HM Treasury

Strengthening the incentive to save: a consultation on pensions tax relief

Cm 9102

July 2015

Strengthening the incentive to save: a consultation on pensions tax relief

Presented to Parliament by
the Chancellor of the Exchequer
by Command of Her Majesty

July 2015

Cm 9102

This publication is available at www.gov.uk/government/publications

Any enquiries regarding this publication should be sent to us at public.

enquiries@hmtreasury.gsi.gov.uk

Print ISBN 9781474123013

Web ISBN 9781474123020

PU1827

ID 01071577 07/15

Printed on paper containing 75% recycled fibre content minimum

Printed in the UK by the Williams Lea Group on behalf of the Controller of Her Majesty's Stationery Office

Contents

Foreword

The government's long-term economic plan is providing the foundations for the UK's future economic security. Key parts of this plan have been continuing to put the public finances back on track, giving individuals greater freedom with their money and fostering a strong culture of saving.

The pension reforms announced at Budget 2014 have given people control over what happens when they access their pension, and automatic enrolment is ensuring that more and more people have the opportunity to build up savings for their retirement.

But it has been over a decade since the government last reviewed the support on offer through the tax system for those saving into a pension.

At the heart of the current system is a simple principle: the contributions you make to a pension during your working life are tax free, and you pay tax on them when you come to take your pension.

However, recent years have seen a substantial increase in life expectancy. This has resulted in a shift away from final salary defined benefit pensions towards defined contribution pensions in which you and your employer save into a pot that you can access at retirement.

With increased longevity and the changing nature of pension provision, the government needs to make sure that the system incentivises more people to take responsibility for their pension saving so that they are able to meet their aspirations in retirement.

That is why the government is today publishing a consultation on pensions tax relief. If people are to take responsibility for their retirement, it is important that the support on offer from the government is simple and transparent, and that complexity does not undermine the incentive for individuals to save.

It is also vital that the system is sustainable. Over the course of the last Parliament, the government took action to control the growing cost of pensions tax relief through the lifetime and annual allowances. The State Pension age was also raised, to reflect the pressure placed on the public finances by increased life expectancy. These difficult but important decisions have helped put the public finances on a more sustainable footing.

Pensions tax relief is a complex area which has wide-ranging implications for employers, the pensions industry and most importantly, pension savers. That is why the government is approaching the consultation with an open mind, rather than putting forward a specific proposal for reform.

The government's interest is in a lasting system that stands the test of time. The issues surrounding any reform will need to be considered carefully.

I encourage you to take the opportunity to contribute to the consultation.

George Osborne
Chancellor of the Exchequer

July 2015

1 Context for reform

1.1 Over the past decade, demographic changes have changed the nature of retirement and the way that people save towards it. People are now living longer, which has increased the need for them to have adequate savings to meet their aspirations.

1.2 During the last Parliament, the government responded to the changing shape of our society and the challenges posed by increased longevity through several reforms to pensions. The central aims of these reforms were to foster a culture of saving and provide individuals with greater security and dignity in retirement. Through the introduction of the new State Pension, pensions flexibility and automatic enrolment, individuals now have greater opportunity to save, and more certainty that when they come to retire, they will have the freedom and support to do what is right for them.

1.3 Longevity has also changed the way that pensions are provided. In the private sector, employers are now less likely to offer a defined benefit pension scheme to new employees and instead are frequently turning to defined contribution pensions. This has changed the way that the pensions industry is structured and consumer expectations of how pensions should be provided. Similarly, the last government recognised the need to limit the cost to taxpayers of continuing to provide final salary defined benefit pensions for the public sector and in April 2015 introduced new career-average schemes, which share the costs of pension provision more fairly between members, employers and taxpayers.

1.4 Increasing longevity and changes in pension provision therefore provide the context for considering whether there is a case for reforming pensions tax relief. As our society continues to age, it will become increasingly important for government to ensure that all individuals are supported to save for their retirement by offering clear, simple and transparent incentives. However, in the context of the deficit and the continuing pressure on the public finances, it will also be important to ensure that this support is sustainable for the longer term.

1.5 The government is clear that the conclusion of this consultation may be that maintaining the current system is the most effective method of achieving the aims described above. The current system is based on a simple principle – that taxation of pensions should be deferred until retirement. Sustainability of the system has been improved, with restrictions made since 2010 contributing over £6 billion a year to repairing the public finances.

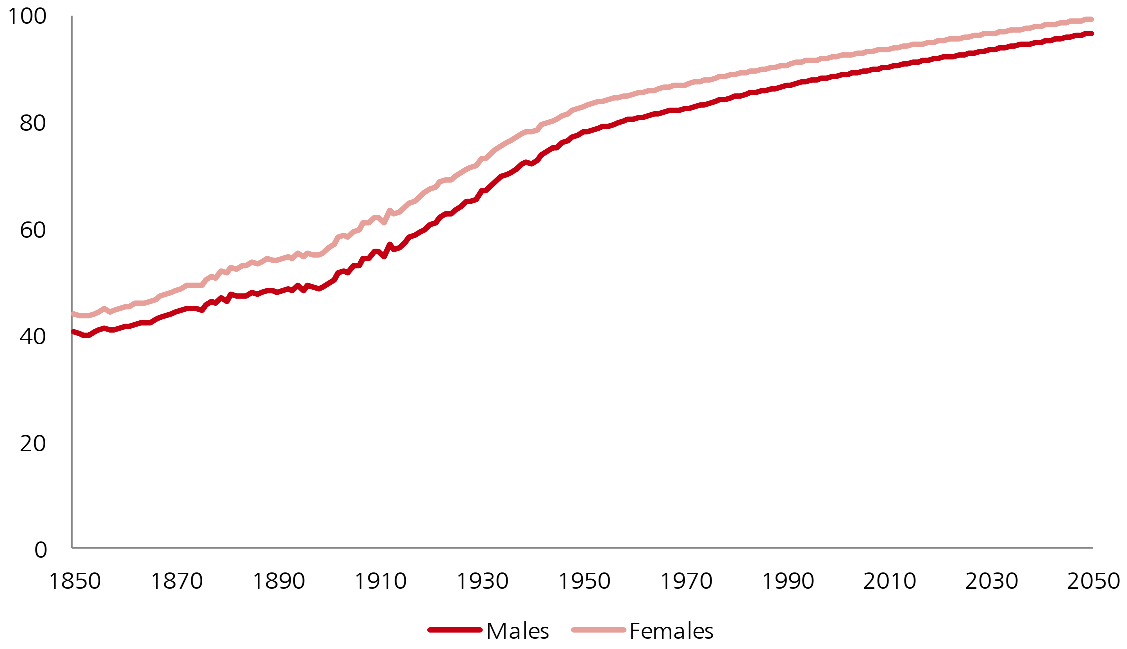
1.6 However, the government is interested in views on the various options that have been suggested for how the system could be reformed. These range from a fundamental reform of the system (for example moving to a system which is "Taxed-Exempt-Exempt" and providing a government top-up on contributions) to less radical changes (such as retaining the current system and altering the lifetime and annual allowances), as well as options in between.

1.7 This section of the consultation outlines the key changes and trends in pensions over the past decade and looks at how these provide a basis for considering whether the current system of pensions tax relief remains appropriate.

The changing shape of society

1.8 The past few decades have seen shifts in demographics that are changing the shape of our society. As shown by Chart 1.A, life expectancy has increased significantly over the past century.

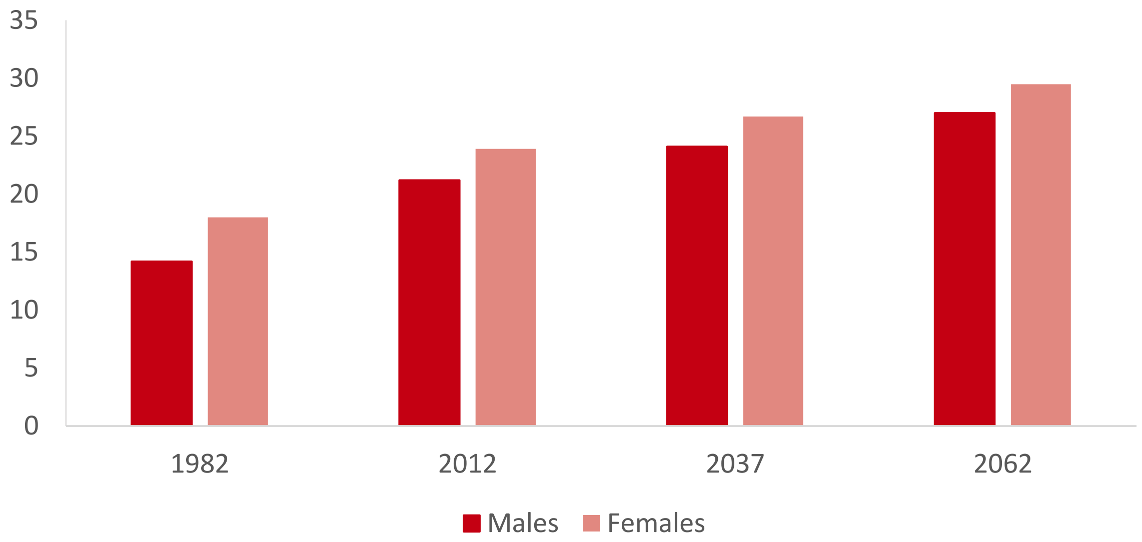
Chart 1.A: Cohort expectation of life at birth according to historic and projected mortality rates, persons born 1850–2050, England and Wales (male and female)



Source: Office for National Statistics

1.9 Individuals are now expected to live much longer than before, and therefore spend significantly more time in retirement. A man reaching age 65 in 2012 can now expect to live for 21 years, and a woman for 24 years.[1] As shown by Chart 1.B, this trend is set to continue.

Chart 1.B: Cohort life expectancy at age 65, United Kingdom, years



Source: Office for National Statistics

[1] Office for National Statistics

1.10 While this is positive for our society, it has implications for pensions. Although individuals are now living and working for longer, they will require a greater level of savings to provide them with an adequate income in retirement. Increased longevity therefore makes it more important that all individuals build up an adequate level of pension savings to meet their aspirations in retirement, and plan for how they use their savings throughout retirement.

Changes in pension provision

1.11 Not only have changes in longevity resulted in a change to the shape of our society, they have also encouraged a shift in the type of pension that most employers are able to provide. Until recently, the most common form of pension provision open to individuals through their workplace was a defined benefit scheme. This is where an individual pays a monthly contribution to their pension scheme in return for a promise of a regular income in retirement, the level of which is normally related in some way to their salary.

1.12 However, increased life expectancy of scheme members and factors such as low asset yields have led to defined benefit schemes becoming more expensive for employers to provide. Although a significant number of members (1.6 million) are still paying into defined benefit schemes in the private sector[2] and membership of defined benefit schemes remains high in the public sector, many private sector employers have now closed their defined benefit schemes to new members. Active membership of open private sector defined benefit scheme sections (those which admitted new members), fell to 0.6 million in 2013 from 1.4 million in 2006.[3] This shift away from defined benefit schemes and towards defined contribution is demonstrated in Chart 1.C.

Box 1.A: Different types of pension

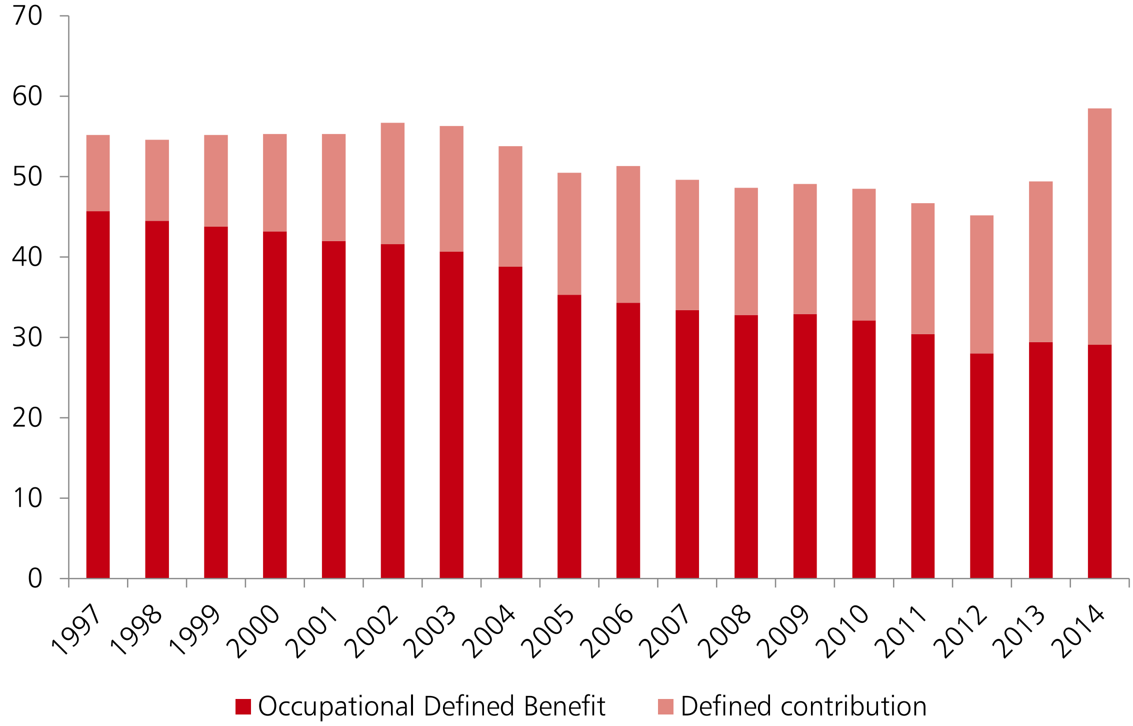
Although there are many different types of pension, there are broadly speaking two main categories.

A **defined benefit** pension is an employer-provided pension where the amount an individual receives in retirement is based on a formula using factors such as salary history and duration of employment. Investment risk and investment decisions sit with the employer and pension scheme.

A **defined contribution** pension (also known as a 'money purchase' pension) can be provided by an employer, but can also be set up on a personal basis. Money is paid into a pot by the individual, employer or a combination of the two. This money is then invested through the pension provider. The value of the pension pot is therefore dependent on how much is contributed, and can also go up or down depending on how the investments perform.

[2] Office for National Statistics, Occupational Pension Schemes Survey, 2013
[3] Office for National Statistics, Occupational Pension Schemes Survey, 2013

Chart 1.C: Proportion of employees with workplace pensions, by pension type, 1997 to 2014, percentages



Source: Office for National Statistics[4]

1.13 In response to these shifts in demographics, and the changing nature of pension provision, the government has implemented several reforms to ensure that the pensions system is sustainable for the future and provides individuals with a strong incentive to save.

Changes in government policy

1.14 The past ten years have seen several changes in pensions policy in response to the changing shape of our society, building on the proposals suggested by the Turner Commission in 2005.

1.15 The central part of these changes has been ensuring that the state support on offer to individuals in retirement is clear and transparent. The introduction of the new State Pension for people reaching State Pension age on or after 6 April 2016 means that individuals will have much greater certainty over what they will receive from the government in retirement. This will be a flat-rate payment set above the basic level of the means-test and some of the most complicated areas of the State Pension, such as the State Second Pension, will also come to an end.

1.16 The introduction of the triple lock also guarantees that the State Pension will rise by the highest of earnings, inflation or 2.5%. As a result of this policy, someone on a full basic State Pension can expect to receive around £560 more in 2015-16 than if it had been uprated by average earnings since the start of the last Parliament.

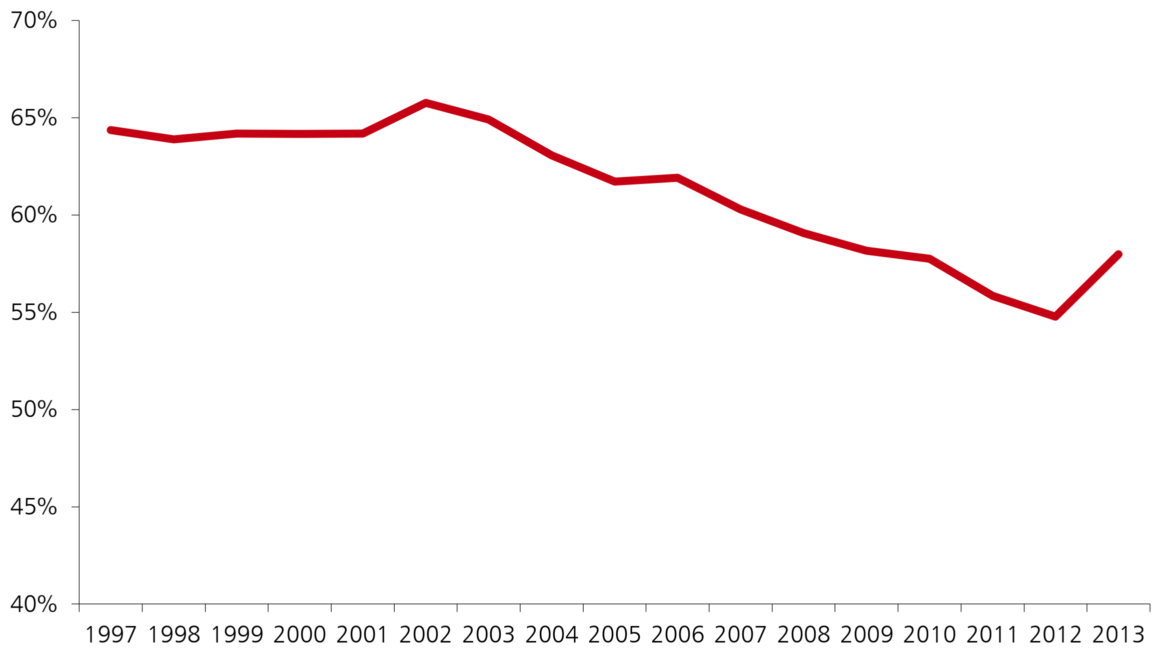
[4] 'Defined contribution' includes Occupational Defined Contribution and Group Personal and Group Stakeholder pensions. Results for 2005 are based on a new questionnaire and may not be comparable with earlier results. In 2011 the Annual Survey of Hours and Earnings (ASHE) replaced the Standard Occupational Classification 2000 (SOC 2000) with the Standard Occupational Classification 2010 (SOC 2010). ASHE estimates for 2011 onwards are produced on a Standard Occupational Classification (SOC) 2010 basis

1.17 The government has also taken steps to ensure that individuals who save into a pension have the freedom and choice to access their private pension as they wish when they come to retire. These reforms, announced at Budget 2014 and implemented in April 2015, ensure that those saving into a pension have greater confidence in their savings. They now know that they will be free to choose how and when to access their money. There is evidence that this has already led to greater engagement with pension savings, particularly among young people.[5]

1.18 Alongside changes to the offer for those in retirement, the government has also sought to ensure that individuals have the opportunity to save into a pension during their working life. The introduction of automatic enrolment now means that more than five million people are newly saving into a private pension through their workplace. By 2020, the government expects to see 8 to 9 million people newly saving or saving more, generating £11 billion a year more in workplace pension saving.

1.19 Since the start of automatic enrolment in 2012, workplace pension membership in the private sector has risen from 32% to 49%. With only around 9 to 10% of individuals choosing to opt out of being enrolled, this reform is beginning to reverse a long-term decline in the number of individuals saving for their retirement. Before the introduction of automatic enrolment the proportion of workers saving in a workplace pension had been falling steadily, as shown by Chart 1.D.

Chart 1.D: Percentage of workers in the automatic enrolment eligible population with a workplace pension scheme, 1997 to 2013[6]



Source: DWP estimates derived for ONS Sustainable Development Indicators, July 2014

1.20 As automatic enrolment continues to roll out to small employers over the next few years, the number of individuals saving for their retirement will increase further. This will lead

[5] http://www.napf.co.uk/PressCentre/Press_releases/0400-28-per-cent-of-workers-more-likely-to-save-into-a-pension-following-Budget.aspx

[6] The automatic enrolment eligible population refers to workers aged at least 22 and under State Pension age, and who earn £8,105 or more per year (in 2012-13 earnings terms). These data are Department for Work and Pensions estimates derived from the ONS Annual Survey of Hours and Earnings

to a transformation in our saving culture, with everyone given the opportunity to save for their retirement.

1.21 However, a noticeable trend during the roll out of automatic enrolment has been the number of individuals who have been enrolled into a defined contribution scheme. As of March 2014, the majority (72%) of employers enrolling their employees into a pension through automatic enrolment were using a defined contribution scheme.[7] As the roll out of automatic enrolment continues, this trend is set to be maintained.

1.22 While the increase in the number of people saving into a pension is encouraging, the increasing prevalence of defined contribution schemes has increased the importance of ensuring that individuals are contributing enough to their pension. Unlike in a final salary defined benefit scheme, where an individual's contribution level may have only an indirect bearing on pension outcomes, contribution levels are one of the key factors that determine the level of pension an individual will receive if they are a member of a defined contribution scheme.

1.23 Evidence suggests that current contribution levels to defined contribution schemes are low and may not meet individuals' expectations when they come to retire. In 2013 average employee contributions into private sector occupational defined contribution pension schemes were 2.9% of salary and average employer contributions were 6.1% of salary.[8] However, research by the Pensions Policy Institute suggests that a lower earner will need a total contribution rate of 11% to have a three-quarters chance of achieving their target replacement income[9] in retirement; a median earner will need to contribute 13%; and a higher earner will need to contribute 14%.[10]

1.24 Average contribution rates will rise as the minimum contribution levels under automatic enrolment increase to 8% in 2018 (of which the individual will pay 4%, the employer will pay 3%, and the government will add tax relief of 1%). However, it is still important that the right incentives are in place to support individuals to take responsibility for making sufficient contributions to their pension to meet their expectations. That is why the government is considering how it can go further to ensure that individuals are supported to save.

Innovation and reform in the pensions and savings industry

1.25 Changes in pensions policy and the changing nature of pension provision have also had implications for the pensions and savings industry. The last decade has seen significant change in the structure of the industry, consumers' experience of it, and the challenges it faces.

1.26 A key trend has been innovation in the design and distribution of savings products. For example, online platforms, which aggregate investment products from different providers and allow consumers direct control of their investments, have grown rapidly to be the conduit for over £130 billion of savings.[11] This has in part contributed to the popularity of

[7] The Pensions Regulator, Automatic Enrolment: Commentary and Analysis: April 2013 – March 2014, 2014

[8] Office for National Statistics, Occupational Pension Schemes Survey

[9] Replacement income is a common method of determining whether retirement income will allow individuals to replicate the standards of living they had while in working life. Replacement income is calculated as the ratio of retirement income in the year of retirement to the average earnings in the 10 years previous to retirement, adjusted by average earnings growth

[10] Pensions Policy Institute, What level of pension contribution is needed to obtain an adequate retirement income?, 2013. These examples are based on an individual starting to save at age 22 in 2018 (once automatic enrolment is fully rolled out), following a traditional lifestyle investment approach and retiring at State Pension age in 2064. They represent the total contribution rates needed (as a % of band from £5,668 and £41,450 per annum) to reach a 75% probability of achieving the target replacement income at State Pension age with income from private and state pensions, and in line with government policy, assume that the State Pension will continue to be uprated by the triple lock. The low earner individual is assumed to earn at the 30th percentile of age-specific economy-wide earnings, the median earner at the 50th percentile and the higher earner at the 70th percentile

[11] Platforum, UK D2C Guide: Direct Platforms and Investors, 2015

investment through Individual Savings Accounts (ISAs). In parallel, there has been an expansion of lower-cost alternatives to traditional mutual fund investments, such as Exchange Traded Funds (ETFs). Fees and charges have fallen while companies have had to innovate rapidly to keep pace with consumers' rising expectations of choice, simplicity, and transparency.

1.27 The advice market for pensions and savings has also changed dramatically, partly as a result of the implementation of the Retail Distribution Review and associated reforms. Commission-based sales from advisers tied to individual companies have been brought to an end, and there are now new professional qualification and conduct requirements in place for advice, although this does not apply to non-advised sales. The creation of the Financial Conduct Authority, a tough new regulator to champion consumers' interests, has also helped raise standards across the board.

1.28 A final trend has been consolidation. For example, since 2006 the number of authorised life insurance firms has fallen by around a third.[12] This has helped pension providers realise economies of scale and reduce charges for savers. The new framework for insurance company regulation, Solvency 2, has also rewarded more diversified, strongly capitalised firms. This change has often been a costly process and consolidation in the sector has also created legacy issues, such as incompatible IT systems and a potentially fragmented landscape of products within individual firms. This has affected the pace at which some companies have been able to respond to change.

1.29 Together these issues have led to a shift in consumers' expectations of how savings products should operate, how they should be priced and how they should be sold.

Summary

1.30 As discussed above, increased longevity and the changing nature of pension provision provide the basis for considering how the government should support individuals to save into their pension. As individuals live longer and defined benefit schemes become less prevalent, individuals in defined contribution schemes will need to be clear on the support they are eligible to receive from the government. Meanwhile changes in the pensions and savings industry are raising consumers' expectations and putting increasing pressure on pension companies.

1.31 Currently, government support for pension saving is provided to individuals through the tax system. Individuals and employers are provided with tax relief on the contributions they make to a pension. Contributions to pensions by employers are also exempt from National Insurance contributions. An overview of this system is provided in the next Chapter.

[12] Prudential Regulation Authority

2 Pensions tax relief

2.1 In order to incentivise long term saving, the government provides tax incentives for both individuals and employers to save into pensions. The principle of the current system is that contributions to pensions are exempt from tax when they are made, but taxed when they are paid out to the individual. The current structure of the system can therefore broadly be characterised as "Exempt-Exempt-Taxed" (EET):

- Exempt. Pension contributions by individuals and employers are exempt from income tax, and employer contributions are also exempt from National Insurance contributions (NICs) (although total contributions are subject to both an annual allowance and a lifetime allowance).
- Exempt. No personal tax is charged on investment growth from pension contributions while in accumulation, subject to the lifetime allowance.
- Taxed. Pensions in payment are taxed as income, but individuals are able to take up to 25% of their pension fund as a tax-free lump sum on retirement.

2.2 Over the course of the last Parliament, the government made several changes to limit the amount of tax-privileged pension saving that individuals can make, either personally or by their employer, through changes to the lifetime and annual allowances. This has been necessary to ensure that the public finances are sound and that pensions tax relief is targeted at pension savers who need it most.

Box 2.A: The lifetime and annual allowance

The lifetime and annual allowances were introduced at 'A-day' in 2006. They were originally set at £1.5 million (the lifetime allowance) and £215,000 (the annual allowance), and were designed to ration the amount of tax-privileged saving an individual could make into a pension. By 2010-11 they had risen to £1.8 million and £255,000 respectively.

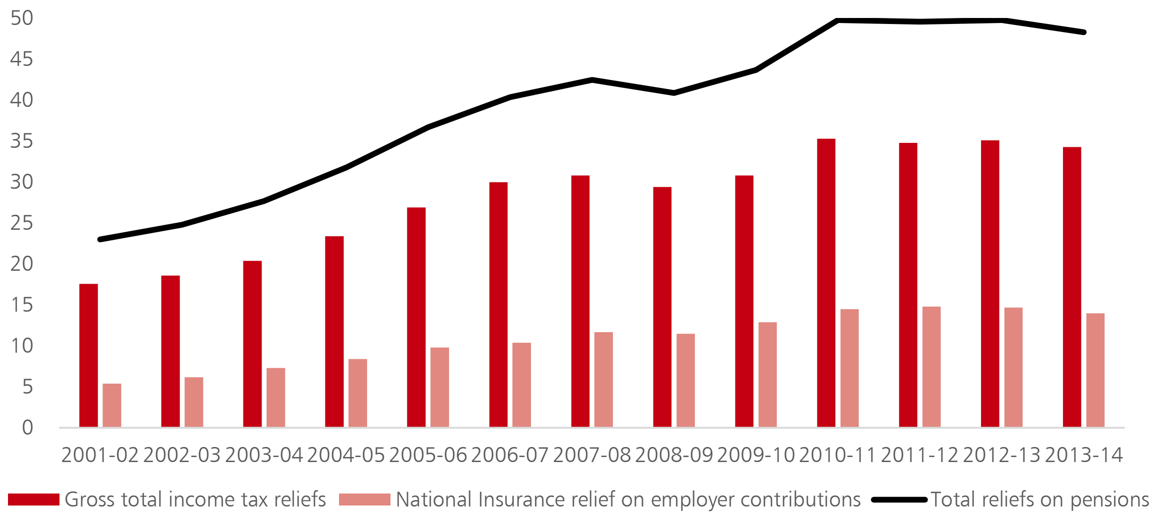
Over the course of the last Parliament, both limits were gradually reduced in order to manage the growing cost of pensions tax relief. The annual allowance is now £40,000 and the lifetime allowance is £1.25 million. However, it was announced at Budget 2015 that the lifetime allowance would be reduced to £1 million in April 2016, and then uprated by the Consumer Prices Index from April 2018.

The current system also has two further restrictions on annual savings – the money purchase annual allowance, which applies to those who have accessed a pension flexibly (currently £10,000), and the tapered annual allowance which will be introduced in April 2016 for those with an income (including pension contributions) of over £150,000.

The cost of pensions tax relief

2.3 In offering pensions tax relief, the government foregoes revenue in the form of income tax. The government also provides tax incentives for employers to save into pensions on behalf of their employees. Employer pension contributions are not subject to employer or employee National Insurance contributions. HM Revenue & Customs (HMRC) publishes annual estimates of the cost of these reliefs and Chart 2.A shows how they have changed over time.

Chart 2.A: Gross cost of registered pension scheme tax relief, £billion



Source: HMRC, Table PEN 6[1]

2.4 The government also receives tax revenue from pensions in payment. In 2013-14, the government received £13.1 billion in tax on pension payments. It could therefore be argued that the net cost to the Exchequer from pensions tax relief in 2013-14 was £21.2 billion.[2] However, this may misrepresent the actual cost to the government each year. First, the income received by the government from pensions in payment will in all likelihood come from pensions which received tax relief many years ago. Therefore subtracting it from the gross cost of relief provided on pensions today may not provide an appropriate estimate of the net cost. Second, tax rates of individuals may change over their lifetime and therefore the rate of relief they receive may not correspond to the amount of tax they ultimately pay on their pension.

2.5 This rising cost of pensions tax relief in recent years has been driven by a number of factors. Most notably, contributions to pensions by employers have increased, partly due to the need to finance deficits in defined benefit schemes. Wage growth has also played a role in increasing the level of contributions to pensions, therefore adding to the growing cost.

2.6 The distribution of pensions tax relief across the population has also evolved over time. Over two thirds of pensions tax relief currently goes to higher and additional rate taxpayers. However, the introduction and gradual reduction of the lifetime and annual allowances have significantly reduced the share of pensions tax relief that goes to additional rate taxpayers since 2009, a trend that is likely to continue when the tapered annual allowance is introduced in April 2016 for those with an income over £150,000. Increases in the Personal

[1] The figures are based on HMRC administrative data and information compiled from a variety of sources by the Office for National Statistics (ONS). Costs are subject to large revisions and have a particularly wide margin of error. The cost of the tax relief is calculated as the tax that would be paid on contributions to registered pension schemes presuming they were not registered and the payments were subject to the normal tax rules applying to individuals' remuneration. The estimates do not represent the yield from withdrawing tax relief as there would be significant changes in taxpayers' behaviour

[2] HMRC, Table PEN 6

Allowance in recent years have also led to a decrease in the share of pensions tax relief which goes to those with an income below £19,999.

Summary

2.7 As noted above, pensions tax relief is designed to provide an incentive for individuals to defer their income until their retirement. However, the gross cost of pensions tax relief is significant. Including relief on both income tax and National Insurance contributions, the government forwent nearly £50 billion in 2013-14.

2.8 The government has sought to manage this cost through the lifetime and annual allowances and in doing is projected to save around £6 billion per year. The government has also significantly restricted the amount of pensions tax relief that goes to additional rate taxpayers, thereby making the system more progressive – a trend that will be furthered by the introduction of the tapered annual allowance for higher earners.

2.9 However, the government is interested in considering suggestions on whether and how the current system of pensions tax relief could be reformed. This is explored in the next Chapter.

3 Principles for reform

3.1 Increased longevity and the changing nature of pension provision provide the basis for considering how the government can best support people to save into their pension. The government needs to make sure that the system incentivises more people to ensure that they have sufficient savings for later life.

3.2 The current system of pensions tax is simple in principle. Individuals are encouraged to defer their income and pay tax on it when they retire. A sound case can therefore be made that the best method of achieving the government's aim of fostering a strong culture of saving is to retain the current system, particularly as it is deeply embedded in many processes used by employers and pension providers.

3.3 However, the government is also interested in exploring options for how the system of pensions tax could be reformed to strengthen the incentive to save. This section of the consultation document outlines some principles which the government believes any proposed reform would need to meet in order to constitute a viable alternative to the current system. It also sets out a number of specific questions on which the government would welcome views.

3.4 The principles the government believes any reform should meet are:

- It should be **simple and transparent**. The government believes that greater simplicity and transparency may encourage greater engagement with pension saving and strengthen the incentive for individuals to save into a pension.
- It should allow individuals to take **personal responsibility** for ensuring they have adequate savings for retirement. It should encourage people to save enough during their working lives to meet their aspirations for a sufficient standard of living in retirement.
- It should **build on the early success of automatic enrolment** in encouraging new people to save more.
- It should be **sustainable**. Any proposal for reform should also be in line with the government's long-term fiscal strategy.

3.5 The government believes that these principles provide a useful framework for considering any reform to pensions tax relief. Further detail, including specific questions on each, is provided below.

3.6 The government recognises that while there may be synergies between these principles, there may also be tensions. For example, it may be that the simplest system does not allow individuals to take personal responsibility. Equally, it may be that a simple system offers greater sustainability because it increases the incentive for individuals to save into a pension, meaning less direct support from the government is necessary. In coming to a conclusion on the way forward, the government will therefore need to consider how these principles interrelate and may need to prioritise some over others.

3.7 The government is clear that there is a need to proceed gradually. Following consultation, the consensus may be that no change is needed and that the current system of pensions tax relief offers the most effective model for encouraging pension saving.

3.8 In considering the options for reform, the government will need to be mindful of a number of issues and competing objectives, including:

- Any macro-economic implications of reform. In particular, the government will need to carefully consider the role that pensions play in financing long-term investment and the potential impact on financial markets, including the gilt markets, of any options for reform.
- The treatment of defined benefit and defined contribution pensions, including understanding the fiscal implications of changes, in particular for the unfunded public service pension schemes.
- The context of other changes to the wider personal tax system.
- The timing and implementation costs of any reform, for the pensions industry, employers and HMRC.

Simplicity and transparency

3.9 While the current system is simple in principle, there is evidence that some pension savers are unaware or not motivated by the tax benefits associated with paying into a pension. In particular, research suggests that for lower income groups tax relief is not an important determinant in people's decision to save.[1] Some are unaware that they will be required to pay tax on their pension when they come to retire.

3.10 There are also wider concerns about complexity in pensions. As the Office for Fair Trading (OFT) found in its 'Defined contribution workplace pension market study' in September 2013:

"The buyer side of the defined contribution workplace pensions market is one of the weakest that the OFT has analysed in recent years. Part of the reason for this is that most employees do not engage with or understand their pensions. Pensions are complicated products, the benefits of which occur, for many people, a long time in the future. Considerable survey evidence testifies to the low levels of understanding and engagement that many employees have in relation to their pensions."[2]

3.11 A case could therefore be made that the current system of pensions tax relief does not sufficiently help to foster engagement and understanding of pensions. This may not in itself mean that pensions tax relief has not incentivised individuals to save. However, it may be that individuals find the current structure of providing tax relief at their marginal tax rate and being taxed at a potentially different rate in retirement confusing.

3.12 For example, it has been suggested that a fundamental reform of the system so that pension contributions are taxed upfront (a "Taxed-Exempt-Exempt" system like ISAs), and then topped up by the government, may allow individuals to better understand the benefits of contributing to their pension as the government's contribution might be more transparent, and they would no longer need to consider the future tax implications of their pension choices or work out how much their pension pot is worth given their expected tax rate in retirement. Equally, others have argued that the current system, where no tax is due on pension contributions while working but tax is paid in retirement, is simple for individuals to understand and also provides an incentive to leave money in their pension pot. Many other variants have also been suggested.

3.13 The government is therefore interested in views on whether an alternative system that is simple and transparent, in which savers can better understand the benefits and risks, is likely

[1] Pensions Policy Institute, Tax relief for pension saving in the UK, 2013

[2] Office for Fair Trading, Defined contribution workplace pension market study, 2013

to result in greater engagement with pension saving and therefore increase the overall level of saving, or whether it would be better to keep with the current system.

1	To what extent does the complexity of the current system undermine the incentive for individuals to save into a pension?
2	Do respondents believe that a simpler system is likely to result in greater engagement with pension saving? If so, how could the system be simplified to strengthen the incentive for individuals to save into a pension?

Personal responsibility

3.14 The shift towards defined contribution pensions in recent years has increased the importance of ensuring that individuals are contributing enough to their pensions.

3.15 The exact level of income an individual needs in retirement is dependent on a number of factors, most notably their expectation of a certain standard of living. However, the government wants to make sure that the system of support for pension saving encourages individuals to save a larger amount for a longer period of time, and that they are able to take personal responsibility for doing so. The government is keen to ensure that the support provided is effective in incentivising individuals to make sure they have adequate retirement savings.

3.16 While the introduction and gradual reduction of the lifetime and annual allowances have been necessary to ensure that the cost of pensions tax relief has been kept under control, the government recognises that such changes may have an impact on individuals planning their pension saving in defined contribution schemes. The government therefore welcomes views from respondents on how best to ensure that the system of pensions tax relief provides individuals with greater clarity so they can plan for their future.

3	Would an alternative system allow individuals to take greater personal responsibility for saving an adequate amount for retirement, particularly in the context of the shift to defined contribution pensions?
4	Would an alternative system allow individuals to plan better for how they use their savings in retirement?
5	Should the government consider differential treatment for defined benefit and defined contribution pensions? If so, how should each be treated?

Automatic enrolment

3.17 As outlined above, the early success of automatic enrolment has led to a large increase in the number of individuals saving into a pension. The government believes that any reform of pensions tax relief should build on this early success. This means ensuring that any reform works alongside automatic enrolment, building on existing processes that have been developed. It also means making sure that employers continue to have a strong incentive to contribute to pensions on behalf of their employees.

6 What administrative barriers exist to reforming the system of pensions tax, particularly in the context of automatic enrolment? How could these best be overcome?

7 How should employer pension contributions be treated under any reform of pensions tax relief?

Sustainability

3.18 When considering their responses, respondents are invited to consider how any solution fits with the government's wider fiscal strategy, particularly in the context of the current pressure on the public finances. In the longer term, when the public finances have been fixed, there will be a trade-off between the tax relief citizens receive and the tax rates they pay. Views are therefore welcomed on how the government can ensure that the system is sustainable, and that its overall cost can be managed in the future.

3.19 It will also be important to consider how and over what period reform could be implemented to ensure it provides a lasting solution, especially where it may involve significant changes for employers and the pensions industry.

8 How can the government make sure that any reform of pensions tax relief is sustainable for the future?

4 How to respond to this consultation

4.1 This paper is available at www.gov.uk/government/publications.

4.2 The government welcomes responses to the questions raised in this consultation; these are summarised in Annex A. Respondents are encouraged in their responses to add any additional information they feel is relevant to this consultation.

4.3 Responses to this consultation should be received by Wednesday 30 September 2015. Please ensure that responses are sent in before the closing date. The government cannot guarantee that responses received after this date will be considered. The government will also engage with relevant stakeholders ahead of this date.

4.4 Responses to this consultation should be sent to:

Pensions Consultation 2015
Pensions and Savings Team
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

Alternatively, please send responses by e-mail to:
pensionsconsultation2015@hmtreasury.gsi.gov.uk.

4.5 When responding, please state whether you are doing so as an individual or on behalf of an organisation.

Consultation process

4.6 This consultation is being run in accordance with the Code of Practice on Consultation, and will be run for the full 12 week period.

Confidentiality

4.7 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

4.8 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, among other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury.

4.9 HM Treasury will process your personal data in accordance with the Data Protection Act and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

A Summary of questions

1 To what extent does the complexity of the current system undermine the incentive for individuals to save into a pension?

2 Do respondents believe that a simpler system is likely to result in greater engagement with pension saving? If so, how could the system be simplified to strengthen the incentive for individuals to save into a pension?

3 Would an alternative system allow individuals to take greater personal responsibility for saving an adequate amount for retirement, particularly in the context of the shift to defined contribution pensions?

4 Would an alternative system allow individuals to plan better for how they use their savings in retirement?

5 Should the government consider differential treatment for defined benefit and defined contribution pensions? If so, how should each be treated?

6 What administrative barriers exist to reforming the system of pensions tax, particularly in the context of automatic enrolment? How could these best be overcome?

7 How should employer pension contributions be treated under any reform of pensions tax relief?

8 How can the government make sure that any reform of pensions tax relief is sustainable for the future?

HM Treasury contacts

This document can be downloaded from www.gov.uk

If you require this information in an alternative format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

Email: public.enquiries@hmtreasury.gsi.gov.uk

ISBN 978-1-4741-2301-3