for encouraging saving for retirement
  - But less so when use of money from age 60 unrestricted
  - (Applies to both LISAs and DC pensions)
- Less clear rationale for encouraging saving for a home more than other pre-retirement consumption
  - OBR expects it to increase house prices by 0.3%
- Further shift from deferred to upfront taxation

Annual limits on saving in pensions and ISAs



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- Less clear rationale for encouraging saving for a home more than other pre-retirement consumption
  - OBR expects it to increase house prices by 0.3%
- Further shift from deferred to upfront taxation
  - Flatters public finances in the short run
  - Aligns tax revenue less well with public finance costs of ageing
  - Government no longer takes a share of any exceptionally high (or low) returns earned
  - Makes it harder for people to smooth their taxable income

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