Centre for Policy Studies

Pointmaker

FIVE PROPOSALS TO SIMPLIFY SAVING

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SUMMARY

- The household savings ratio in Britain is now just 4.9%, the lowest level since records began in 1963.
- While ISAs have soared in popularity, the amount going into pensions has fallen. For basic rate taxpayers, the existing tax relief is insufficient to overcome the complexity, cost and inflexibility of pensions products.
- The current system is not only incomprehensible to the public, but expensive. In 2016-17, the combined cost of tax relief and National Insurance rebates on pension contributions was £47 billion – of which 40% went to the top 10% of earners. The top 1% received more than double the total amount paid out to the bottom half of the population.
- Government recently announced a review of pensions tax relief.[1] This paper makes five proposals to simplify the retirement savings landscape and to create a much broader savings base.

1. Tax reliefs should be replaced by bonuses on individual and employer retirement savings contributions.
2. The Treasury should introduce a cap of £2,500 on the total bonus that any individual could receive in one year. The bonus rate should be 25% – or perhaps 50% on the first £2,000 saved, and 25% thereafter.
3. The rules governing auto-enrolment should be reformed, and the £10,000 minimum earnings threshold should be scrapped.
4. NIC rebates should be replaced with bonuses paid on employer contributions, paid directly into employees' personal accounts.
5. A Workplace ISA should be introduced to house employer contributions, locked in until the age of 60.

- Implementation of these proposals would facilitate the introduction of a better framework for all future savings contributions. This would help incentivise mass savings, and save the Treasury an estimated £10 billion a year.

[1] Baroness Buscombe, Parliamentary Under Secretary of State for Work and Pensions, House of Lords, 25 June 2018. The Treasury Select Committee subsequently reiterated the call for a review of tax relief on pension contributions.

INTRODUCTION

Given the UK's dependence on imported capital, and the prospect of rising international competition for capital, particularly from other (developed) nations with ageing populations, we need to stimulate a *broad-based* savings culture — that is, more people saving more (as opposed to just the wealthy saving more). We should aspire to increase the nation's household savings ratio from 4.9% (in 2017, the lowest annual figure since records began in 1963) to, say, the 1980s average of 11.3%.[2]

Embracing simplification in the financial arena is central to promoting a broad-based savings culture.

1. TWO DISPARATE WORLDS: EET AND TEE

The savings landscape is characterised by a fundamental schism. Saving within a pensions framework provides tax relief on the way in ("EET" — Exempt, Exempt, Taxed), whereas subscriptions to ISAs are made with post-tax income, but withdrawals are tax-free.[3] Consequently, ISAs are "TEE" (Taxed, Exempt, Exempt).

Over the last decade, stocks and shares ISA subscriptions have increased by 115%, to £22.3 billion in 2016-17, taking their total market value to £315 billion.[4] In the same year an additional £39.2 billion was subscribed to 8.5 million cash ISA accounts, taking the ISA cash mountain to £270 billion.

Clearly, engagement with ISAs is high, as confirmed by industry surveys and acknowledged by the Chancellor when he raised the annual subscription limit by 31%, to £20,000, from April 2017. Importantly, the ISA brand is still reasonably trusted.

Conversely, in 2016-17, individuals contributed only £9.4 billion to the EET world of private pensions schemes (a figure which *includes* basic rate tax relief), down 8% over the last decade.[5] Official data excludes SIPPs and SSASs, which attracted perhaps another £5 billion.

It is clear from the manner in which basic rate taxpayers (i.e. 84% of all taxpayers) are saving that the lure of 20% tax relief on pension contributions is insufficient to overcome pension products' complexity, cost and inflexibility (until the age of 55). The widespread distrust of the pensions industry is also often cited as a deterrent. In addition, pension products are increasingly at odds with how people are living their lives, particularly Generation Y (broadly, those born between 1980 and 2000). Ready access to savings is their key requirement, valued above tax relief. Indeed, Generation Y is so disengaged from private pension saving that the industry's next cohort of customers could be very thin.[6] Consequently, savers are missing out on upfront tax relief: an EET tax framework for retirement saving is failing the next generation.

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2 ONS.

3 Retirement savings products are codified chronologically for tax purposes. Pensions are "EET", as Exempt (contributions attract tax relief), Exempt (income and capital gains are untaxed, bar 10p on dividends), and Taxed (capital withdrawals are taxed at the saver's marginal rate). Conversely, ISAs are "TEE", except for the Lifetime ISA, which is *effectively* EEE for basic rate taxpayers.

4 *Individual savings accounts statistics, Tables 9.4 and 9.6;* HMRC, April 2018.

5 *Personal pension contributions, Table Pen 1;* HMRC, February 2018.

6 The workplace arena is, however, benefiting from automatic enrolment.

2. EET: MANY FLAWS

2.1 Expensive for the Treasury

In 2016-17, tax reliefs on pensions contributions cost some £47 billion, comprising:[7]

(i) upfront income tax relief on contributions (£30.8 billion); and

(ii) rebates on National Insurance Contributions (NICs) related to employer contributions, at a cost of £16.2 billion (a figure that will accelerate with auto-enrolment).

To put this into perspective, this cost is equivalent to more than half of the Department for Education's Total Managed Expenditure (£90 billion for 2016-17), substantially more than Defence's £40 billion, and more than the combined budgets for Transport (£20 billion), the Home Office (£14 billion), the Ministry of Justice (£7.7 billion) and DEFRA (£2.2 billion).[8]

In addition to the "cash" cost of tax reliefs, there was an (annual) opportunity cost of nearly £13 billion:

(i) £7.9 billion in respect of the tax-exempt status of investment income generated within a pensions framework (this assumes relief at the basic rate of tax). HMRC does not make an estimate of the relief provided for capital gains realised by pension funds; and

(ii) at least £5 billion as a result of the 25% tax-free lump sum available for withdrawals.

Meanwhile, in 2016-17, the pensioner population (12.6 million) paid income tax of only £13.5 billion on personal pension income (i.e. excluding the state pension), less than one third of the cost of tax relief. And while these figures obviously relate to different age cohorts of the population, they involve very similar numbers of people. The Treasury is unlikely ever to recover what is a very large net negative cashflow, the principal cause being income tax band downshifting upon retirement.

Indeed, the cashflow gap is likely to widen because the rapidly rising personal allowance (£11,850 this year) will increase the number of pensioners who pay no income tax at all (just over 50% today). In addition, automatic enrolment's statutory minimum contributions are in the process of quintupling (by April 2019), so we should expect the tax relief bill to rise rapidly.[9]

2.2 Tax relief: incomprehensible

Roughly half of the adult population do not understand pensions tax relief. Consequently, it is unlikely to motivate them to save. In addition, it is accompanied by a panoply of allowances (annual and lifetime), tapering rules and technical complexities – such as the uncrystallised funds pension lump sum, known as UFPLS (also called a FLUMP).

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7 *Cost of Registered Pension Scheme Tax Relief, Table Pen 6;* HMRC, February 2018.

8 *Public Expenditure Statistical Analyses 2017;* HM Treasury.

9 From 0.8% of qualifying earnings (plus 0.2% basic rate tax relief) to 4% (plus 1% tax relief).

2.3 Tax relief: ineffective

(a) Distribution of tax relief

The purpose of a tax relief is to influence behaviour. However, it is evident that for many of the wealthy, tax relief on contributions to pension pots is primarily a personal tax planning tool, rather than an incentive to save: they would save without it. Consequently, it is extraordinary that we accept a framework through which higher and additional rate taxpayers garner 68% of tax relief, with 40% (£12.3 billion) of the total flowing to the top 10% of earners.[10] The top 1% of earners, who are in least need of financial incentives to save, receive more than double the total amount paid out to half of the working population.

This inequitable distribution of tax relief partly explains why the huge annual Treasury spend has failed to meet an underlying policy objective, which is to establish the broad-based retirement savings culture that Britain desperately needs.

(b) Most people save passively

Tax-based incentives to save have been found to be largely ineffective because most people (perhaps 85% of the population) are passive savers: they do not proactively pursue such incentives. Default ("nudging") policies are deemed to be far more effective for broadening retirement savings across those who are least prepared for retirement – lower-income workers in particular. The Danes, for example, concluded that for each DKr1 of government expenditure on incentivising retirement saving, only one ore (DKr 0.01) of net new savings was generated across the nation.[11]

Given that Denmark is not wildly different to the UK (both culturally and economically), one could conclude that much of the UK Treasury's spend on upfront tax relief is wasted.

2.4 Tax relief: inequitable

(a) A fundamental conundrum

Income tax is progressive, so tax relief is inevitably regressive. Consequently, the broad acceptance by society that higher earners pay higher average rates of income tax is partly nullified because they are able to reduce their income tax by harvesting tax relief on pensions contributions.

In addition, upon retirement, most people drop down to a lower tax bracket before making further (taxable) drawings. Only one in seven (roughly) of those who receive higher rate tax relief while working go on to *ever* pay higher-rate income tax in retirement. In this respect, tax relief is *not* income tax deferred, as claimed by proponents of higher and additional rates of tax relief.

Higher and additional rates of tax relief come at a huge net cost to the state: they are a bad investment of taxpayers' funds. Recurring budget deficits are one by-product of this financial largesse, and the accumulating debt mountain will loom over the next generation.

(b) Salary sacrifice schemes: not available to all

Salary sacrifice schemes are offered by employers as a means to save on NICs, both for employers and employees. Essentially, an

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[10] *Venturing to Retire;* RSA, April 2018.

[11] Chetty R, Friedman J, Leth-Petersen S, Nielsen T, and Olsen T (2012), *Active v. passive decisions and crowd-out in retirement savings accounts: evidence from Denmark. NBER Working Paper, No. 18565.* Available at: obs.rc.fas.harvard.edu/chetty/crowdout.pdf.

employee "sacrifices" some gross pay in exchange for pensions contributions paid on his behalf by his employer. A smaller gross pay means that both the employee and the employer pay fewer NICs and, in addition, some employees will fall into a lower income tax band.

Consequently, the Treasury foregoes NICs and income tax revenue: salary sacrifice schemes are an arbitrage at taxpayers' expense (costing roughly £2 billion per year). In addition, they are only available to employees with access to a workplace pensions scheme. The self-employed, for example, miss out, which is unfair.

2.5 Tax relief: incompatible with pensions freedoms

(a) Before pensions freedoms

The end of the annuitisation requirement (2015) demolished the historic (tacit) arrangement between the Treasury and the people, that tax relief is provided in return for a term commitment to saving, with asset realisation being subject to taxation at the marginal rate (effectively to repay the Treasury its earlier incentive).

This expectation was made clear by Lord Turner's Pensions Commission, which explicitly linked the receipt of tax relief with annuitisation, thereby reducing the risk of becoming a burden on the state in later life:

> Since the whole objective of either compelling or encouraging people to save, and of providing tax relief as an incentive, is to ensure people make adequate provision, it is reasonable to require that pensions savings is turned into regular pension income at some time.[12]

In addition, a subsequent review of annuities by the Treasury stated that:

> the fundamental reason for giving tax relief is to provide a pension income. Therefore when an individual comes to take their pension benefits they can take up to 25 per cent of the pension fund as a tax-free lump sum; the remainder must be converted into a pension – or in other words annuitised.[13]

Today one can contribute to a pension pot just before reaching the age of 55, receive tax relief, and shortly thereafter control one's drawdowns to fall under the Personal Allowance, thereby paying no income tax, *and* access the 25% tax-free lump sum *and* recycle some of the drawings back into the pension pot, collecting more tax relief in so doing. This makes no sense from a Treasury perspective.

It is patently clear that tax relief and pensions freedoms are incompatible: the door is wide open for wholesale reform of tax relief.

(b) Where to from here?

The Treasury Select Committee's response to the 2014 Budget (which announced the introduction of pensions freedoms) commented that in light of pensions' improved flexibility, ISAs and pensions will become *increasingly interchangeable in their effect.* It

[12] *A New Pension Settlement for the Twenty-First Century: The second report of the Pensions Commission* (2005).

[13] *The Annuities Market;* HM Treasury, 2006.

went on to suggest that the government should work towards a single tax regime to reflect this, and also examine the appropriateness of the present arrangements for the pension 25% tax-free lump sum.

The then committee chairman, Andrew Tyrie MP, was clear:

> in particular, there may be scope in the long term for bringing the tax treatment of savings and pensions together to create a "single savings" vehicle that can be used – with additions and withdrawals – throughout working life and retirement. This would be a great prize.

A single tax framework for all savings would represent a huge simplification of the savings landscape, as well as an acknowledgement that the distinction between work and retirement is fading. A savings incentives landscape that is wholly based upon ISAs' TEE surely beckons.[14]

3. A SIMPLER, FAIRER INCENTIVE FRAMEWORK

3.1 Bonuses, not tax relief

Replacing all tax relief with bonuses would address tax relief's progressive/regressive conundrum because bonuses would be *disconnected from tax-paying status.* This would also provide a much-needed reframing of the incentives language: the word "bonus" is readily understood, so bonuses would be better appreciated than tax relief. From the Treasury's perspective they would be a more effective investment in respect of encouraging people to save.

In addition, replacing tax relief with bonuses would represent a huge simplification of the savings arena: gone would be ludicrous complexities such as the high earners' annual allowance taper.

Contributions in a bonus-based framework would be made using post-tax income, with employer contributions (also eligible for bonuses) being treated as part of employees' gross income and taxed as such.

PROPOSAL 1: Tax relief should be replaced by bonuses, paid on individual and employer retirement savings contributions, with all contributions being made from post-tax income.

Ideally, bonuses would be paid on a calendar year basis, to reinforce the disconnection between the saving incentive and taxation. Alternatively, the savings bonus year could be timed to coincide with when many people have some disposable income available to save – for example, just after they receive employment-related bonuses.

[14] The author has written several CPS papers proposing that all pensions tax relief be scrapped, including *Costly and ineffective: why pension tax reliefs should be reformed* (2012); *Retirement saving incentives: the end of tax relief and a new beginning* (2014); *Time for TEE: the unification of pensions and ISAs* (2015); *An ISA-centric savings world* (2015); *What of DB, in a TEE world?* (2016); and *An ISA-centric framework beckons* (2016).

3.2 A £2,500 annual bonus cap

A 25% bonus combined with a £2,500 cap, say, would be equivalent to a £10,000 annual allowance. Alternatively, we could, for example, introduce a 50% bonus on the first £2,000 of post-tax contributions, and 25% up to the annual bonus cap. This approach would be more progressive, the intention being to particularly encourage the most reluctant savers, including those who may find it hardest to save anything at all. It should also be politically attractive because, on the first £2,000 saved, the rate of savings incentive would be *double* that provided to today's basic rate taxpayers through tax relief (84% of working adults).

A single 25% bonus rate would facilitate incentivised annual savings of up to £12,500 (including the bonus), or £10,500 if there were an initial 50% rate on the first £2,000 saved.[15] Annual sums of this magnitude would be more than adequate for almost everyone: only the very highly paid are in a position to save more than this in a single year (and they do not need to be incentivised to do so). As an aside, we could allow any unused bonus capacity to be carried forward for up to ten years.

PROPOSAL 2: The Treasury should introduce an annual cap of £2,500 on the total bonus that any individual can receive. The bonus rate could be either a flat 25% or perhaps 50% on the first £2,000 saved, and 25% thereafter. Unused bonus capacity could be rolled up for up to ten years.

The introduction of an annual cap on the total *bonus* that any individual could receive would make today's annual contribution allowance (£40,000) redundant.

3.3 Bonuses: major advantages for the low-paid[16]

Today, low earners miss out on the tax relief incentive to save in several different ways. This is absurd. Replacing all tax relief with a simple bonus framework, thereby disconnecting the savings incentive from tax-paying status, would play a significant part in rectifying this injustice.

(a) Promoting gender equality

Pensioner poverty is far more prevalent among women than men, partly because women traditionally earn less during their working lives. Bonuses, as envisaged, would help low earners because, unlike tax relief, they would be paid even if total earnings (from one or multiple jobs) were below the Personal Allowance.

(b) Tackling the "net pay" mess

The damaging complexity of today's incentives framework is epitomised by the arrangements to pay incentives on employee contributions to occupational schemes. Two very different structures are in use: relief at source, and net pay.

(i) Relief at source

Income tax is first deducted by the employer, who then deducts the employee's *net* contribution from his post-PAYE earnings. Thus, the employee receives tax relief at source. The scheme provider reclaims income tax from the government at the basic rate of 20%, which is

[15] As 50% on £2,000, plus 25% on £6,000, plus the £8,000 contributed.

[16] Further discussed in *Reinforcing automatic enrolment: a response to the DWP's consultation;* Michael Johnson, CPS, July 2017.

then added to the pension pot. Higher and additional rate taxpayers have to claim back further tax on their tax return.

(ii) Net pay

With a "net pay" arrangement, used by the majority of trust-based schemes, the employer deducts the gross contribution from the employee's earnings before deducting any income tax via PAYE. Consequently, full tax relief at the highest rate is automatic and no income tax is paid on the money being contributed to a pension.

There is, however a major downside of "net pay": those who earn between the auto-enrolment trigger of £10,000 and the Personal Allowance still make a gross contribution *but do not receive any tax relief.* This currently disadvantages some 280,000 workers, but once the Personal Allowance rises to £12,500 (by 2020) some 500,000 workers are expected to be affected.

Clearly, the low-paid should be in a "relief at source" scheme, thereby receiving tax relief (even though they do not pay tax). But reconfiguring a "net pay" payroll system is potentially complex and expensive.
If the savings incentive were instead disconnected from tax-paying status, in the form of bonuses, the injustice would be immediately remedied.

(c) Automatic enrolment

People with multiple low-paid jobs are essentially shut out of auto-enrolment. AE's £10,000 minimum earnings threshold, the inability to aggregate multiple incomes for AE contribution purposes, and the use of band earnings[17] for determining contributions, all conspire against the low-paid. Consequently, many miss out on employer AE contributions, as well as tax relief on their own AE contributions. These rules serve no consumer purpose.

Replacing tax relief with a bonus arrangement would provide an opportunity to bring many more people into AE's embrace, as well as simplifying the process for determining contributions. With tax considerations rendered irrelevant, "band earnings" could be replaced by "total aggregate earnings" for determining AE contributions, thereby addressing the multiple small incomes problem. Implementation of this proposal would produce a significant benefit for the Government: the size of contributions would increase *without having to increase AE's minimum contribution rates.*[18] The £10,000 minimum earnings threshold should also be scrapped.

Proposal 3: The rules governing automatic enrolment contributions should be reformed. "Band earnings" should be replaced by "total aggregate earnings" for determining AE contributions, and the £10,000 minimum earnings threshold should be scrapped.

[17] Band earnings: between the Lower and Upper Earnings Limits (£6,032 and £46,350 respectively, for 2018–19). Today, someone with two jobs each paying £11,000 per year, for example, would suffer two deductions of £6,032 in the AE contributions calculation process.
[18] AE is currently ramping up to 8% of band earnings (April 2019), equivalent to 6.3% of median earnings. Many people believe they are saving based on a percentage of total incomes; not so.

3.4 The Lifetime Allowance

The introduction of an annual bonus would render redundant the Lifetime Allowance in respect of future contributions. This would be a much-welcomed simplification of today's complex pensions framework. Any decision to scrap the Lifetime Allowance in respect of *past* contributions is a separate consideration, but the cost to the Treasury of doing so would be relatively low.[19]

3.5 Employer NICs rebates

NICs rebates on employer contributions (£16.2 billion in 2016-17) have increased by 18% in the last two years, driven by rising contributions via automatic enrolment. They directly benefit shareholders: invisible to employees, NICs rebates are an ineffective incentive to save. They have long been considered for abolition. The IFS's Mirrlees Review, for example, suggested "ending the excessively generous treatment of employer contributions".

A better use of Treasury resource would be to redeploy NICs rebates within a budget for savings bonuses on employer contributions, paid directly into personal accounts, where they would be visible and therefore more engaging.

Proposal 4: NIC rebates on employer contributions should be replaced with savings bonuses paid directly into employees' personal accounts. Scrapping NICs rebates would put an end to salary sacrifice schemes, saving the Treasury at least £2 billion per year. This could be redeployed as savings bonuses.

[19] For example, cutting the Lifetime Allowance from £1.25 million to £1 million (from 2016-17) is forecast to save £245 million in 2016-17, rising to £570 million in 2020-21. See *Budget 2016*; HM Treasury.

4. Whither TEE?

4.1 EET already in retreat

Replacing tax relief with a bonus structure disconnected from tax-paying status would extinguish today's EET framework, but would not, by itself, complete a move to TEE for new contributions – that is, an ISA-centric framework. It would actually see BET ("Bonus, Exempt, Taxed") operating alongside TEE.

Some believe that it is only a matter of time before the Treasury fully embraces TEE. Recent years' reductions in pensions' lifetime and annual allowances, from £1,800,000 and £255,000 respectively in 2010-11, to £1,030,000 and £40,000 today, alongside sharp increases in the ISA allowance (£20,000 this year) certainly suggest a direction of travel towards TEE.[20]

4.2 TEE in the workplace

The author has previously proposed that we introduce a Workplace ISA to house employer contributions in respect of workplace retirement saving.[21] This would be TEE-based, but eligible for the same 25% upfront bonus as the LISA. Employers would no longer have to be concerned with gross pension deductions: they could make their employer contributions net of tax, with the Treasury contributing the bonuses in parallel.

Savings derived from the workplace should be as personal as a bank account, ideally without all the jargon and paraphernalia of pension pots.

[20] The £20,000 can be split any way between a Cash ISA, a Stocks and Shares ISA, an Innovative Finance ISA. The Lifetime ISA can form up to £4,000 of the £20,000.

[21] See *The Workplace* ISA; CPS, April 2016, and *Reinforcing auto-enrolment;* CPS, July 2017.

Consequently:

(i) the Lifetime ISA should be eligible to receive employee contributions, including those made via automatic enrolment AE (plus bonus); and

(ii) employer contributions should be payable into a Workplace ISA, locked in until 60 (with bonus).

The Workplace ISA would reside inside the Lifetime ISA so that everyone could have one savings vehicle to serve from cradle to grave. Again, simplification is of the essence.

Proposal 5: A Workplace ISA should be introduced to house bonus-eligible employer contributions in respect of workplace retirement saving, locked in (with the bonuses) until the age of 60.

4.3 The Treasury's perspective: TEE preferred

Making the move to a pure TEE framework could be attractive to the Treasury, from annual budgeting and cashflow perspectives.

In extremis, the Treasury could save £47 billion in annual tax relief and NICs rebates *now*, to forego income tax from the *next generation* of pensioners. Bear in mind that in 2016-17 pensioners paid income tax of only £13.5 billion on personal pension income. When determining its net financial position, the Treasury would have to take into account changes in the demographic age profile, as it evolves through time. This, and other considerations (notably how savings behaviours may change), including implementation of a purely TEE framework, are discussed by the author in previous papers.[22]

Implementation of these proposals would facilitate the introduction of a universal TEE framework for all future savings contributions (after a specific "demarcation" date). This would, however, leave a legacy of millions of EET pension pots that would slowly disappear over the next 50-plus years.

4.4 TEE plus a bonus? It's called a Lifetime ISA

The Treasury is unlikely to put an end to *all* forms of upfront saving incentive. Shutting down EET would, most likely, have to be accompanied by some form of bonus-based incentivised saving within a TEE framework. The Lifetime ISA (LISA), proposed by the author in 2014 and introduced in 2017, already provides this, with a 25% up-front bonus on contributions.[23]

The LISA, although ostensibly TEE, in reality behaves as EEE for basic rate taxpayers. This includes almost everyone who could open a LISA (it is available to those aged 18 to 39) because 92% of all workers under 40 are basic rate taxpayers. If savings were not accessed until 60 then the initial 25% bonus is retained, and all subsequent withdrawals are tax-free (along with accumulated income and capital growth). Retention of the bonus offsets any basic rate tax initially paid, converting the initial

[22] Notably *Retirement saving incentives: the end of tax relief, and a new beginning* (2014); *Time for TEE: the unification of pensions and ISAs* (2015); and *What of DB, in a TEE world?* (2016). All are available on the CPS website.
[23] *Introducing the Lifetime ISA;* CPS, 2014.

"T" to an "E".[24] This effective EEE status is not widely appreciated (and the pensions industry has no incentive to publicise it). The experience for higher and additional rate taxpayers would be tEE, the small "t" indicating partial tax (i.e. the saver's marginal rate less 20%).[25]

There are a number of ways to extend the availability, capability and flexibility of the Lifetime ISA, which the author will detail later in 2018.

4.5 TEE plus bonuses: net impact on the Treasury

Moving to a TEE framework combined with upfront bonuses would provide the Treasury with an opportunity to make a substantial annual saving of perhaps £10 billion. Some of the underlying considerations have been discussed in previous papers[26] and, clearly, the Treasury would want to confirm such a figure through its own modelling. In so doing, it would have to make a number of significant assumptions concerning future savings behaviour.

4.6 Winners and losers

As discussed (Section 3.3), replacing tax relief with a saving incentive wholly detached from tax-paying status would help boost gender equality and tackle the "net pay" problem. Combined with replacing "band earnings" with "total aggregate earnings" for determining AE contributions, it would also bring many more (low paid) people into automatic enrolment's embrace, as well as simplifying the process for determining AE contributions.

The estimated £10 billion a year saving to the Treasury would arise largely through a reduction in savings incentives paid to the very highest earners, who are least in need of an incentive to save.

4.7 TEEn

TEE could be developed into "Taxed, Exempt, *Enhanced*", redeploying some of the savings (from having ended upfront tax relief) into post-retirement top-ups. This would be particularly appropriate given today's interest rate environment. The Swiss, for example, subsidise annuities, which perhaps explains why they have the highest level of voluntary annuitisation in the world (some 80% of pension pot assets). We could extend the concept to include drawdown.

CONCLUSION

There is a growing sense that pensions tax relief has had its day. Replacing it with a TEE-based framework plus an upfront bonus disconnected from tax-paying status makes eminent sense, particularly for the low-paid and the self-employed. This would boost the effectiveness of the Treasury-funded incentive to save (i.e. *more people saving more*, particularly amongst the low paid). And with EET vanquished, the savings landscape for future contributions would be greatly simplified.

[24] £100 gross income less 20% Income Tax = £80. If this is then paid into a LISA, a 25% bonus is added; £20, taking the total in the LISA back up to £100.

[25] Note that the LISA's 25% bonus and pension pots' 20% tax relief are economically equivalent. A LISA bonus of 25% on an £80 post-tax contribution is equivalent to receiving pension pots' 20% tax relief on £100 pre-tax.

[26] *Retirement saving incentives; the end of tax relief and a new beginning*; CPS, 2014 and *What of DB, in a TEE world?;* CPS, 2016.

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ABOUT THE AUTHOR

Michael Johnson is a Research Fellow at the Centre for Policy Studies (CPS). He trained with JP Morgan in New York and, after 21 years in investment banking, joined the actuarial consultants Towers Watson. Subsequently he was responsible for the running of David Cameron's Economic Competitiveness Policy Group.

Michael is the author of more than 40 pensions-related papers published through the CPS, sometimes supported by both Conservative and Labour peers. A number of his proposals have been implemented, including scrapping the annuitisation requirement ("freedom and choice"), the pooling of the LGPS's funds, and the introduction of the Lifetime ISA and bonus. More recently he detailed proposals for a Workplace ISA to compete with occupational pension products, residing within the Lifetime ISA.

In April 2018 the Work and Pensions Select Committee endorsed three of Michael's earlier proposals: there should be a new default decumulation pathway to support the disengaged ("auto-protection"); that NEST should be permitted to provide it; and there should be a single, public, mandatory pension dashboard.

Michael is occasionally consulted on pension reform by serving Ministers, shadow Ministers and the Cabinet Office. He has given oral and written evidence to Select Committees in both Houses of Parliament.

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