

With the budget on the horizon, the government should take the opportunity to create a fairer and more equal tax system for pensioners

Mar 5 2012

*The British government is rightly committed to raising the tax allowance argues **Tim Leunig**. However, more could be done to ensure that affluent pensioners are not unfairly benefitting from the tax free lump sum and the national insurance exemption options.*



Given that the tax allowance is going up, the government should revisit the additional tax allowance given to pensioners. This was originally created to ensure that pensioners with small private pensions would not have to pay tax. This happens anyway, given that the basic allowance is going up dramatically. The additional allowance is no longer needed. The government should therefore cut the additional allowance as the basic allowance is raised. By doing so, it cuts the cost of raising the allowance, allowing the government to go further and faster. The goal should be for everyone to get the same, decent tax allowance.

More generally, the government should question the way the tax system treats pensioners and non-pensioners. Currently, for any given income, pensioners pay about half as much of their income to the government as people of working age. As well as the additional tax allowance, pensioners can take a tax free lump sum, and are exempt from national insurance. The exemptions are strongly regressive: both the tax free lump sum and the national insurance exemption are worth most to wealthy pensioners. We need to ensure the middle income pensioners are protected from this unequal balance.

Someone with £1.5m in pension savings, for example, is able to avoid £150,000 in tax by taking a £375,000 tax free lump sum. This makes no sense. The tax free lump sum should be limited to say £40,000, effective immediately. It should also be taken away from the wealthiest pensioners altogether, in just the same way that the richest lose their personal allowance. Finally, the government should cease to allow further rights to tax free lumps sums to accrue. This will automatically reduce this regressive tax exemption further in the future.

The government should also reconsider the pensioner exemption from national insurance. In theory, national insurance payments are savings towards a pension, and insurance against unemployment. The reality is different. The contributory principle is dead, and we should give it a humane burial. We don't want to hit poorer pensioners, so applying national insurance to pension incomes above median earnings or so would seem appropriate.

Together these three changes deliver a more coherent, progressive tax system. It would be much fairer between pensioners and those of working age. These changes do not affect pensioners on low incomes, and would not increase pensioner poverty. And they would raise enough money to allow the government to go even further in delivering a decent personal tax allowance for everyone.

Please read our [comments policy](#) before posting.

You may also be interested in the following posts (automatically generated):

1. [The current jobs crisis is the result of a lack of business confidence and a shortage of consumers with money to spend. The government needs to create a long-term framework to drive innovation and raise productivity across the economy](#)

2. The recommendations of the Hutton Report will protect workers and pensioners, but we must come to terms with retiring later
3. As the coalition government moves to create new public-private partnerships and sell off government assets, the QinetiQ privatization of 2006 is a case study in how not to do things 'transparently'
4. Why are Labour Lords keeping their peers up late? Opposition to the coalition's plans for fewer MPs and more equal constituencies