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Briefing Note

THE WORKPLACE ISA AND THE ISA PENSION

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1. INTRODUCTION

Replacing current support for occupational pensions with a Workplace ISA would have the following benefits:

- A radical simplification of the UK savings landscape.
- Clearly in line with what people want from savings products.
- An opportunity to make a significant reduction in the deficit, perhaps by up to £10 billion.

Last year the Centre for Policy Studies published proposals to abolish all Income Tax and employer NICs relief on pension contributions, to be replaced by a redistributive 50p incentive per £1 saved, paid irrespective of tax-paying status.[1] In contrast, the Conservative Party's 2015 manifesto

[1] See *Retirement saving incentives; the end of tax relief, and a new beginning*; Michael Johnson, CPS, April 2014.

proposed reducing tax relief on pension contributions for those earning more than £150,000 a year, reducing it from £40,000 to £10,000 by the time income reaches £210,000: mere tinkering and added complexity. More significantly, the envisaged saving is already ear-marked to fund proposed inheritance tax reforms, so it will do nothing to help the Chancellor meet his target of a balanced budget by 2019-20.

2. The Chancellor: in a straitjacket?

The Conservatives have ruled out increasing the basic and higher rates of Income Tax, and the rates of National Insurance and VAT. Add Corporation Tax to the list, something that this Conservative government is unlikely to contemplate increasing, plus business rates, and then 75% of the tax base has (arguably) been excluded from any rate rise, at least in the near-term. The Chancellor's fund-raising flexibility is seriously curtailed, a problem compounded by the Prime Minister's twin objectives of increasing the Personal Allowance to £12,500 and the higher rate Income Tax threshold to £50,000, by the end of this Parliament (2020).

The manifesto was, however, silent on the matter of the £14 billion of annual tax reliefs in respect of employer contributions. If the Chancellor were to look at this tempting sum, perhaps as soon as in the forthcoming Budget, the prospect of a Workplace ISA, operating within the auto-enrolment arena, becomes all the more attractive.

This could lead to an ISA Pension, a regular income stream derived from the liquidation of Workplace ISA assets. It would be tax-exempt, consistent with ISAs' TEE tax framework.[2]

3. ISAs to the fore

The Centre for Policy Studies will shortly publish an exploratory paper looking at how a Workplace ISA could replace occupational pension provision. This follows complementary proposals made in 2014 for a Lifetime ISA, to replace private pension provision.[3]

The introduction of these two ISAs and the ISA Pension would make manifest a purely TEE savings world, eliminating the need for pension products' EET framework. This would mark a radical simplification of the savings landscape, which would be widely welcomed by many consumers.

4. Consumer interests should trump commercial interests

The primary driver for moving from pensions' EET framework, to the TEE world of ISAs, is the inflexibility of pension savings prior to 55. This is at odds with how those in Generation Y, in particular, are living their lives. Many eschew pension saving, thereby missing out on tax relief, but engagement with ISAs is high. Ready access and flexibility is valued above tax relief: EET is patently failing the next generation.

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[2] A product's tax status is described chronologically by three letters, either E or T, i.e. Exempt or Taxed. The first letter refers to contributions (of capital), the second to investment income and capital gains and the last letter to post-retirement income. ISAs are "TEE", pensions "EET".

[3] See *Introducing the Lifetime ISA*; Michael Johnson, CPS, August 2014.

But, in progressing from EET to TEE, it would be naïve to assume that the Chancellor would pass up an opportunity to reduce the budget deficit by perhaps £10 billion per year.

5. A fairer incentive

The forthcoming CPS paper will consider today's tax relief incentives, updating the data in a 2014 paper but arriving at the same conclusions: all tax and employer NIC reliefs should be scrapped. Pension contributions from employers should be treated as part of employees' gross income, and taxed as such, and employee contributions would be made from post-tax income. Crucially, the former would attract the previously proposed Treasury incentive of 50p per £1 contributed, paid *irrespective* of the saver's taxpaying status, up to a modest annual limit (£2,000, say, subject to modelling, for a total of £6,000). This would not be a tax relief, thereby nailing the conundrum that because Income Tax is progressive, tax relief is inevitably regressive.

6. The self-employed

The contributions of the self-employed to a Workplace ISA would attract the same 50p incentive as an employer's contributions. The *quid pro quo* would be that at some time after reaching private pension age, Workplace ISA assets funded by employer and self-employed contributions, including the Treasury's 50p, would have to be used to secure an ISA Pension.

Transition to a TEE framework should draw on international experiences. A "Big Bang" approach is favoured. The Treasury should name a date when EET simply ceases in respect of all future contributions. Existing pension pots would wither naturally, with the saver paying his marginal rate of Income Tax on withdrawals.

Some may consider the paper to be an act of heresy, but let us have the debate. Certainly, there should be an extensive consultation with consumer groups, Generation Y and employers.

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