Restricting pensions tax relief

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Introduction

Despite predicting it would eliminate the budget deficit by 2015, then 2017, and then 2019, after nearly nine years in power the government has failed to do so. It now only expects to balance the budget by the middle of the next decade. Should the governments' current fiscal targets prove over optimistic, as they have to date, they may be tempted raise taxes further. This is despite the tax burden being at its highest level for nearly 50 years.[1]

Some opinion formers propose increasing taxes by restricting income tax relief to the basic rate on pension contributions.[2] Whilst raising tax for those trying to save for their future retirement is bad enough, this action would unfairly affect those in the private sector more.

Key findings

If pension tax relief is limited to the basic rate, **private sector workers in occupational pension schemes earning over £46,350 would pay up to 37 per cent more tax to build up the equivalent pension benefits as, for example, civil servants.**[3]

Higher rate pensions tax relief

New employees entering the public sector today can already expect to retire on a pension **three times higher than their private sector equivalents**.[4] The removal of full income tax relief for higher rate taxpayers will further increase the inequality between private and public sector occupational pension schemes.

This unfairness arises because the tax increase would need to be levied on both the employees' and employers' pension contributions. The value of employers' pension contributions declared by the main unfunded central government pension schemes are substantially understated. The real value of this contribution for new entrants, measured on the same basis as a private sector pension, is much higher than that claimed by government.

Table 1 illustrates how the combined employer and employee pension contribution required by a private sector worker to achieve a pension benefit at civil service levels is 35.5 per cent. However, the government claims it can achieve the same result with a combined pension contribution of just **25.85 per cent for new civil service entrants**. As the tax increase will be based on these combined contribution levels, the private sector worker will experience a tax increase up to 37 per cent higher than their civil service counterpart trying to build up the same pension. This is grossly unfair on private sector workers who are already hugely disadvantaged compared to public sector workers in the pensions arena.

In short, a private sector worker must see far higher combined pension contributions going into their pension fund to achieve the same pension benefit outcome as a public sector worker.

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[1] Meakin, R., *Briefing: highest tax burden this year since 1969-70*, Taxpayers' Alliance, 1 August 2018.
[2] Johnson, M., *Five Proposals For Savings Reform*, Centre for Policy Studies, 27 August 2018.
[3] Note: this applies to new entrants to the civil service and is based on the latest Government Actuary's Department valuation 2012.
[4] Basey, P. *Pensions inequality*, TaxPayers' Alliance, 27 August 2018.

Table 1: cost of civil service level pensions for private sector employees[5]

	Civil service (%)	Private sector (%)
Employee contribution[6]	7.35	7.35
Employer contribution[7,8]	18.50	4.00
Combined contribution	25.85	11.35
Annual pension as percentage of final salary	69.58	22.42
Combined contribution percentage required to provide average public sector level of pension benefit	-	35.50

The true value of public sector pension contributions can be disguised because the pension schemes are unfunded. This means that no pension fund is set up, and the obligation to pay future pensions is just an IOU from the government with no asset backing. Taxpayers will face this for decades into the future.

This is on top of the **£11 billion in tax HM Treasury already take from private pension funds annually**.[9] Public sector pensions now cost the taxpayer **£38 billion a year**[10] and liabilities for existing unfunded pension obligations stand at **£1.7 trillion**[11]. This further discrimination against private sector pension savers would add insult to injury**. The many private sector workers would be rightly dismayed if preferential treatment were received by the few public sector workers, in the event of such an assault on pension savings**.

[5] Based on the latest Government Actuary's Department valuation 2012.
[6] Based on civil service lpha pension scheme rates for earnings over £51,516 per annum.
https://www.civilservicepensionscheme.org.uk/members/contribution-rates/, (accessed 26 September 2018).
[7] Employer contribution current cap cost rates for 2015 scheme pensions (based on new entrants).
[8] Basey, P. *Pensions inequality*, TaxPayers' Alliance, 27 August 2018.
[9] OBR, *Policy Measures Database*, November 2017, obr.uk/download/policy-measures-database, (accessed 19 September 2018).
[10] HM Treasury, *Whole of Government Accounts: year ended 31 March 2017*, 28 June 2018.
[11] Ibid.

Sources and methodology

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