Pensions, savings and business taxation

Stuart Adam
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?
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
DC annuity holdings in England by age, 2012-13

% receiving DC annuity (left axis)

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Source: Calculations by Gemma Tetlow using data from the English Longitudinal Study of Ageing.
DC annuity holdings in England by age, 2012-13

Source: Calculations by Gemma Tetlow using data from the English Longitudinal Study of Ageing.
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
% of those with a DC annuity who say they have problems managing their money, 2012-13

Source: Calculations by Gemma Tetlow using data from the English Longitudinal Study of Ageing.
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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<table>
<thead>
<tr>
<th>Income decile group</th>
<th>£ per year (left axis)</th>
<th>% of net income (right axis)</th>
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<tbody>
<tr>
<td>Poorest</td>
<td>£0</td>
<td>0.00%</td>
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<tr>
<td>2</td>
<td>£20</td>
<td>0.02%</td>
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<td>7</td>
<td>£120</td>
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<td>8</td>
<td>£140</td>
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<td>9</td>
<td>£160</td>
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<td>Richest</td>
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<td>0.18%</td>
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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

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<td>£1.8m lifetime limit</td>
<td>£1m lifetime limit</td>
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<td>Neither limit uprated</td>
<td>Lifetime limit uprated</td>
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<td>Less flexible use of funds</td>
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- 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
• 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

- OBR December 2014 forecast
- OBR March 2015 forecast with reforms
- OBR March 2015 forecast without reforms

£ billion

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Bank taxation increased

- Bank levy increased from 0.156% to 0.210% from April 2015
  - Raising £0.9bn
  - The 9\textsuperscript{th} 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
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