

Tax Relief and Partnership Pensions



The Government is currently reviewing pension provision. In a CASE discussion paper Julian Le Grand and Phil Agulnik examine a crucial part of the current system of state support for pensions: tax reliefs for private pensions (occupational and personal). They estimate the cost of these reliefs, point out their weaknesses as instruments of social policy and propose an alternative 'partnership' scheme.



Currently pension contributions are free of tax; there is tax relief on pension funds' capital gains; and the lump-sum component of any pension pay-out is tax-free. These tax reliefs are offset by the taxation of pensions when they are paid out as income, but the offset is only partial. The net cost of the system is estimated as £9 billion: between one quarter and one third of the cost of the state pension.



The system is highly regressive. In 1996 taxpayers on incomes over £100,000 benefited by an amount equivalent to 3.3% of their income; those on incomes between £3,500 and £4,000 by half of one per cent. Half the benefit went to the top 10% of taxpayers: one quarter to the top 2.5%. In addition, the system is opaque, inflexible and unaccountable.



An alternative 'partnership' scheme (see over) can be devised that would involve abolishing pension contribution tax relief and using the revenue raised to fund a state contribution to the pension scheme that matches the individual's own contribution, up to a fixed limit. The matching rate could be £ for £; or it could be some fraction of a £ such as 66p or 50p.



Such a scheme would cost no more than the present system but be much more progressive. With a 66p rate, taxpayers with incomes over £100,000 receive the equivalent of 0.3% of their income in aid; those with incomes between £3,500 and £4,000 receive 1.3%. The top 10 per cent get 18.5% of the benefit (compared with half under the present system) and the top 2.5% get 3.5% (compared with one quarter at present). The scheme would also be more transparent, flexible and accountable.

Further Information

A more detailed account of sources and methods can be found in CASEpaper 5, *Tax Relief and Partnership Pensions*, by Julian Le Grand and Phil Agulnik. Copies are available free of charge from Jane Dickson, CASE, at the address below. IT can also be downloaded free from our internet site at <http://sticerd.lse.ac.uk/Case>.

An alternative ‘partnership’ scheme can be devised that offers the same amount of assistance to private pensions but in a way that is fairer, more transparent and more accountable. This would involve abolishing pension contribution tax relief and using the revenue raised to fund a state contribution to the pension scheme that matches the individual’s own contribution, up to a fixed limit. The matching rate could be £ for £; or it could be some fraction of a £ such as 66p or 50p.

Such a scheme would be transparent, in that people would be able to see how much assistance they were receiving. It would be flexible with the key parameters of the system (the matching rate and the fixed limit) being set by the Department of Social Security and not as a by-product of the tax system. And, as an item of direct public expenditure, it would be much more accountable than the existing system.

Moreover, it would be much more progressive. The CASE researchers have tested the distributional impact of three versions of the scheme, one where the state matches each £ of an individual’s contribution with 50p, another with a matching rate of 66p and the third with a £ for £ matching rate.

With the 50p rate, taxpayers with incomes over £100,000 receive the equivalent of 0.4% of their income in aid; those with incomes between £3,500 and £4,000 receive 1%. For the 66p rate the comparable figures are 0.3% and 1.3%.; for the £ for £ rate, 0.3% and 2%. With the 50p rate, the top 10 per cent of taxpayers receive a quarter of the benefit (half what they currently receive), and the top 2.5% get 5% (one fifth of what they currently receive). With the 66p and the £ for £ rates, the top 10 per cent get 18.5% and 17.5 % respectively; the top 2.5% get 3.5% of the benefits under both rates.

Both the 66p and the £ for £ scheme reduce inequality in post-tax incomes. The 50p scheme increases it, but by less than the present system.

**Distribution of gains from tax relief and partnership scheme
(value of state support as a % of taxpayer group income)**

