Retirement Income
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Britain’s Exchequer Mulls an End to Tax Deferred Savings

By Kerry Pechter *Wed, Jul 15, 2015*

Retirement industry watchers in the U.S. should watch what's happening in the U.K. It's a living experiment in pension and tax reform, and it could offer important lessons about what we should or shouldn't do.

Britain’s Tory government got rid of one of the relics of the English “nanny state” when it ended mandatory annuitization of tax-deferred savings, effective last April. But apparently that was just one of its ideas for shaking up the retirement system like a dice cup.

In his summer budget, released last week, Britain’s chancellor of the exchequer said that the government would study the possibility of taxing most retirement contributions and allowing retirees to withdraw their incomes tax-free.

That’s how Individual Savings Accounts (ISAs) currently work in the UK, and it’s the way savings are taxed in another part of the old British Empire—in Australia’s “Superannuation” plan. It’s similar to the way Roth IRAs and Roth 401(k)s work in the U.S.

Ironically, in the U.K. a conservative wants to roll back tax deferral, while only the liberal Obama administration has dared to mention it in the U.S. In both countries, most of the tax subsidy for savings, which amounts to about $100 billion a year, goes to the highly-compensated, who can afford to take full advantage of it. Some of that money comes back to the government later, when distributions are taxed.

Chancellor of the Exchequer George Osborne said that any changes to the tax system “would aim to encourage people to save more for retirement,” the *Financial Times* reported. Advocates of the changes say that it would simplify an overcomplicated system.

A *Times* columnist, Chris Giles, praised the idea in today’s paper, but raised concerns. “A switch would add some complications to the tax treatment of employer contributions to the remaining defined benefit pension schemes,” he wrote.

“A switch would also take years to implement because pension savings which have already attracted tax relief would still be liable to taxation when it is received. More importantly, the move to abolish tax relief on pension contributions would bring forward huge amounts of tax revenues, flattering the public finances by possibly in excess of £40bn ($60bn) a year.”

According to the 2015 Budget document:

Possible Roth-style savings. "The government is… consulting on whether there is a case for reforming pensions tax relief to strengthen incentives to save, offering savers greater simplicity and transparency, or whether it would be best to keep the current system. The government is interested in views on the various options [ranging] from a fundamental reform of the system (for example moving to a system which is "Taxed-Exempt-Exempt" like ISAs and providing a government top-up on pension contributions) to less radical changes (such as retaining the current system and altering the lifetime and annual allowances)."

Easier transfers. "The government will consult before the summer on options aimed at making the process for transferring pensions from one scheme to another quicker and smoother, including in relation to any excessive early exit penalties. If there is evidence of such penalties, the government will consider imposing a legislative cap on these charges for those aged 55 or over."

Secondary market for annuities. "The government wants existing annuity holders to have the freedom to sell their annuity income. The government will set out plans for a secondary annuities market in the autumn, and agrees with respondents to the recent consultation that implementation should be delayed until 2017 to ensure there is an in-depth package to support consumers in making their decision."

Fixed tax-break on savings. "The government is committed to supporting savers at every stage of their life. From April 2016 the government will deliver a major reduction in the level of tax on savings with the introduction of the Personal Savings Allowance, which will exempt the first £1,000 of savings income from tax for basic rate taxpayers and the first £500 for higher rate taxpayers."

Reaction from UK pensions sector

A shift in the taxation of pensions could have far-reaching effects on the British retirement industry, according to media reports. "By treating pensions more like ISAs, the changes would further erode the distinction between retirement savings and regular investments," the *Times* reported.

"That could open the market up to investment houses including BlackRock and digital platforms such as Hargreaves Lansdown, which are already set to benefit from new pensions freedoms."

The UK pensions industry expressed alarm over the news of the possible change. In an article in *The Actuary*, benefits consultant Hymans Robertson warned that "such a move would increase costs for defined benefit schemes, resulting in up to 250 closing in the next nine months, cut defined contribution pension pot sizes and 'potentially lead to a collapse in retirement savings.'"

The retirement industry in the UK is still digesting the termination of mandatory annuitization, a move that has halved the sale of individual income annuities in half. The investment industry, meanwhile, is dealing with the impact of Retail Distribution Review, which capped fund management charges and banned commissions on many products sales.

Phil Loney, chief executive of Royal London, Britain's biggest mutual life and pensions group, questions the plan. "Long-term saving is better served by giving people tax relief upfront," he told the *Times*.

He suspected that Osborne budget was an attempt to bring in a windfall of tax revenues now instead of later. "You kick tax relief 30 years hence and you make a significant impact on the budget today," he said.

The 2015 budget proposal also raised taxes on dividend income, treating it as ordinary income. It would also reduce the amount of money that high earners could defer to retirement accounts by one pound for every two pounds they earn over £150,000. The maximum deferral is currently £40,000 ($62,526). The deferral would drop to a minimum of £10,000 for those earning £210,000.

On another front, the Association for British Insurers reported that British retirees are exercising the new access to their money that the end of mandatory annuitization has given them. Almost a quarter of a million payments worth £1.8 billion were made to about 85,000 customers from retirement accounts in April and May, according to new figures published today by the Association of British Insurers.

In the same period £1.3 billion was put in to buying nearly 22,000 regular income products, with over 50% of this going into income drawdown (systematic withdrawal) products rather than annuities. In 2012, when annuity sales were at their peak, over 90% of the total value of sales were annuities. Less than 10% of total sales were income drawdown sales.

In a press release, Huw Evans, director general of ABI, said this week: "We strongly welcome a full review of how to strengthen the tax incentives to help people save more for their retirement. Pension providers share the Chancellor's concern that Britain isn't currently saving enough and have been calling for this review for some time. We will be keen to actively contribute to this consultation, including highlighting the risks of a workplace ISA replacing pensions.”

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