PERSPECTIVE

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SAINTs can get Britain saving again

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SUMMARY

To get Britain saving again, pensions must be abolished. It has to be recognised that, despite their significant tax advantages, not enough people are using pensions to build up adequate savings for their retirement.

Pensions should be replaced by a Self-Administered Investment Trust (or "SAINT") – a universal savings wrapper that is:

- simple;
- flexible;
- agreeable across the political spectrum;
- and easy to understand.

With a SAINT, savers would not need to lock their money up for decades. Instead, they would be able to control how their money is invested; and decide when they wanted to spend their savings.

Savers would not get tax relief going in – but savings returns would not be taxed; and there would be no tax when money is withdrawn.

Why is this necessary? In large part, because the Labour Government has undermined trust in pensions to the point where a new savings vehicle is now needed. People fear that the Government will continue to raise taxes from pension funds. Nor do they believe that their savings will be invested properly. They worry that companies may not honour their occupational pension commitments. They do not want to lock up their savings for 30 to 40 years. And they do not like the fact that they will have to use their pension to buy an annuity (which is subject to tax and whose rates are low: £25,000 saved becomes a £20 per week subject to tax and the withdrawal of means-tested benefits).

SAINTs would be more simple and flexible than pensions. SAINTs would also enable the virtual abolition of savings income tax and Capital Gains Tax (CGT) – further simplifying the tax system as well as boosting savings.

INTRODUCTION

As Tony Blair recognises, private savings are the foundation of a healthy society:[1]

> *Money put aside changes your horizons. It makes you plan, brings responsibility, and offers protection and opportunity. And I want to ensure that those on lower incomes – and the next generation – can share those advantages.*

However, the chart overleaf shows how the savings ratio has plunged from 10% of disposable income a year during the Major Government to less than 5% under Labour.

This fall in the savings ratio can be reversed by building on both the Government's and the Conservative Party's latest proposals with the SAINTs proposal. The Government's plans for SIPPs are an admirable advance in the direction of simplicity and flexibility. However, the proposals for SIPPs will most benefit the well-off and do not go far enough to address the depth of the underlying crisis. Reform will only be effective if it is so simple that it encourages *everyone* to save.

The proposals for a LiSA, made by the Conservative Party in its 2005 manifesto, are certainly a step in the right direction, as is the recently announced SARA. But they too need to be bolder.[2]

PRINCIPLES AND OBJECTIVES

Across the political spectrum, there is a consensus on the need to encourage savings. This paper suggests a new approach based on the following principles and objectives:

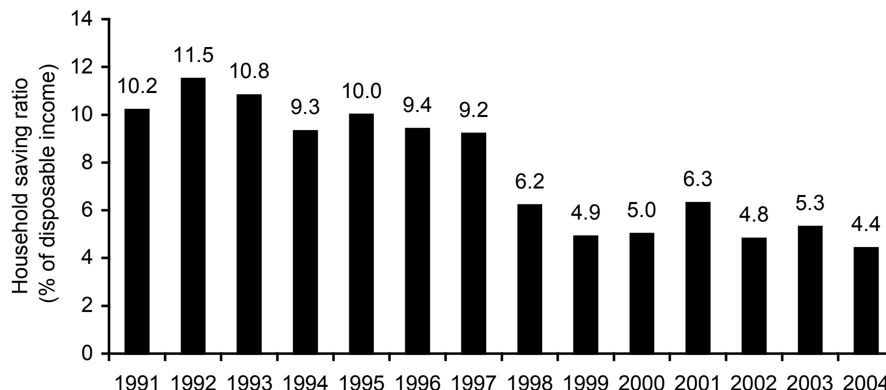
- axe the distinction between medium- and long-term saving;
- scrap the incentive for dedicated pension saving. There is no inherent advantage in long-term saving over medium-term saving. Such choices should be left to savers;
- make savings easy to understand and very simple to operate, reducing costs and making it easier for savers to make their own savings choices;
- increase the number of savers and the amount saved;
- eliminate Capital Gains Tax in a way that does not enable the avoidance of income tax;
- introduce one simple, catch-all, flexible savings wrapper that is inexpensive to manage and easy to understand;
- end the favouritism currently shown to higher rate taxpayers (who enjoy 40% tax relief on their pension contributions);
- end means-testing which has the unintended consequence of discouraging savings.

THE PROPOSAL: A "SAINT"

One particular problem for individuals who are saving at present is that when savings are switched from one investment to another, gains are subject to CGT, regardless of whether the proceeds are reinvested. This discourages savers from managing their investment portfolios efficiently. It also reduces liquidity in investments. Unit trusts deal with this problem in the following way; they operate as funds where capital gains on investments are not taxed so long as the funds remain in the unit trust. However, income generated by the trust is generally taxable on the investor.

Allowing individuals to establish their own Self-Administered Investment Trust (or "SAINT") would build on the unit trust concept and the concept of the PEP. Savers would have as much control over investments as they would wish. The SAINT could invest in shares, debt, property, art or other investments. Investments sold would not be subject to CGT, thereby encouraging efficient portfolio management and asset liquidity. Income arising from the SAINT would not be subject to tax either. Where assets are removed from the SAINT there would be no exit charge on investment gain if the investment were left in the SAINT for over three years.

The falling savings ratio, 1991 - 2004



There is no reason why there should be any limit on the size of investments that may be put into a SAINT, although to avoid the charge that SAINTs would unduly benefit the super rich, an investment limit of £50,000 to £100,000 per annum could be imposed.

THE ABOLITION OF CGT

While CGT yields just 0.3% of the UK Government's total revenue, compliance costs involved with the tax are extremely high.

The SAINT concept offers a vehicle for the abolition of CGT. The abolition is structured so that the absence of CGT cannot be easily used to avoid income tax (by turning income into capital). To this end, all funds invested in a SAINT that have been invested for three years would be free of tax if and when withdrawn from the SAINT. Gains of a capital nature realised outside a SAINT (or held for less than three years in a SAINT) would be taxable as though they were income – just like earnings from a job. In other words, CGT can best be abolished by absorbing it into the income tax regime. It is envisaged that certain asset classes not held in a SAINT would remain exempt from taxation – for example, main residences, cars and other assets designated "wasting assets".

Today, higher rate taxpayers enjoy a more favourable tax treatment than standard rate taxpayers. SIPPs will increase this advantage. But with a SAINT, this favouritism would end.

MERGE MEDIUM- AND LONG-TERM SAVINGS REGIMES

The argument in favour of the tax advantages that pensions enjoy is that people require a strong incentive to encourage them to lock savings away for retirement. Underlying this argument is a view that people are essentially frivolous and will fritter their savings away. Hence, the argument goes, pension savings must be inaccessible until retirement – and only then paid out as an annuity.

Pension saving enjoys two major tax advantages. First, it is deductible from income tax: gross income can be invested in a pension.

The second major advantage is that the fund itself is exempt from tax (albeit that this benefit has been somewhat reduced by the abolition of dividend tax credits and reduction of National Insurance rebates in recent years).

Yet, despite all these advantages, pension savings – and savings generally – are far too low. This is because the very strong tax incentive is outweighed by a general distrust of long-term savings.

The solution proposed to this problem would be to extend the advantages which pensions enjoy to medium-term savings. With SAINTs, long- and medium-term savings would be put on the same footing, with all returns from savings free of tax.

To make savings simpler still, SAINTs could be an all-inclusive and all-embracing savings wrapper. This would mean the abolition of the confusing array of unit trusts, PEPs, ISAs, TESSAs, pensions and many other savings products. In this way, there would be one savings vehicle and one alone.

SAINTs would be extremely flexible and easy to manage. The saver would be able to make any investment whatsoever without limit – and would be able to hire and fire fund managers as desired.

A DECENT MINIMUM STATE PENSION

Would some people fritter their savings away and have nothing left for retirement? Clearly the current pensions regime has given rise to exactly this problem as the savings ratio is now so low. The proposal for a SAINT would be accompanied by an increase in the Basic State Pension for a single person from £80 to £120 a week.[3]

Any income from private savings would therefore be the discretionary bonus of an individual's efforts. In view of this, the need for dedicated pension saving falls away.

Finally, unlike the present system, a SAINT would end the favouritism currently enjoyed by higher rate taxpayers – a favouritism that will be exacerbated with the introduction next year of SIPPs.

HOW IT ALL ADDS UP

The table below shows that for the year 2004/05, the "cost" of tax relief for pensions and other savings will be £32.1 billion.

Cost of Tax Relief for Pensions Savings, 2004/05

	£ billion
Tax relief for pensions	12.9
Tax relief for ISAs	1.2
Tax relief for PEPs	0.4
NIC relief for employer pension contributions	6.6
NIC relief for contracted out NICs	11.0
Total	**32.1**

Source: HM Treasury, Red Book, Table A3.1, 2005.

Impact on the Exchequer, 2004/05

	£ billion
Cost of pension tax relief	32.1
– minus income from CGT	2.3
– minus income from savings	23
Total	**6.8**

In comparison, the tax projected to be raised in 2004/05 from CGT is £2.3 billion. Income received by individuals from savings.[4] For the tax year 2004/05, this amounts to some £23 billion.[5] Most of this tax would not be collected if SAINTs were to be introduced.

This SAINTs reform – on the assumption that savings patterns did not change – would leave the Exchequer approximately £7 billion per annum better off. It is to be hoped that savings patterns will change, that more people will save and that over time the Treasury surplus arising from this reform will be eliminated.

ENDNOTES

1 Tony Blair, Welfare Reform Speech, 10 June 2002.
2 Under the LiSA proposal, the Government would have matched the money that individuals put into their Lifetime Savings Account. It was particularly aimed at the less well-off. People would have been able to access the money they had put into a LiSA but if they did so before retirement, the government contribution would be lost.
3 For more details of this proposal, see by the same author, *Ending Pensioner Poverty*, (CPS, November 2004).
4 This includes all income from savings that is not employment related.
5 This has been calculated from HM Revenue and Customs statistics on income tax receipts, table 2.8. See www.hmrc.gov.uk/stats/t_receipt/table2-8.pdf

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© Centre for Policy Studies, November 2005

ISBN 1 905389 12 2

Printed by the Centre for Policy Studies, 57 Tufton Street, London SW1P 3QL