# CHARTERED INSTITUTE OF TAXATION

## FELLOWSHIP THESIS

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# The complexities of government-incentivised savings for people on low incomes


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## 1. Introduction and scope

***The changing tax, related welfare benefits and savings landscape***

Personal debt and lack of disposable income may prevent many people from saving. But automatic enrolment into workplace pensions means the issue is inescapable for many, as a savings plan is put in place for them unless they opt out.

The tax, benefits and savings landscape has changed dramatically in recent years, and continues to change. For example, we have seen the following:

- Pensions freedom from 6 April 2015 means that saving into a pension no longer means tying up savings 'for life', as funds can be drawn out of defined contribution pension schemes in full if desired at age 55 (rising to 57 from 2028).
- In addition to increases in the basic personal allowance for income tax, there are now two nil rates of tax on savings income (the starting rate for savings and the so-called 'personal savings allowance'), and from 6 April 2016 tax is no longer deducted at source from bank and building society interest.
- A nil rate of tax on dividends has been introduced, but the amount of income it covers is to be cut from £5,000 (2017/18) to £2,000 from 6 April 2018.
- From April 2017, the Lifetime ISA has been introduced offering a 25% government bonus, aimed at the under 40s to save up for a first house (otherwise tied up to age 60, without losing the government bonus and suffering a penalty).
- The Help to Save scheme for eligible tax credits and universal credit claimants will be introduced by April 2018. This will allow up to £50 a month to be saved

for a maximum of four years. The main selling point of Help to Save is the ability to earn a 50pence-in-the-pound government bonus.

- In-work support is moving from tax credits to universal credit. This shines a light on the importance of how savings are treated for benefits assessment: tax credits ignore capital wherewithal and assess only income from savings; whereas universal credit takes into account capital as part of the eligibility conditions (unless it is 'disregarded'). Actual income from savings is ignored, but the capital is treated as giving rise to notional or 'tariff' income as part of calculating the claimant's weekly income. Capital above a certain level can prevent a claim altogether.

As the complex interactions of the tax and benefits systems are inescapable for people on low incomes when choosing a savings vehicle, this paper considers the issues that can arise. The government wishes to incentivise people to save, and there are myriad reports, research and articles on the issue of savings – even the mainstream media seemingly have something to say on the subject every day (the bibliography at appendix B illustrates this).

Yet interaction issues between particular types of savings schemes have not been drawn together in a single work. People need to understand the financial impacts of different savings vehicles and how to choose between them, particularly their effects on tax and means-tested benefits. My aim is therefore to explore how and why different types of government-incentivised savings schemes might appeal to the low-income population, and to highlight their advantages and pitfalls.

It is likely to prove impossible to conclude exactly which savings choice will be 'right' for any particular group of people, as this would require detailed analysis of individual

circumstances (and indeed 'advice' on such matters is regulated by the Financial Conduct Authority). Nevertheless, this report aims to examine the tax and welfare benefits interactions to illustrate how difficult it is for an unrepresented, low-income person to work out which might be the best savings option for them. It will illustrate how hard it is to compare savings, even in terms of fundamentally understanding the return that individuals would see as a result of tax relief (or other similar 'government bonus') and the impact on their means-tested benefits – let alone fully comparing all the scheme nuances as to access, and other considerations as to suitability.

***The law referred to in this paper***

This paper slightly diverges from the fellowship 'guidance notes' under the heading 'changes in the law during dissertation preparation'.

Given that I wish to include Help to Save as a government-incentivised savings scheme, it is necessary to include some anticipatory comment on its introduction. Therefore, while referencing pensions and Lifetime ISA legislation per the statute book, this paper uses primary legislation[1] in place for Help to Save and draft regulations that are under consultation until 27 October 2017[2].

***Defining the 'low-income' population***

The population under consideration in this paper is hard to define, because the question of whether or not someone is in financial hardship is not necessarily answered as simply as determining that they have a certain level of income. Much is also dependent on the level of their outgoings, which in turn might be dictated by

[1] Savings (Government Contributions) Act 2017
[2] HM Revenue and Customs, *'Draft legislation: Help-to-Save accounts',* 15 September 2017, < https://www.gov.uk/government/consultations/draft-legislation-help-to-save-accounts >, accessed 5 October 2017

personal circumstances (such as the nature and number of financial dependants, or disabilities and consequent care requirements); and their capital means (such as property or savings).

The Low Incomes Tax Reform Group of the Chartered Institute of Taxation 'define[s] low income as household income below £20,000'[3]. TaxAid also states that their 'remit is those individuals on income of £20,000 a year or less'[4]; and Tax Help for Older People say their service is 'for older people on lower incomes… (£20,000 gross per annum or less.)'[5].

Regard could be had to levels of income and capital below which the government chooses to boost people's income and support their expenditure (such as support for childcare costs) via means-tested benefits. But again those vary considerably depending on factors such as the composition of the family unit (single, couple, whether or not the claimant(s) are responsible for children or have caring commitments and so forth), which makes it difficult to state precisely the population covered in this report.

It is better to consider the target population not in terms of income level, but instead in terms of people's ability to save (effectively 'disposable income' levels), and therefore what might be the best home for savings if someone of relatively low means were to be able to set aside a regular sum. It follows that someone with net income of £40,000 a year with outgoings of £39,000 (mainly due, for example, to the care requirements of a disabled dependent child) will have the same ability to save as

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[3] Low Incomes Tax Reform Group, *'About us'*, < http://www.litrg.org.uk/about-us >, accessed 28 July 2016

[4] TaxAid, *'About TaxAid'*, < http://taxaid.org.uk/about >, accessed 28 July 2016

[5] Tax Help for Older People, *'About us'*, http://www.taxvol.org.uk/about-us/, accessed 28 July 2016

another person with £20,000 a year net income and outgoings of £19,000. The examples chosen in chapter 3 look at the options if a person were to be able to save £50 a month, in cash terms.

Nevertheless, for ease of writing, the report uses the terms ‘low-income person’ or ‘low-income saver’ and similar to describe the population under consideration, using the term low-income as a proxy for ‘low or limited means to save’.

Those looking to save a small amount would clearly not be able to afford paid-for professional services, for example a tax adviser, to help them understand the tax reliefs available on certain savings options. They are therefore likely to be faced with a series of complex decisions on which is the best option for them, each in turn having its own potential tax and benefits consequences as well as different ‘strings’ attached to the access and use of the funds.

First, they would need to appreciate that there are a range of options open to them and to understand that they might need to consider each in some depth. This paper explores why people might not even consider those choices – for example, because they are automatically enrolled into a pension scheme; or perhaps because they have been hooked in by a government campaign promoting a particular type of savings scheme, such as the Lifetime ISA[6].

***What is meant by ‘government-incentivised’ in this paper***

This paper looks at savings schemes that have a headline government incentive – this includes tax relief and employer contributions for pensions, and government bonuses for the Lifetime ISA and Help to Save scheme.

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[6] HM Government, *‘Lifetime ISA’,* < https://lifetimeisa.campaign.gov.uk/#home >, accessed 12 October 2017

*Tax relief*

'Tax relief' is often used as a means of incentivising people to act as the government would prefer – that is, as a means of influencing behaviour. However, for some people, the concept of 'tax relief' is difficult to understand, as individuals are not familiar with the jargon of tax professionals where we talk of marginal rates and how reliefs are calculated.

It can also be confusing for non-taxpayers. Earners on the lowest incomes will not necessarily identify that the term 'tax relief' provides them with any benefit, even where they enrol into a pension that is operated on a relief at source basis (and so 'tax relief' is added to their savings). In that situation, my experience (in particular, from helping to explain automatic enrolment to a group of low-income playgroup workers) is that people struggle to understand how they gain from tax relief when they do not pay tax.

Also, when considered in isolation, tax relief does not always achieve policymakers' intentions. This is because all too often, important tax and benefits interactions are not considered.

This is a point frequently flagged by the Low Incomes Tax Reform Group, for example when the personal allowance for income tax has been increased in recent years as a means of alleviating the tax burden on the low-income population and incentivising work. The group has pointed out that 'because universal credit, like other means-tested benefits, is assessed on after-tax income, claimants will see a reduction in their universal credit equivalent to the cut in their tax bill. The net result is that they will

receive only 35% of the benefit of any increase in the personal allowance'[7] (now 37% due to the reduction in universal credit taper from 65% to 63%).

People can also fall into the cracks between the systems – for example, due to different definitions for tax and benefits and misalignment of thresholds. One particular example relevant to this paper is that the threshold for being automatically enrolled into a workplace pension is earnings of £10,000 a year in a single employment; yet the personal allowance for income tax is £11,500 (2017/18). This might be fine for workers enrolled into a pension scheme run on a relief at source basis, but those contributing to a net pay arrangement scheme could miss out on tax relief (as further described and explored later in this paper).

Differences between the tax and benefits systems can also cause problems simply because people are confused, meaning they do not claim their entitlements or perhaps make poor choices (the latter being particularly relevant to the savings schemes under consideration in this paper).

*Government bonuses and other incentives*

Differing descriptions of what is essentially a government incentive – 'tax relief', 'government bonus', 'government top-up' and so forth – can cause confusion. Some reliefs are tailored to the individual (for example, a tax relief based on their marginal rate), whereas others are a flat 'bonus' applied to the scheme regardless of individuals' circumstances. Yet potential savers might not even appreciate that they should be comparing different types of savings scheme because of these different descriptions.

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[7] Low Incomes Tax Reform Group, *'Press Release: Personal allowances increase welcome for higher earners but of no benefit to those on the lowest incomes'*, 16 March 2016, < https://www.litrg.org.uk/latest-news/news/160316-press-release-personal-allowance-increase-welcome-higher-earners-no-benefit >, accessed 12 October 2017

Regardless of the particular nomenclature, these are merely various terms for describing essentially the same thing – a government incentive of some kind.

The government bonus approach is, however, what I would call an 'easier sell'. While people may not necessarily understand percentages[8], it is arguably easier to explain the Help to Save scheme bonus whereby the government will pay 50p into the account for every £1 saved by the account holder. Of course, there is then the further 'small print' of how the bonus is calculated to contend with – such as the impact on bonuses if withdrawals are made – but the basic premise is relatively simple to convey.

Pensions are, for workers and employees, further 'government-incentivised' in the sense that the law now requires most employers (those that have passed their 'staging date'[9]) to contribute to pensions, if the qualifying criteria for automatic enrolment are met (or if the individual is able to to opt in with an employer contribution).

***The tax-incentivised savings schemes reviewed and compared in this report, and why***

The schemes under consideration are:

- Pensions (including automatic enrolment for employees) – focusing particularly on defined contribution schemes;
- Individual Savings Accounts (ISAs), with emphasis on the Lifetime ISA, as this benefits from a direct government incentive;
- Help to Save.

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[8] The Guardian, *'A fifth of adults have forgotten how to do fractions or percentages: YouGov survey reveals a poor recall of elementary mathematics, English and science among adults',* 7 March 2016, < https://www.theguardian.com/education/2016/mar/07/a-fifth-of-uk-adults-have-forgotten-how-to-do-fractions-or-percentages-mathematics-english-science >, accessed 12 October 2017

[9] The Pensions Regulator, *'Automatic enrolment guide for business advisers: 1. Checking your client's staging date'*, < http://www.thepensionsregulator.gov.uk/checking-your-clients-staging-date.aspx >, accessed 5 October 2017

Note that the Help to Buy ISA has not been included, as this is of limited future interest with the scheme being closed to new account holders from 30 November 2019[10], and is not of primary relevance to this report.

The scope is limited to considering the financial return on an investment in terms of both government incentives and how entitlement to means-tested benefits might be affected.

Of course, there will be many more considerations affecting an individual's choice, such as their other family and personal circumstances both now and in the future. Regulated advice would ideally be required before making such decisions, though many cannot afford individual advice and may have to rely on guidance. While touching on those issues peripherally, it is not the purpose of this paper to duplicate other work in that area (for example, the Financial Advice Market Review[11]) but to focus attention on tax and related welfare benefits aspects that may not necessarily be at the forefront of people's minds when making savings choices.

It is also acknowledged that each of the three savings schemes reviewed have different aims – Help to Save perhaps more so than pensions and the Lifetime ISA (which both have a common 'saving for later in life' theme). However, it is necessary to compare all three as those with low or limited means to save may well have to choose between shorter term (Help to Save), purposed (Lifetime ISA, home purchase), or longer term (Lifetime ISA or pension) savings, as a result of not having the means to do all three.

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[10] HM Government, *'Help to Buy: ISA: FAQ – How long will Help to Buy: ISA be available for?'*, < https://www.helptobuy.gov.uk/help-to-buy-isa/faq/ >, accessed 5 October 2017

[11] Financial Conduct Authority, *'Financial Advice Market Review',* 21 December 2015 and ongoing, < https://www.fca.org.uk/firms/financial-advice-market-review-famr >, accessed 5 October 2017

There is also the risk that people will opt out of pension saving (which the government is aiming to stimulate via automatic enrolment) in favour of Help to Save, attracted by its accessibility, shorter term return and headline 50pence-in-the-pound bonus. It is therefore helpful to try to identify where pension savings may still be the better option, and to explore how one type of government savings policy might have a detrimental effect on another.

***Welfare benefits impacts – limitation in scope***

Like tax, there is a great volume of welfare benefits legislation. Matters might be brought together in future (if not simplified as such) with the roll out of universal credit (replacing child tax credit, working tax credit, income support, income-related employment and support allowance, income based jobseeker's allowance and housing benefit – together known as the 'legacy benefits').

However, tax credits will remain part of the in-work support system until March 2022 under current plans[12], so it is necessary to consider both tax credits and universal credit in this paper. Furthermore, pension credit will remain in place as the main support for the low-income population in 'retirement' (although due to the lines between working age and retirement becoming increasingly blurred, the interactions between universal credit and pension credit bring about their own set of problems).

This paper has to focus its attention somewhere, however. For this reason, pension credit impacts have not been considered. Nor have other forms of support, such as council tax reductions for those who might qualify. Clearly, some of the issues explored in this report – for example, taking funds out of pensions – will have impacts on those

[12] RevenueBenefits, *'Universal credit: when will tax credits stop?'*, updated 21 July 2017, < http://revenuebenefits.org.uk/universal-credit/guidance/stopping-tax-credits/when-will-tax-credits-stop >, accessed 16 October 2017

benefits. Further work would need to be done to cover those, but there is not space within this paper to do so.

This paper looks at tax credits and universal credit impacts of savings choices. It is particularly important, since the introduction of pension freedom from 6 April 2015 (which allows largely unfettered access to pension savings from age 55), that people consider the impact of pension withdrawals on working age benefits. I therefore seek to highlight those issues, while acknowledging that impacts on other means-tested benefits also need to be considered.

***General rules on savings – overview***

Savings in ordinary deposit accounts could also have been included in this report, but have not been taken into account in chapters 2, 3 and 4. This is partly due to space limitations, but also because the intention of the report is to explore the detail of specifically **incentivised** savings schemes and to make comparisons between them, identifying the complexity of choice for people on low incomes.

It could of course be argued that even ordinary savings accounts are now 'tax incentivised' in a manner of speaking, given the combination of the personal savings allowance (or savings nil rate[13]) and 0% starting rate for savings[14]. The complex interactions of the personal allowance and these various tax rates could themselves be the subject of a separate report – as can be seen from the difficulties (as described in, for example, Tax Adviser's Technical section[15]) even HM Revenue and Customs have

[13] Income Tax Act 2007, ss 7, 12A and 12B
[14] Income Tax Act 2007, ss 7 and 12
[15] Margaret Curran, Tax Adviser, *'2016/17 Self-Assessment tax returns affected by exclusions'*, 1 September 2017, < https://www.taxadvisermagazine.com/article/201617-self-assessment-tax-returns-affected-exclusions >, accessed 12 October 2017

experienced in programming their computers to deal with 2016/17 tax calculations because of them!

These rules are in fact so incomprehensible as to be described as a ‘shambles’ by Giles Mooney and Tim Good in a July 2017 article:

> ‘…as majorities have shrunk and backbench power has grown, Chancellors have been forced to tinker more subtly and either change things that are off the radar of average voters or, alternatively, things that sound tempting to the electorate. The changes to dividend tax, the starting savings rate band and the introduction of the personal savings allowance all meet that logic. However, while appealing to the section of the electorate Mr Osborne was keen to impress, it seemed very little thought had been given to policing, administering or applying the rules. What has followed is, quite simply, a shambles.’[16]

In view of the difficulty in working out how ordinary savings are taxed, it is easy to see the attraction of putting savings into a scheme that is specifically tax favoured – even more so when taking into account the added appeal of a scheme incentive, as for those types of savings covered in this report.

***Capital taxes***

This report focuses primarily on the income tax consequences of a low-income person’s savings choices, and the interactions with welfare benefits.

Capital taxes, while relevant to savings choices, are arguably a peripheral consideration for those on low incomes and are unlikely to feature greatly in their deliberations.

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[16] Giles Mooney and Tim Good, *‘Riding the tax rollercoaster’*, Tax Adviser, 1 July 2017, < https://www.taxadvisermagazine.com/article/riding-tax-rollercoaster >, accessed 12 October 2017

Awareness of capital tax considerations is likely to be low amongst the population under consideration. Furthermore, the current capital tax regime for those with the lowest means is relatively benign (an annual capital gains tax exemption of £11,300 for 2017/18; and an inheritance tax nil rate band of £325,000, now supplemented by the residence nil rate band of £100,000 which is due to rise to £175,000 by 2020/21). This means that it does not need to feature greatly in the 'low-income' population's savings considerations. As described above, and in all further references throughout this paper, 'low-income' should be read as meaning those who have low or limited means in both income and assets terms.

If, however, steps were taken in future such that those 'caught' by capital taxes were to increase in number, the impact of those taxes on savings would be brought much more to the fore. For example, pension savings are usually outside of the inheritance tax net, whereas ISA savings are chargeable to inheritance tax. A significant reduction in, or removal of, the inheritance tax nil rate band would therefore make pension saving much more attractive than the Lifetime ISA (assuming no change in the inheritance tax status of those products).

While it would be beneficial if the low-income saver were to understand the capital tax effects of their savings choices, it would likely be an uphill battle to put the issues across in any meaningful way – particularly if they are of little or no relevance to the individual at the time. Arguably, far more important is that they are educated in the income tax and benefits interactions of their choices. Hence, this report focuses on those issues. This is particularly as there would be insufficient space to do justice to the capital taxes considerations on top of the income tax and welfare benefits

interactions – at the lower income end, the treatment of capital for means-tested benefits purposes, explored in this paper, is of far greater relevance.

***Death of the taxpayer/saver***

Finally, the position of the savings schemes under consideration in this paper when the saver dies has not been included. As noted above, the inheritance tax position of savers accumulating small amounts of savings over their lifetime is unlikely to be a significant concern. And while there are different income tax consequences arising on death from the three schemes under consideration (such as pension savings potentially continuing to be tax-favoured after the death of the original saver, and ISAs now effectively being transferable to a surviving spouse by way of an additional permitted subscription), these are tangential to the core focus of the report. As explained above, the main focus is to consider how a person would choose a savings scheme and what the impacts are on their tax and benefits position during their own lifetime.

***Should people save at all?***

This paper is likely to raise questions as to whether it is worth people saving at all, particularly at the low-income end. Arguably, some people might be better not to save anything during their working life. With spiralling personal debt, the best option might, for example, be for a person to pay off borrowings before even thinking of saving.

There is also the question of at what point a person will have amassed enough savings for it to have been worth their while. For example, if all that a person achieves by saving into a pension is to have the level of their pension credit reduced in retirement, they might well think that they would have been better to spend the money during their working life as the state would have made up the difference in any event.

Such issues stray into sociology, however – for example, whether everyone should save for themselves and to what extent they might rely on the state, funded by other taxpayers (and indeed, into economics, considering to what extent the state can afford to continue such support without, for example, means testing the state pension itself). These issues are, however, outside the main scope of this paper. My aim is to examine instead how someone who **is** motivated to save chooses the right savings scheme for them in terms of the best financial return from government incentives.

***Summary***

This paper reviews pensions, the Lifetime ISA and the Help to Save scheme.

After outlining the rules of each schemes (chapter 2A), the aim of this report is to highlight their individual complexities (chapter 2B) and then to compare and contrast them. This is done by assuming a low-income saver has, say, £50 a month to save, and to see what complexities arise in terms of considering where to put these savings (chapter 3). Conclusions and recommendations will then be drawn together (chapter 4 and appendix A respectively).

**Chapter 2A – Savings schemes and their tax, tax credits and universal credit treatment – the rules**

This chapter sets out the three main investments under consideration – pensions, the Lifetime ISA and Help to Save. The best way to illustrate the rules applying to each of these investment types, in order to facilitate the comparison in chapter 3, is to set them out in a table. Lines are numbered, and columns are given the references 'P' (Pension), 'L' (Lifetime ISA') and 'H' (Help to Save) for ease of reference later. Chapter 2B then goes on to discuss some of the complexities of these individual schemes before comparing them in chapter 3.

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| **1** | **Date available from** | Existing | April 2017 | April 2018<br>(Regulations confirming detail due to be laid in early 2018[1].) |

[1] HM Revenue and Customs, *'Draft legislation: Help-to-Save accounts'*, 15 September 2017, < https://www.gov.uk/government/consultations/draft-legislation-help-to-save-accounts >, accessed 29 September 2017

| | | Pension (Column P) | Lifetime ISA (Column L) | Help to Save (Column H) |
|---|---|---|---|---|
| 2 | **Date available until** | Ongoing | Ongoing (but individuals' ability to open a new account is subject to age criteria). | To be available for new applications for five years[2] (but once an account is open, the saver will be able to pay in for the full four years). |
| 3 | **Investment limits** | Gross relievable contributions are limited to:<br>• 100% of 'relevant UK earnings'[3]; or | Maximum saving is £4,000 a year[6]. Lifetime ISA savings count towards the investor's overall ISA subscription limit for a year of £20,000[7]. | £50 a month[9] for up to four years. If the full £50 is not saved in full in one month, there is no carry forward to the next month. |

[2] HM Revenue and Customs, *'Draft Explanatory Memorandum to the Help to Save Accounts'*, 15 September 2017, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/645043/Draft_Explanatory_Memorandum_to_the_Help_to_Save_Accounts.pdf >, accessed 29 September 2017
[3] Finance Act 2004, s189(2)-(7)
[6] ISA Regulations 1998, reg 4ZA(1A)
[7] ISA Regulations 1998, reg 4ZA(1)
[9] Savings (Government Contributions) Act 2017, sch 2, para 10

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| | | • the basic amount of £3,600, if earnings are less than or equal to that amount.<br>Overlaying the 100% earnings rule is an 'annual allowance' of £40,000, above which contributions may create an income tax charge at the taxpayer's marginal rate.[4]<br>To minimise double tax relief (tax-free cash 'recycling'), a reduced money purchase annual allowance of £4,000 | (In 2017/18 only, amounts saved in a Help to Buy ISA can also be transferred to a Lifetime ISA without counting towards the subscription limit, and can also qualify for the government bonus[8].) | |

[4] Finance Act 2004, s228

[8] ISA Regulations 1998, reg 21; and HM Government *'Help to buy: FAQ – I already saved into a Help to Buy: ISA. Can I take advantage of the Lifetime ISA?'*, < https://www.helptobuy.gov.uk/help-to-buy-isa/faq/#Lifetime-ISA > accessed 25 September 2017

| | | Pension (Column P) | Lifetime ISA (Column L) | Help to Save (Column H) |
|---|---|---|---|---|
| | | applies where the individual has already flexibly accessed their pension savings.[5] | | |
| **4** | **Overall maximum investment** | There is an overarching 'lifetime allowance' for pensions saving, of £1million[10]. | This depends on when saver opens the account, as contributions cannot be made from reaching age 50 (see line 6 below). | A maximum investment of £2,400 over a four year[11] period. |

[5] Finance Act 2004, s227ZA(1)(b), s227B(1)(b) and (2), s227D(4) Steps 4 and 5; and Finance Bill 2017-19, clause 7 < https://services.parliament.uk/bills/2017-19/finance.html >, accessed 2 October 2017
[10] Finance Act 2004, s218
[11] Savings (Government Contributions) Act 2017, sch 2, para 3(6)

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| **5** | **Minimum age to open/invest** | No minimum age (criteria is that the investor is a 'relevant UK individual'[12] and can invest up to £3,600 a year even if there are no 'relevant UK earnings'[13]). | Investor has to be aged 18 or over[14] but under 40[15] to open their first Lifetime ISA. | Eligibility is not contingent upon age *per se*, but as the scheme is limited to qualifying tax credits and universal credit claimants, broadly the saver has to be of 'working age'. |
| **6** | **Maximum age to invest** | Contributions after the individual has reached age 75 are not 'relievable'.[16] | No further savings can be made when account holder reaches age 50[17]. | There is no maximum age in the statute, but given that eligibility is determined by reference to 'in-work' |

[12] Finance Act 2004, s189(1)
[13] Finance Act 2004, s189(2)
[14] ISA Regulations 1998, reg 10A(2)(b)
[15] ISA Regulations 1998, reg 12B(4)(d)
[16] Finance Act 2004, s188(3)(a)
[17] ISA Regulations 1998, reg 10A(2)(b)

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| | | | | benefits, older people may not qualify (for instance, pension credit claimants). |
| **7** | **Restrictions on withdrawal – age or other criteria** | Normal minimum pension age is 55.[18] It is planned to increase this to 57 from 2028.[19] Limited exceptions apply: <br>• some scheme members with early retirement rights prior to 6 | Penalty-free withdrawals may be made: <br>• After having held a Lifetime ISA for at least 12 months, on a qualifying first-time purchase of a UK residential property[23]; <br>• Any time from age 60[24]; or | Penalty-free withdrawals may be made at any time. However, the Government bonus is paid by reference to the 'qualifying balance' – that is, the highest value achieved in the first two-year period and second two-year (maturity) |

[18] Finance Act 2005, s279(1) – note, it was age 50 before 6 April 2010

[19] HM Treasury, *'Freedom and choice in pensions: government response to consultation',* Cm 8901, July 2014 – page 6, 5th bullet, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/332714/pensions_response_online.pdf >, accessed 14 October 2017

[23] Savings (Government Contributions) Act 2017, sch 1 paras 7(1)(b), and 7(5)(a) and (b); and ISA Regulations 1998, sch 1 para 6ff

[24] Savings (Government Contributions) Act 2017, sch 1 para 7(1)(a); and ISA Regulations 1998, sch 1 para 4(1)

| | | Pension (Column P) | Lifetime ISA (Column L) | Help to Save (Column H) |
|---|---|---|---|---|
| | | April 2006 have an earlier protected pension age[20];<br>• an ill-health pension may be authorised, where the member is unable to carry on their occupation[21]; | • On diagnosis of a terminal illness (where the investor is expected to live for less than one year)[25].<br>Withdrawals can also be made at any other time, subject to a 25% withdrawal charge[26]. | period[27], so withdrawals may affect the amount of the bonus.<br>Closure of an account before the end of the four-year 'maturity period' will result in nil bonus.[28] |

[20] HM Revenue and Customs, *'Pensions Tax Manual',* PTM062210 < https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm062210 >, accessed 23 June 2017
[21] HM Revenue and Customs, *'Pensions Tax Manual',* PTM062100 < https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm062100 >, accessed 23 June 2017
[25] Savings (Government Contributions) Act 2017, sch 1 para 7(1)(c); and ISA Regulations 1998, sch 1 para 4(2)
[26] Savings (Government Contributions) Act 2017, sch 1 para 8; and ISA Regulations 1998, sch 1 para 5
[27] HM Revenue and Customs, *'Draft legislation: Help-to-Save accounts'*, draft reg 10(5), 15 September 2017 < https://www.gov.uk/government/consultations/draft-legislation-help-to-save-accounts >, accessed 29 September 2017
[28] HM Revenue and Customs, *'Draft legislation: Help-to-Save accounts'*, draft reg 10(2), 15 September 2017 < https://www.gov.uk/government/consultations/draft-legislation-help-to-save-accounts >, accessed 29 September 2017

| | | Pension<br>(Column P) | Lifetime ISA<br>(Column L) | Help to Save<br>(Column H) |
|---|---|---|---|---|
| | | • a serious ill-health lump sum may be paid where life expectancy is less than a year[22]. | | |
| **8** | **Restrictions on withdrawal - amounts** | Defined contribution schemes:<br>• Pensions flexibility (freedom)[29] applies, allowing full encashment of pensions, or flexible withdrawals as desired (if the pension provider/scheme rules allow); or<br>• An annuity may be taken. | No limit on withdrawals.<br>However, where a 'non-exempt' withdrawal is made – ie, one which is subject to a withdrawal charge – the ISA manager should deduct the withdrawal charge before making the 'net' payment to the investor[31]. | No limit on withdrawals.<br>However, as noted in line 7 above, withdrawals might affect bonus earned. |

[22] HM Revenue and Customs, *'Pensions Tax Manual',* PTM062100 < https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm062100 >, accessed 23 June 2017
[29] Taxation of Pensions Act 2014, s1 and sch1 amended FA2004 and related secondary legislation to introduce pension flexibility with effect from 6 April 2015
[31] Savings (Government Contributions) Act 2017, sch 1 para 8(3)(b)

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| | | Defined benefit schemes:<br>• Lump sums and pension income are payable according to the scheme rules.<br>• Private scheme members may be able to transfer to a defined contribution scheme to access pensions freedom, though independent financial advice must be taken for transfer values over £30,000. Transfers are restricted from public schemes. | | |

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| | | • Some small pensions may be encashed in full, from age 60, under 'trivial commutation' (broadly for those with up to £30,000 in pension savings) and 'small pots' (£10,000 per pot) rules[30]. | | |
| **9** | **Other eligibility criteria** | Plan holder must be a 'relevant UK individual'[32], ie any of the following apply for the tax year when a contribution is made: | Investor must be:<br>• resident in the UK; or<br>• an overseas Crown employee; or | The saver must either:<br>• have a valid sole or joint claim to working tax credit, or working tax credit and child tax credit, where |

[30] Low Incomes Tax Reform Group, '*How do I cash in my small 'works' pension (Trivial commutation)?*', updated 6 April 2017, < http://www.litrg.org.uk/tax-guides/pensioners-and-tax/how-do-i-cash-my-small-pension-trivial-commutation >, accessed 23 June 2017
[32] Finance Act 2004, s189(1)

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| | | • they have relevant UK earnings chargeable to income tax;<br>• they are resident in the UK at some time during the year;<br>• they were resident in the UK both at some time during the five years immediately before the year, and when the individual joined the pension scheme; or | • the spouse or civil partner of an overseas Crown employee[34].<br>If at any time an investor ceases to meet these conditions, they cannot subscribe further funds to their account.[35] | there is some payment being made (ie it is not a nil award); or<br>• have a valid sole or joint universal credit claim and have earnings (as defined for universal credit purposes) equal to or greater than 16 hours at the National Living Wage.[36] |

[34] ISA Regulations 1998, reg 10(2)(d)
[35] ISA Regulations 1998, reg 11
[36] HM Revenue and Customs, *'Draft legislation: Help-to-Save accounts'*, draft reg 3, 15 September 2017 < https://www.gov.uk/government/consultations/draft-legislation-help-to-save-accounts >, accessed 29 September 2017

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| | | • they, or their spouse/civil partner, has general earnings from overseas Crown employment subject to UK tax.<br>Also, the scheme itself has to be a registered pension scheme[33] for contributions to qualify for tax relief. | | Joint claimants to the above benefits can each open a Help to Save account where the qualifying criteria are met. The account holder must be present in the UK (per tax credits or universal credit regulations, depending on which is claimed) when opening the account, and while paying into it (savings must stop if the UK presence rules are not met).[37] |

[33] Finance Act 2004, s150 and s153

[37] HM Revenue and Customs, *'Draft legislation: Help-to-Save accounts'*, draft regs 4 and 5, 15 September 2017 < https://www.gov.uk/government/consultations/draft-legislation-help-to-save-accounts >, accessed 9 October 2017

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| | | | | A saver must not have had a Help to Save account previously (only one account is permitted per lifetime).[38] |
| **10** | **Set up of savings** | Automatic enrolment applies to workers, depending on their age and earnings, and they may qualify for an employer contribution.<br>The self-employed have to set up their own personal pension plan and contribute via regular or one-off contributions. | The individual can make savings into a Lifetime ISA out of other 'ordinary' ISA funds if they so wish, and those funds will be eligible for the government bonus[39]. | The account holder pays into the account direct. |

[38] HM Revenue and Customs, *'Draft legislation: Help-to-Save accounts'*, draft reg 7(2)(b)(i), 15 September 2017 < https://www.gov.uk/government/consultations/draft-legislation-help-to-save-accounts >, accessed 29 September 2017

[39] ISA Regulations 1998, reg 4 para 1B(d)

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| **11** | **Income tax relief/ government bonus** | Tax relief[40] depends upon the individual's marginal rate of income tax.<br>If paid to a 'relief at source'[41] scheme, individual contributions are paid net of basic rate tax and basic rate tax relief is reclaimed by the pension scheme and added to the investment. | A tax-free[45] government bonus is added to the account. This bonus is 25% of total qualifying additions[46]. | A tax-free[47] government bonus is added to the account at a rate of 50% of the highest account balance achieved in the first two years.[48]<br>A further 50% bonus on the maximum additional savings achieved in the second two year period will be added at the end of four years.[49] |

[40] Finance Act 2004, s188 et seq
[41] Finance Act 2004, s192
[45] Income Tax (Trading and Other Income) Act 2005, s775A
[46] ISA Regulations 1998, sch 1 para 1
[47] Income Tax (Trading and Other Income) Act 2005, s775A
[48] HM Revenue and Customs, *'Draft legislation: Help-to-Save accounts'*, draft reg 10, 15 September 2017 < https://www.gov.uk/government/consultations/draft-legislation-help-to-save-accounts >, accessed 9 October 2017
[49] HM Revenue and Customs, *'Draft legislation: Help-to-Save accounts'*, draft reg 10, 15 September 2017 < https://www.gov.uk/government/consultations/draft-legislation-help-to-save-accounts >, accessed 9 October 2017

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| | | Higher rate relief, if due, is given via an extension of the basic rate band[42] (not explored further in this report, given the low-income focus).<br>Some non-taxpayers (or those whose taxable income is less than the amount of their pension contributions) who are members of an occupational pension scheme that is operated on a 'net pay arrangement'[43] basis will miss out on | | |

[42] Income Tax Act 2007, s 10(6)(b); and Finance Act 2004, s 192(4)
[43] Finance Act 2004, s193

| | | Pension (Column P) | Lifetime ISA (Column L) | Help to Save (Column H) |
|---|---|---|---|---|
| | | basic rate relief, because in those cases, tax relief is given by deducting gross employee contributions from gross pay.<br>Scottish taxpayers receive relief according to the Scottish income tax rates and bands[44].<br>Employer contributions are paid gross. | | |

[44] Low Incomes Tax Reform Group, *'How does the Scottish income tax… affect my pension contributions?'*, updated 4 June 2017, < http://www.litrg.org.uk/tax-guides/tax-basics/what-scottish-rate-income-tax/how-does-scottish-income-tax-work#toc-how-does-the-scottish-income-tax-scottish-rate-of-income-tax-in-2016-17-affect-my-pension-contributions- >, accessed 6 July 2017

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| **12** | **Income tax on decumulation** | Generally, 25% of the fund may be taken tax-free[50], the rest being taxed at the individual's marginal rate of income tax.<br>Serious ill-health lump sums are tax-free if the member is under the age of 75, or taxable at marginal rate if aged 75 or over[51]. | Tax-free on withdrawal (but a penalty may be triggered if withdrawal does not fall within the restrictions described above – line 8). | Tax-free on withdrawal. |

[50] HM Revenue and Customs, *'Pensions Tax Manual',* PTM063230, < https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm063230#IDA1TEIC >, accessed 6 July 2017

[51] HM Revenue and Customs, *'Pensions Tax Manual',* PTM063400, < https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm063400#IDAFQIBC >, accessed 23 June 2017

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| **13** | **Tax on investment growth** | Growth is tax-privileged[52]. | Nil[53]. | If interest is paid on Help to Save accounts, this would be taxable (though it may fall within the 0% starting rate for savings or 0% savings rate). The Government response to the Help to Save consultation is silent on whether or not interest will be paid in addition to bonuses.[54] |

[52] Finance Act 2004, s186; and HM Revenue and Customs, '*Pensions Tax Manual*', eg PTM121000 < https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm121000 >, accessed 2 October 2017

[53] ISA Regulations 1998, reg 22

[54] HM Treasury, *'Help to Save: Response to the consultation on implementation'*, October 2016, section 3 – Government response, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/559099/Help-to-Save-october_final.pdf >, accessed 29 September 2017

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| **14** | **National insurance contributions** | No National Insurance contributions relief is available for individual pension contributions, but employers do not pay class 1 secondary contributions on contributions made to employees' pensions. | N/A | N/A |
| **15** | **Tax credits treatment – on accumulation** | To calculate tax credits income, the gross amount of any contributions to a registered pension scheme is deducted from total income[55].<br>As a taper rate of 41% is applied in tax credits (as explained on, for example, | No deduction from tax credits income for amounts saved. | No deduction from tax credits income for amounts saved. |

[55] Tax Credits (Definition and Calculation of Income) Regulations 2002, SI 2002/2006, Reg 3(7)

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| | | the LITRG website[56]), this – very broadly – means that for every £1 gross pension contribution paid, the claimant will receive an extra 41p in tax credits. | | |
| **16** | **Tax credits treatment of capital/growth in the account** | Not taken into account as income. The tax credits system does not assess capital and savings (ie, entitlement is assessed on income alone). | Growth is not taken into account as income.[57] Government bonus is wholly disregarded investment income for tax credits[58]. | Interest may be taken into account as other income for tax credits, but might fall within the £300 other income disregard[59]. |

[56] Low Incomes Tax Reform Group, *'How do I calculate tax credits?'*, updated 5 April 2017, < https://www.litrg.org.uk/tax-guides/tax-credits-and-benefits/tax-credits/how-do-i-calculate-tax-credits >, accessed 9 October 2017
[57] Tax Credits (Definition and Calculation of Income) Regulations 2002, SI 2002/2006, Reg 10(2)(a) and Table 4, Item 1(b)
[58] Tax Credits (Definition and Calculation of Income) Regulations 2002, SI 2002/2006, Reg 10(2)(a) and Table 4, Item 15
[59] Tax Credits (Definition and Calculation of Income) Regulations 2002, SI 2002/2006, Reg 3(1) *Step one*

|  |  | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
|  |  |  | The tax credits system does not assess capital and savings (ie, entitlement is assessed on income alone). | Government bonus is to be wholly disregarded for tax credits. Tax Credit regulations will be amended later in 2017 to give effect to this intention[60]. The tax credits system does not assess capital and savings (ie, entitlement is assessed on income alone). |
| **17** | **Tax credits treatment – on decumulation** | As explained on www.revenuebenefits.org.uk, | Not taken into account as income. (Statutory references as in line 16 apply.) | Not taken into account as income. (Statutory references as in line 16 apply.) |

[60] HM Revenue and Customs, *'Technical consultation on draft secondary legislation relating to Help-to-Save accounts'*, para 22, 15 September 2017, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/645135/Technical_consultation_on_draft_secondary_legislation_relating_to_Help-to-Save_accounts.pdf >, accessed 29 September 2017

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| | | 'Pension income for tax credits mirrors the tax treatment.'[61] Therefore, any pension withdrawals that are treated as taxable income are also income for tax credits. The Regulations cross refer to the income tax legislation[62]. As pension income is added together with other 'unearned' income in *Step One* of the tax credits income calculation, it is only taken into | | |

[61] 'Revenuebenefits' website, '*Tax credits: pension income*', updated 28 July 2016, < http://revenuebenefits.org.uk/tax-credits/guidance/how-do-tax-credits-work/what-is-income/pension-income/ >, accessed 25 September 2017

[62] SI 2002/2006 – Tax Credits (Definition and Calculation of Income) Regulations 2002, reg 5

| | | Pension (Column P) | Lifetime ISA (Column L) | Help to Save (Column H) |
|---|---|---|---|---|
| | | account to the extent that the total of that calculation exceeds £300[63]. | | |
| **18** | **Universal credit treatment – on investment of funds** | In calculating employed[64] or self-employed[65] income assessable in a universal credit claim, any 'relievable pension contributions'[66] are deducted.<br>The term 'relievable pension contributions' has the same meaning as in section 188 of the Finance Act | No deduction from universal credit income for amounts saved. | No deduction from universal credit income for amounts saved. |

[63] SI 2002/2006 – Tax Credits (Definition and Calculation of Income) Regulations 2002, reg 3(1)
[64] SI 2013/0376 – The Universal Credit Regulations 2013, reg 55
[65] SI 2013/0376 – The Universal Credit Regulations 2013, reg 57
[66] SI 2013/0376 – The Universal Credit Regualtions 2013, reg 53(1)(b)

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| | | 2004, which is understood to be the gross amount of contributions. As a taper rate of 63% is applied in universal credit (as explained on, for example, the RevenueBenefits website[67]), this – very broadly – means that for every £1 gross pension contribution paid, the claimant will receive an extra 63p in universal credit. | | |

[67] RevenueBenefits, *'Universal credit: Calculating universal credit'*, Step 2: Calculate earned income, sub-heading *'Applying the taper'*, updated 29 August 2017, < http://revenuebenefits.org.uk/universal-credit/guidance/entitlement-to-uc/calculating-universal-credit/#Step 2 >, accessed 9 October 2017

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| | | However, if a person is treated as gainfully self-employed for universal credit, they have to earn a minimum income (the 'minimum income floor'[68]) after all deductions are taken into account. If their actual net income is less than the minimum income floor, the claimant is deemed to have earned that minimum income in any case, therefore meaning that they may get no 'relief' for pension contributions. | | |

[68] SI 2013/0376 – The Universal Credit Regulations 2013, reg 62

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| **19** | **Universal credit treatment of capital/growth in the account** | Provided that the claimant (or neither party to a claim in the case of joint claimants) has reached state pension credit age, capital saved into a pension that has not been crystallised (that is, 'the value of any right to receive a pension'[69]) is disregarded for the purposes of assessing means for universal credit.<br>In the case of claimants over state pension credit age, or where one | Unless it is specifically disregarded, capital is taken into account in the universal credit means test.<br>If claimants have over £16,000[71] in capital, they are not able to claim universal credit.<br>If claimants have between £6,000 and £16,000, they are treated as having 'tariff income' from it. This is calculated | Unless it is specifically disregarded, capital is taken into account in the universal credit means test.<br>If claimants have over £16,000[74] in capital, they are not able to claim universal credit.<br>If claimants have between £6,000 and £16,000, they are treated as having 'tariff income' from it. This is calculated |

[69] SI 2013/0376 – The Universal Credit Regulations 2013, sch 10, para 10(1) and (2)
[71] SI 2013/0376 – The Universal Credit Regulations 2013, reg 18; and part 6 of those Regulations – Calculation of Capital and Income
[74] SI 2013/0376 – The Universal Credit Regulations 2013, reg 18; and part 6 of those Regulations – Calculation of Capital and Income

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| | | party to a joint claim has reached state pension age, untouched pension savings are treated as if an annuity had been purchased – that is, the claim is calculated to take into account an amount of 'notional income' (equivalent to an annuity).[70] | as £4.35 a month for each £250 (or part thereof) of capital over £6,000[72]. Some claimants migrated from tax credits to universal credit may have 'transitional protection' so could be excepted from these capital rules. Further details are awaited.[73] | as £4.35 a month for each £250 (or part thereof) of capital over £6,000[75]. Some claimants migrated from tax credits to universal credit may have 'transitional protection' so could be excepted from these capital rules. Further details are awaited.[76] |

[70] Department for Work and Pensions, *'Pension flexibilities and DWP benefits'*, March 2015, < https://www.gov.uk/government/publications/pension-flexibilities-and-dwp-benefits >, accessed 25 September 2017

[72] SI 2013/0376 – The Universal Credit Regulations 2013, reg 72

[73] Revenue Benefits, *'Universal credit, Transitional protection'*, updated 20 April 2017, < http://revenuebenefits.org.uk/universal-credit/guidance/entitlement-to-uc/transitional-protection/ >, accessed 19 October 2017

[75] SI 2013/0376 – The Universal Credit Regulations 2013, reg 72

[76] Revenue Benefits, *'Universal credit, Transitional protection'*, updated 20 April 2017, < http://revenuebenefits.org.uk/universal-credit/guidance/entitlement-to-uc/transitional-protection/ >, accessed 19 October 2017

| | | Pension (Column P) | Lifetime ISA (Column L) | Help to Save (Column H) |
|---|---|---|---|---|
| | | | | There is to be no change to the Universal Credit to disregard any Help to Save amounts[77]. |
| **20** | **Universal credit treatment on decumulation** | Annuities are treated as unearned income[78].<br>The treatment of pension withdrawals under pension flexibility rules is less than clear cut. On the one hand, the law[79] and DWP staff guidance on | As above (line 19), capital assessed for universal credit.<br>This means that withdrawals do not impact specifically on a universal credit claim. | As above (line 19), capital assessed for universal credit.<br>This means that withdrawals do not impact specifically on a universal credit claim. |

[77] HM Revenue and Customs, *'Technical consultation on draft secondary legislation relating to Help-to-Save accounts'*, para 22, 15 September 2017 < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/645135/Technical_consultation_on_draft_secondary_legislation_relating_to_Help-to-Save_accounts.pdf >, accessed 29 September 2017

[78] SI 2013/0376 – The Universal Credit Regulations 2013, reg 66(1)(i)

[79] SI 2013/0376 – The Universal Credit Regulations 2013, reg 67; and The State Pension Credit Act 2002, s16

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| | | unearned income[80] says that all income from pensions is to be taken into account as unearned income in the universal credit income calculation. Yet the rules on capital[81], coupled with Department for Work and Pensions' staff guidance on capital[82] and some further guidance for the public[83] together may be taken | | |

[80] Department for Work and Pensions, *'Advice for decision making: staff guide'*, Chapter H5: Unearned income, H5019, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/620330/admh5.pdf >, accessed 25 September 2017

[81] SI 2013/0376 – The Universal Credit Regulations 2013, reg 46

[82] Department for Work and Pensions, *'Advice for decision making: staff guide'*, Chapter H1: Capital, H1020 and H1021, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/618960/admh1.pdf >, accessed 2 October 2017

[83] Department for Work and Pensions, *'Pension flexibilities and DWP benefits'*, March 2015, < https://www.gov.uk/government/publications/pension-flexibilities-and-dwp-benefits >, accessed 25 September 2017

| | | **Pension (Column P)** | **Lifetime ISA (Column L)** | **Help to Save (Column H)** |
|---|---|---|---|---|
| | | as suggesting that payments taken under pensions flexibility might be treated as capital if they do not have the characteristics of income payments (for example, irregular payments). | | |

Finally, I have not included universal credit 'capital deprivation' rules (as described in Department for Work and Pensions' staff guidance[84]) in this table. This is because capital deprivation rules are not specific to these schemes – they potentially affect all three. Capital deprivation rules also apply to benefits other than universal credit (but not tax credits because, as noted in line 16 above, capital is not assessed for tax credits purposes). Basically, the capital deprivation rules mean that savers must always be aware that they may be treated as still having savings that they are deemed

[84] Department for Work and Pensions, *'Advice for decision making staff – Chapter H1: Capital'*, H1795ff, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/618960/admh1.pdf >, accessed 19 October 2017

to have deprived themselves of (for example, as a result of making gifts). Therefore, although not discussed in detail in the subsequent chapters, guidance to savers needs to be clear on this issue.

## Chapter 2B - Savings schemes – complexities of each scheme

For an individual to determine whether a savings scheme is appropriate for them, the rules relating to it in broadly three respects need to be considered. This is to say that the saver must think about:

- the rules relating to starting the savings scheme;
- its treatment while it is 'live' and savings are being made into it; and
- its treatment at the end of its life and/or when funds are withdrawn.

The table in chapter 2A sets out the rules for pensions, the Lifetime ISA and Help to Save. This second part of chapter 2 goes on to examine some of the complexities of each, in isolation, as they affect savers of limited means. It aims to follow the above 'sequence' of complexities arising on starting to save, during the life of the plan and then highlighting any issues on withdrawal.

Only key points meriting further discussion from the chapter 2A table are covered here in chapter 2B, as chapter 3 then goes on to compare the three types of savings against each other.

### ***Pensions***

#### *General issues concerning pensions*

Pensions seem to suffer from a perception that they are complex. Perhaps rightly so, considering the difficult interactions with not only the tax system but also welfare benefits systems as set out in the table in chapter 2A.

Yet this perception might mean that people are at risk of jumping to conclusions – for example, that ISAs are much simpler – and losing out financially as a result. On this

subject, during a Chartered Institute of Taxation debate on the role of tax in pensions and savings, Charles McCready of the Tax Incentivised Savings Association said:

> 'We did some research ahead of the announcement of the Lifetime ISA, pre-empting that the government might want to do something with the ISA brand and encourage people to go down that route with their pension savings. So we asked about 2,000 people 'would they prefer an ISA over a pension?' We got back a 70% response that said 'absolutely, we much prefer ISAs, we understand ISAs, we can take our money back out – great'. And then we took a number of those 70% of people, we stuck them in a room and we just laid out how much employers contribute, how much they get back from the tax system and how that compares to an ISA (as was). 95% of the people suddenly said 'do you know what, I think I'll stick with my employer-contributing pension'. So it just shows there's a lot of misinformation that we can tackle.'[1]

The feeling that people are confused by, and indeed cannot trust, longer term savings products such as pensions (and perhaps also the Lifetime ISA which is less accessible – at least in terms of getting at the funds without penalty – than a 'plain vanilla' ISA) might be a consequence of the continual changes to pensions and their tax rules over recent years. For example, an article from the Independent in summer 2015, anticipating the introduction of the Lifetime ISA, raised that people are likely to be wary of promised tax-free access to savings at some distant future point, saying:

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[1] Chartered Institute of Taxation, *'Audio: Free recording of debate on role of tax in pensions and savings'* 4 July 2016, Charles McCready (Director, Tax Incentivised Savings Association), from 04:00 minutes, < https://www.tax.org.uk/media-centre/latest-news/audio-free-recording-debate-role-tax-pensions-and-savings >, accessed 2 October 2017

> '… many pension experts are growing concerned that people are being put off saving for their retirement because of the changes that successive governments are making to the pension system. Royal London's chief executive, Phil Loney, last week warned against proposals by George Osborne, the Chancellor, to switch tax relief on retirement savings from the current upfront system to one more similar to the Isa regime that would let people withdraw their pensions tax free.
>
> "There is no evidence that the promise of tax-free income, 25 to 30 years in the future, would be believed by the public given the volume of changes to the pension system over the last 25 years," Mr Loney said.
>
> He added that it "could pose considerable risk to the Government's aim of creating a savings culture".
>
> A survey of more than 200 financial advisers by Aegon, published today, found that just 4 per cent expected the current pension system to be in place 30 years from now. Nearly 40 per cent predict a means test scheme that will give wealthier retirees smaller payouts.'[2]

Indeed, the issue of trust in pensions is a factor in people drawing money out of them since the introduction of pension freedom from 6 April 2015. In its 'Retirement outcomes review: interim report', the Financial Conduct Authority says:

> 'Over half (52%) of the fully withdrawn pots were not spent but were transferred into other savings or investments. Some of this is due to mistrust of

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[2] Amy Frizell, Independent, *'Pension system changes are putting people off saving for their retirement, experts warn'*, 23 August 2017, < http://www.independent.co.uk/news/business/news/pension-system-changes-are-putting-people-off-saving-for-their-retirement-experts-warn-10468520.html >, accessed 2 October 2017

> pensions. Mistrust is an issue in itself, but can also give rise to direct harm if consumers pay too much tax, or miss out on investment growth or other benefits.'[3]

And who can blame people for this mistrust? Yet again as we approach the Budget, there are rumours of further changes to pensions due to the increased cost of tax relief to the Exchequer, as reported in the Times for example:

> 'A source close to the Treasury said: "The cost of tax relief is only headed in one direction at the moment. There is widespread recognition that the cost trend needs to be reversed."'[4]

This cost of tax relief may be thanks to automatic enrolment, with more and more people saving into pensions – almost '7 million' people already (as at December 2016) being enrolled since the scheme began in 2012, which is expected to rise to 'around 10 million people newly saving or saving more by 2018'[5].

Now that the Government is, however, incentivising people to save with tempting 'government bonuses' available through the Lifetime ISA and Help to Save, it is essential that the warnings given in Charles McCready's speech above are heeded. Failure to explain the benefits of pension saving – particularly for those who benefit from employer contributions and who may be non-taxpayers in retirement so not get the full advantage from 'tax free' withdrawals from other schemes – could result in

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[3] Financial Conduct Authority, *Retirement outcomes review: interim report'*, page 3, July 2017, < https://www.fca.org.uk/publication/market-studies/retirement-outcomes-review-interim-report.pdf >, accessed 9 October 2017

[4] Andrew Ellson, The Times, *'Pension raid on the horizon as savers push tax relief past £50bn'*, 7 October 2017, < https://www.thetimes.co.uk/article/pension-raid-on-the-horizon-as-savers-push-tax-relief-past-50bn-k08h5v6w2 >, accessed 14 October 2017

[5] Department for Work and Pensions and The Rt Hon Damian Green MP, Press release *'The government has announced a review of automatic enrolment to encourage more people to save into a workplace pension'*, 12 December 2016, < https://www.gov.uk/government/news/review-of-automatic-enrolment-to-build-on-success >, accessed 2 October 2017

some people making a potentially less advantageous choice. As is illustrated further in chapter 3, this could particularly be the case for claimants of tax credits or universal credit who might also see an increase in benefits as a result of contributing to a pension.

*Watching what you put into a pension - investment limits*

The table in chapter 2A (column P, line 3) notes that there are limits on relievable contributions that may be made to qualifying pension schemes. The 'annual allowance' of £40,000 is not discussed in this report, as it is not of concern to people on low incomes. Similarly, the complexities of the lifetime allowance are not considered in this report, as it is outside the scope – that is to say it is not of relevance to low-income savers.

What is of some concern, however, is the 'money purchase annual allowance'. This significantly reduces the amount that can be contributed to pensions in future where an individual has previously crystallised benefits from defined contribution schemes. In that situation, the annual allowance is reduced to £4,000 per annum (£10,000 prior to 6 April 2017).

The Government, understandably in many ways, wish to prevent a tax-free lump sum being taken from pensions which is later put back into pension savings – therefore doubling up on tax relief (sometimes known as tax-free cash 'recycling'). Yet there may be very good reasons why someone might choose to draw on pension saving in their fifties – to pay off a mortgage, for example – and then wish to replenish their pension pot for retirement.

This echoes concerns raised by the Low Incomes Tax Reform Group in response to consultation[6] on the reduction of the money purchase annual allowance. In a press release, the group summarised their concerns, saying:

> 'Given that it is too soon to predict what impact pension freedoms and the Lifetime ISA will have on savings patterns, the Treasury consultation document's view that a MPAA of £4,000 will affect fewer than three per cent of savers may not be accurate in the future. Therefore… the £4,000 limit must be reviewed at least every three years.
>
> …
>
> Maintaining a reduced money purchase annual allowance is preferable to an absolute prohibition on any reinvestment into a pension. But reducing it to £4,000 from April 2017, which equates to savings of £333 a month, is very likely to catch out people of limited means who, for example, may have taken a pension lump sum to repay their mortgage or debts, then reinvested their new-found disposable income towards their retirement.
>
> Clear warnings as to the limit on further pension savings must be given in official and pension company guidance, and the potential tax charge if the MPAA is exceeded.'[7]

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[6] HM Treasury, *'Reducing the money purchase annual allowance: consultation'*, 23 November 2016, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/571622/Reducing_the_money_purchase_annual_allowance_consultation_web.pdf >, accessed 9 October 2017

[7] Low Incomes Tax Reform Group, *'Press release: Flaws in the Government's strategy to tighten pension rules'*, 23 February 2017, < https://www.litrg.org.uk/latest-news/news/170223-press-release-flaws-government%E2%80%99s-strategy-tighten-pension-rules >, accessed 9 October 2017

While the Government's response to the consultation acknowledged that the level of the money purchase annual allowance would be kept under review, the commitment to do so was rather vague, saying:

> '2.7 Many respondents agreed that an MPAA of £4,000 would have little impact on the rollout of automatic enrolment. However, respondents also noted that the government would need to keep this under regular review. The maximum legally-required savings under automatic enrolment are currently £743, rising to £2,974 from 2019. As stated in the consultation, it is the government's intention to ensure that the MPAA remains at a level that does not impact on the future development of automatic enrolment.
>
> 2.8 The MPAA level will be kept under regular review, as are all aspects of the tax system.'[8]

This paper therefore reiterates the Low Incomes Tax Reform Group's recommendation to review the money purchase annual allowance in three years' time (6 April 2020). This review should consider the impact that pensions freedom, which will then have been in place for five years, has had on people's savings patterns and ensure that the money purchase annual allowance does not conflict with minimum pension savings under automatic enrolment (set out below).

[8] HM Treasury, *'Reducing the money purchase annual allowance: consultation response',* paras 2.7 and 2.8, March 2017, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/601500/RMAA_consultation_response.pdf >, accessed 9 October 2017

*Set up of savings - automatic enrolment*

As above, many workers are now saving into pensions due to the success so far of automatic enrolment with lower opt-out rates than anticipated[9]. Yet the qualifying criteria for automatic enrolment are themselves a potential source of confusion. The Pensions Regulator tabulates the different qualifying rules as follows:

| **'Monthly gross earnings** | **Age** | | | **Weekly gross earnings** |
|---|---|---|---|---|
| | **From 16 to 21** | **From 22 to SPA*** | **From SPA to 74** | |
| **£490 and below** | Has a right to join a pension scheme [1] | | | **£113 and below** |
| **Over £490 up to £833** | Has a right to opt in [2] | | | **Over £113 up to £192** |

[9] Work and Pensions Committee, *'Progress with automatic enrolment and pension reforms'*, para 19, 10 March 2015, < https://publications.parliament.uk/pa/cm201415/cmselect/cmworpen/668/66806.htm >, accessed 9 October 2017

| ‘Monthly gross earnings | Age | | | Weekly gross earnings |
|---|---|---|---|---|
| **Over £833** | Has a right to opt in | Must be enrolled [3] | Has a right to opt in | **Over £192** |

Figures correct as of 2017/2018. *SPA = state pension age

[1] **Has a right to join a pension scheme**

If they ask, the employer must provide a pension scheme for them, but the employer doesn’t have to pay contributions into a pension scheme.

[2] **Has a right to opt in**

If they ask to be put into a pension scheme, the employer must put them in a pension scheme that can be used for automatic enrolment and pay regular contributions.

[3] **Must be enrolled**

The employer must put these members of staff into a pension scheme that can be used for automatic enrolment and pay regular contributions. The employer doesn't need to ask their permission. If a member of staff gives notice, or the employer gives them notice, to leave employment before the employer has completed this process, the employer has a choice whether to enrol them or not.

The employer also has a choice whether to enrol a director who meets these age and earnings criteria.'[10]

Minimum contributions apply on qualifying earnings (above the lower earnings limit, as for class 1 national insurance contributions). An employer can meet the entire minimum contribution themselves, but if the employer pays only the strict minimum required by them (as is perhaps more likely to be the case), the employee has to make up the balance. Again, The Pensions Regulator has tabulated the minimum gross contributions, with planned increases, as follows[11]:

| Date | Employer minimum contribution | Staff contribution | Total minimum contribution |
|---|---|---|---|
| Until 5 April 2018 | 1% | 1% | 2% |
| 6 April 2018 to 5 April 2019 | 2% | 3% | 5% |
| 6 April 2019 onwards | 3% | 5% | 8% |

[10] The Pensions Regulator, *'Automatic enrolment guide for business advisers. 3. Checking who to enrol'*, < http://www.thepensionsregulator.gov.uk/checking-who-to-enrol.aspx >, accessed 2 October 2017
[11] The Pensions Regulator, *'Employers: Increase of automatic enrolment contributions'*, < http://www.thepensionsregulator.gov.uk/en/employers/phasing-increase-of-automatic-enrolment-contribution >, accessed 12 October 2017

If the employer pays 2% up to 5 April 2018, the employee will not have to pay anything as the entire minimum contribution has been met, though the employee would be able to opt to pay more if they so wished. This point is confirmed in another part of The Pensions Regulator website, also aimed at employers, where the above figures are expressed in terms of the total minimum contribution due rather than splitting out a 'staff contribution'[12].

Where a relief at source scheme is in place, the staff contribution figures are the net of basic rate tax percentage, that is 0.8%, 2.4% and 4% respectively.

The qualifying criteria for automatic enrolment (or indeed being able to opt in) can cause problems for some people in low-paid employment. For example, the above criteria apply per employment, so someone in two concurrent low-paid jobs might not be entitled to enrol in either of their employers' pension schemes and benefit from an employer contribution, yet someone otherwise in the same circumstances and earning the same amount in a single job would. Fortunately, this is a point that has been noted to be considered in the 2017 review of automatic enrolment[13].

This complexity makes pension saving harder to compare with other options, as discussed further in chapter 3. The example calculations in that chapter show the difference between a worker in a single employment (examples 1 and 1a) as against someone working in two low-paid jobs in otherwise the same circumstances (examples

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[12] The Pensions Regulator, *'Employers: Contributions and funding, How much you must pay'*, < http://www.thepensionsregulator.gov.uk/employers/contributions-funding.aspx#s9379 >, accessed 12 October 2017

[13] Department for Work and Pensions, *'Automatic enrolment evaluation report 2016'*, para 4.2, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/576227/automatic-enrolment-evaluation-report-2016.pdf >, accessed 2 October 2017

2 and 2a). Add to this the myriad further variations there could be in circumstances (for instance, people changing jobs and potentially having automatic enrolment deferred for three months, or working in several 'mini jobs' perhaps, or being in irregular agency work such that they are not entitled to employer contributions), and it is easy to see how working out the benefits of pension saving in isolation can be extremely difficult – let alone comparing pensions to other forms of savings.

Also illustrated further in the calculations in chapter 3, the self-employed do not benefit from automatic enrolment. This may change in future, as there have been calls for some form of similar scheme to be extended to them, for example from Citizens Advice[14] and the FSB[15], and the 2017 review of automatic enrolment by the Department for Work and Pensions is looking at coverage of the scheme, including savings for the self-employed[16].

Even if the self-employed are included in some form of automatic enrolment, however, it is not clear how they would be put in an equivalent position to other workers – there being no employer to add contributions (unless the government contributes extra). But perhaps it is viewed that the self-employed are already receiving an additional 'tax relief' from their working status, given the lower rate of class 4 national insurance

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[14] Citizens Advice, *'Half of self employed people do not trust pensions'*, 28 January 2016, < https://www.citizensadvice.org.uk/about-us/how-citizens-advice-works/media/press-releases/half-of-self-employed-people-do-not-trust-pensions/ >, accessed 12 October 2017

[15] National Federation of Self Employed & Small Businesses Limited (FSB), *'FSB warns of self-employment savings time bomb',* 28 April 2016, < http://www.fsb.org.uk/media-centre/latest-news/2016/04/28/fsb-warns-of-self-employment-savings-time-bomb >, accessed 12 October 2017

[16] Department for Work and Pensions, *'Review of automatic enrolment – initial questions'*, Theme 1 and question 4, 8 February 2017, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/590220/initial-questions-automatic-enrolment-review.pdf >, accessed 12 October 2017

contributions as compared to class 1 (which of course the Chancellor attempted to alter in the March 2017 Budget[17], but from which he was forced to backtrack).

There is also speculation that many self-employed people would not benefit in any case, assuming existing automatic enrolment criteria are applied. Reporting on research by the Pensions Policy Institute and Old Mutual Wealth, The Telegraph[18] noted:

> '… of the 4.8 million self-employed workers, just two million would be caught by the existing auto-enrolment rules.
>
> That would leave nearly three million still not saving into a pension.
>
> Old Mutual Wealth's Jon Greer said applying existing rules to the self-employed was not the right approach.'

The article goes on to quote Jon Greer as saying:

> '"There is evidence that they resist 'locking away their savings' and tend to favour certain investments like Isas over others," he said.
>
> "To make pensions more appropriate for the self-employed, a pension 'sidecar' should be explored, a pool of money made accessible at any age in times of need."'

While the purpose of this paper is not to encroach upon the review of automatic enrolment, these comments are interesting in that they suggest that some form of

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[17] HM Treasury, *'Spring Budget 2017'*, para 1.3, 8 March 2017, < https://www.gov.uk/government/publications/spring-budget-2017-documents/spring-budget-2017 >, accessed 12 October 2017

[18] Sam Brodbeck, The Telegraph, '*Millions to miss out on self-employed pensions revolution',* 2 October 2017, < http://www.telegraph.co.uk/pensions-retirement/news/millions-miss-self-employed-pensions-revolution/ >, accessed 12 October 2017

‘mix and match’ approach to savings might be favoured by the self-employed. For those on low incomes, this could perhaps mean a combination of a pension and a shorter term savings plan, such as Help to Save.

*Income tax relief on pension contributions*

As described in the table in chapter 2A (column P, line 11), tax relief on pension contributions can be given in two different ways – via a ‘relief at source’ or a ‘net pay’ arrangement. Which method applies is determined by the scheme.

Low-income workers contributing to pensions set up on a net pay arrangement can miss out on tax relief. The issue affects those who earn over £10,000 a year and who are therefore automatically enrolled into a workplace pension (assuming they do not opt out), or indeed those earning below that level but who opt in. Those earning below the £11,500 income tax personal allowance miss out on tax relief altogether under a net pay arrangement, and those earning slightly above the allowance might miss out on some relief.

> *Example – net pay arrangement compared to relief at source*
>
> Petra earns £11,600 and contributes £500 gross a year to her employer’s pension scheme.
>
> Under a net pay arrangement, the £500 would be deducted from her wages and therefore £11,100 would be taxable. But Petra would only get basic rate tax relief on the first £100 at 20%, ie £20.
>
> By contrast, under a relief at source arrangement, Petra would pay in 80% of the total contribution and the pension fund would reclaim tax relief of 20%. Petra’s net contribution would therefore be £400 and the tax relief of £100 (gross contribution of £500 at 20%) would go into her pension fund.

The net pay arrangement would therefore mean that Petra is £80 worse off (comparing the tax relief of £100 in the relief at source scheme to the £20 available to her under the net pay arrangement).

It has 'been previously speculated that around 900,000 people'[19] are affected by this issue.

Unfortunately, it is understood that there are no plans to change the legislation to address this issue. The HM Revenue and Customs Pensions Industry Stakeholder Forum minutes from 30 March 2017 note the following on the subject:

> '87. One attendee raised a concern about tax relief on pension contributions for non-taxpaying pension scheme members. The attendee explained that for members in relief at source schemes, both taxpaying members and nontaxpaying [sic] members get tax relief on their pension contributions to their schemes. The scheme administrator then claims the tax relief back from HMRC on behalf of the member.
>
> 88. However, non-taxpaying members of pension schemes operating the net pay arrangement don't get the same tax relief. The attendee asked if there are any plans to address this disparity.
>
> 89. HMRC is aware of this issue and explained that it remains under review but that there aren't any plans to change the legislation.'[20]

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[19] PensionsAge, *''Not possible' to resolve AE tax relief issue for low earners, govt says'*, 4 April 2017, < http://www.pensionsage.com/pa/Not-possible-to-resolve-AE-tax-relief-issue-for-low-earners-govt-says.php >, accessed 2 October 2017

[20] HM Revenue and Customs, *'Pensions Industry Stakeholder Forum minutes',* 30 March 2017, paras 87 – 89, < https://www.gov.uk/government/groups/pensions-industry-stakeholder-forum#meeting-minutes >, accessed 21 September 2017

Pressure continues, however, for something to be done. This is particularly in the light of more and more people being enrolled into workplace pensions, and in view of the fact that there are equality concerns as many of the low-paid affected could be women. For example, a recent article in the Times, quoting Baroness Altmann, the former pensions minister, said:

> 'Hundreds of thousands of lower-paid workers are losing out on the 25 per cent bonus they should be getting as part of their pension savings because the government is failing to act on their behalf.
>
> That's the charge Baroness Altmann, the former pensions minister, is levelling at the Treasury and the Department for Work and Pensions. She says: "This is a hidden scandal that is getting worse every day. Yet the government is doing nothing about it. On the one hand it is supposedly encouraging lower-paid workers to save for their retirement through auto-enrolment; on the other it is knowingly presiding over a situation where those who can least afford it are being robbed of a 25 per cent boost to their savings."…
>
> Lady Altmann says: "This affects many more women than men as they are more likely to have lower-paid jobs or to juggle several different part-time jobs."'

So what can be done to redress the balance between workers contributing to the different types of scheme, some of whom will be receiving tax relief and others not? My recommendation would be to use Pay As You Earn real time information data. HMRC could match pension contributions deducted via the payroll to individuals' records and reconcile where those in a net pay arrangement have not received tax relief but would have done so under a relief at source scheme. The relief they have lost out on could be paid to the pension scheme in which they are enrolled.

There may be some complications with this proposal, but these should not be insurmountable. For example, if a person has left their employment such that they no longer have a ‘live’ pension to which they are contributing, they could be asked to nominate a former scheme for the tax relief to be paid to. Similarly, where they have moved jobs, the relief could be paid into their new scheme; or if they have more than one current employment and are enrolled into more than one scheme, again a nomination could be made as to which they would wish the tax relief to be paid into. This could be a very useful function stemming from real time information, given that HMRC have the data as to both relief at source and net pay arrangement contributions[21].

*National insurance contributions considerations*

No National Insurance contributions relief is available for individual pension contributions, but employers do not pay class 1 secondary contributions on contributions made to employees’ pensions.

This can lead to complications for workers if they are offered a ‘salary sacrifice’ arrangement, under which they can exchange salary for additional employer contributions – this can allow them effectively to benefit from national insurance relief on the amount contributed. Pension contributions were excluded from the ‘optional remuneration arrangements’ legislation introduced in Finance Act 2017 so that salary sacrifice in exchange for additional pension contributions continues to be permitted[22].

[21] HM Revenue and Customs, *‘Real Time Information: Data items guide 2017 to 2018 v 1.3’*, items 58B and 61, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/602734/RTI_Data_Item_Guide_17-18_v1-3.pdf >, accessed 13 October 2017

[22] Finance Act 2007, s7 and sch 2, amending parts 3 and 4 ITEPA 2003

Employees on the lowest incomes are, however, prohibited from participating in salary sacrifice if it would take their pay below the National Minimum Wage. The Low Incomes Tax Reform Group of the Chartered Institute of Taxation explains:

> 'The rules on salary sacrifice are to be changed through legislation to be introduced in Finance Bill 2017, but these will still allow salary to be sacrificed for childcare vouchers, for example. This saves both income tax and NIC for the employee. This can represent a small but significant saving for those on low incomes where the cost of childcare can be significant relative to their earnings.
>
> Unfortunately the National Minimum and Living Wage rules do not allow salary to be sacrificed where it would mean the cash payment received by the employee was less than the statutory minimum. This deprives this group of taking advantage of something that would be available to those on a higher income.'[23]

I would reiterate their recommendation: 'The possibility of salary sacrifice for those on the lowest income should be reviewed' as this could enable those on lower incomes to save more for their future by reducing their liability to class 1 primary national insurance contributions. Even if individuals do not choose to add the amount saved in national insurance contributions to their pension, this at least would provide an additional incentive for them to save by increasing take-home pay. A safeguard would, however, be needed so that individuals could not reduce their pay below the lower earnings limit, and in so doing, jeopardise their contributions record. There would be

[23] Low Incomes Tax Reform Group, *'A future for the low-income taxpayer',* para 5D (March 2017), < https://www.litrg.org.uk/sites/default/files/LITRG-Future-for-low-income-taxpayers-FINAL.pdf >, accessed 12 October 2017

little point saving a small amount privately while compromising entitlement to the state pension.

*Pension contributions deductible from universal credit income*

In reviewing the regulations relating to the calculation of universal credit income, a potentially unintended consequence from the interaction of the regulations and pensions law stands out.

The universal credit regulations refer to deducting from earnings (either employed[24] or self-employed[25] earnings) the amount of 'relievable pension contributions' paid by the claimant. This is defined as being the amount relievable under s188 Finance Act 2004[26].

It follows then, by reference to Finance Act 2004 that the relievable pension contribution is the gross amount. This must be the case, as in Finance Act 2004, s191 *et seq* then go on to describe how relief is given; and s190 gives the limits for contributions that qualify for relief under s188 – the 'basic amount' of £3,600[27] is the gross amount, not the net.

The suspicion is, however, that the Department for Work and Pensions will look at how much the claimant has actually paid, which will often be the net amount. Logically, one would also assume that a means-tested benefit should be calculated based upon the net income that the claimant has got left 'in hand'. So if the gross amount is deducted – which is what the legislation apparently says to do – and the claimant is in a relief at

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[24] SI 2013/0576 – The Universal Credit Regulations 2013, reg 55(5)(a)
[25] SI 2013/0576 – The Universal Credit Regulations 2013, reg 57(2)(b)
[26] SI 2013/0576 – The Universal Credit Regulations 2013, reg 53(1)
[27] Finance Act 2004, s190(4)

source scheme, there is an odd result that you deduct more than the claimant has physically paid.

There does not seem to be any other way of reading the regulations and the interaction with the pensions legislation, because if the universal credit regulations were saying to deduct from income the amount the claimant has physically paid, they would have to specify a different amount for those in a relief at source scheme to those in a net pay arrangement (which they do not).

It is interesting that the universal credit regulations in respect of deductible pension contributions use different terminology than other benefits. For example, the regulations for income support instruct that 'one half of any sum paid by the claimant… by way of a contribution to an occupational or personal pension scheme'[28] is to be deducted from the claimant's employed earnings. Similar wording is used to deduct one half of contributions paid to personal pensions from self-employed earnings[29]. This wording suggests it is either the net or the gross that is deducted, depending on whether the contribution is paid to a relief at source or net payment arrangement – ie account is taken of the amount that the person has actually paid out of their own pocket. This seems to be confirmed by the guidance to Department for Work and Pensions decision makers, which says:

> 'Deduct from the employee's gross earnings for a normal pay period one half of any amount which
>
> 1. a person pays into an occupational pension scheme for that period or

[28] SI 1987/1967 – Income Support (General) Regulations 1987, reg 36(3)(b)
[29] SI 1987/1967 – Income Support (General) Regulations 1987, reg 38(1)(b)(ii)

2. is deducted by the employer from a payment of earnings as a contribution to an occupational pension scheme for that period or
3. a person contributes towards a personal pension scheme for that period.'[30]

Despite, however, the universal credit regulations referring to relievable pension contributions being deducted from income, it appears to be very much more likely that the Department for Work and Pensions will deduct the paid amount, whether that be the net or the gross. This is because they will be using PAYE 'real time information' data to calculate universal credit awards. The data items they receive via PAYE are: the net deductions where a relief at source scheme is in place[31]; and the gross deductions where a net pay arrangement is in place[32].

As noted above, this is arguably the 'right' result in logical terms – ie that the actual amount paid by the claimant should be the amount deducted so that their benefit reflects the net income in their pocket – but it would appear to be the wrong result in terms of the legislation.

I therefore recommend that the Department for Work and Pensions and HM Revenue and Customs together review this issue and: confirm the intention of the regulations; review whether any amendment is required; and ensure that the universal credit software is programmed to give the correct result when using real time information

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[30] Department for Work and Pensions, *'Decision Makers' Guide'*, Vol 3 Ch 15: Earnings, para 15383, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/626632/dmgch15.pdf >, accessed 13 October 2017

[31] HM Revenue and Customs, *'Real Time Information: Data items guide 2017 to 2018 v 1.3'*, item 58B, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/602734/RTI_Data_Item_Guide_17-18_v1-3.pdf >, accessed 13 October 2017

[32] HM Revenue and Customs, *'Real Time Information: Data items guide 2017 to 2018 v 1.3'*, item 61, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/602734/RTI_Data_Item_Guide_17-18_v1-3.pdf >, accessed 13 October 2017

data. Online benefits calculators and guidance (provided by both government and third parties) will also require review.

*Capital treatment of pensions under universal credit*

A significant advantage of saving into a pension is that, generally (as outlined in the table in chapter 2A – column P, line 19), those funds are disregarded for universal credit purposes. This means that if savings are held within pensions, a person's ability to claim universal credit will not be impacted. In chapter 3, we will see that this could be an important factor in terms of choice of savings vehicle.

*Pension withdrawals*

Moving on to complexities for low-income savers from drawing on pensions, it is important to illustrate what impact occurs due to the taxable nature of 75% of pension fund withdrawals, and consider too the effect on means-tested benefits entitlement. As noted in chapter 1, I have focused this paper on the impact on tax credits and universal credit – though effects could also be felt by claimants of other benefits such as pension credit, housing benefit (prior to it being subsumed in universal credit) and council tax reductions. Scope has, however, to be limited somewhere, and I felt it was important to examine the impact on working age benefits in view of the fact that pension freedom allows access to funds from age 55 since 6 April 2015.

The potential pitfalls for low-income taxpayers accessing funds through pensions freedom have been illustrated in detail by the Low Incomes Tax Reform Group. An example on their website[33] illustrates how someone could suffer not only income tax

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[33] Low Incomes Tax Reform Group, *'What is the tax position when I take money from my pension flexibly? Could taking money out of my pension affect my child benefit claim?'*, update 25 April 2017, < https://www.litrg.org.uk/tax-guides/pensioners-and-tax/what-tax-position-when-i-take-money-my-pension-flexibly >, accessed 13 October 2017

on a lump sum, but also a high income child benefit charge and loss of tax credits (showing 'how someone cashing in a £50,000 pension pot could be left with just £33,138 – less than two-thirds of what they took out'). Chapter 3 will contrast these significant risks from pension withdrawals with other savings options.

It is unfortunate that the government's web-based guidance on accessing pensions, Pension wise, does not recognise all of these issues. While it does give a very brief overview of the impact on state benefits when taking pension withdrawals, this does not include any reference to tax credits[34]. The calculator estimating how much tax you might pay on a lump sum is also grossly over-simplified and does not take any account of a potential high income child benefit charge (merely asking two questions – 'What is your yearly income?' and 'How much is in your pot?')[35]. While there is a warning that the result is only an estimate, it is easy to see that many people will set some store in the figure – assuming it to be reasonably accurate, even if not to the penny. One would not expect it to be many hundreds, or even thousands, of pounds out – as it could be if a person were to lose child benefit for one or more children as a result of the high income child benefit charge.

The government's financial guidance offering is changing over the next year or so, with the creation of a single public financial guidance body (legislation making its way through Parliament at the time of writing[36]). I recommend that when reviewing and bringing together the existing guidance, the new body puts some resource into improving the guidance for people taking funds from pensions, for example to create

[34] Pension wise, *'Benefits'*, < https://www.pensionwise.gov.uk/en/benefits >, accessed 13 October 2017
[35] Pension wise, *'Take your whole pot in one go: Estimate what you'd get after tax'*, < https://www.pensionwise.gov.uk/en/take-whole-pot >, accessed 13 October 2017
[36] Financial Guidance and Claims Bill 2017-19, < https://services.parliament.uk/bills/2017-19/financialguidanceandclaims.html >, accessed 13 October 2017

more accurate calculators and thorough guidance on the benefits impacts of decisions (including tax credits). Chapter 4 further touches upon this recommendation in the context of continual changes to the savings landscape, highlighting how frequent change presents a barrier to being able to provide the best guidance and innovation in guidance tools.

*Pension withdrawals, universal credit treatment – is it income or capital?*

Turning to the universal credit treatment of pension withdrawals, I noted in the chapter 2A table (column P, line 20) that the position is less than clear cut. Guidance from Pension Wise, offering 'free and impartial government guidance about your defined contribution pension options' is particularly vague on this point[37]. For example, it says:

> '**Before Pension Credit qualifying age**
>
> Before you or your partner reach the qualifying age for Pension Credit any money you **take out of** your pot will be taken into account when you're assessed for benefits.
>
> This might, for example, be income you get from an annuity, a tax-free lump sum, or an adjustable income.'

While I do not believe the above text is incorrect, it is less than helpful in that it does not say **how** the withdrawal will be taken into account in benefits assessments. As noted in chapter 2A, my reading of the universal credit regulations and Department for Work and Pensions staff guidance is that lump sum or irregular payments might be considered to be capital sums, whereas annuities and other regular income

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[37] Pension wise, *'Benefits'*, < https://www.pensionwise.gov.uk/en/benefits >, accessed 13 October 2017

withdrawals would be treated as income. Amounts treated as capital would only impact on universal credit to the extent that they leave the claimant with total capital of £6,000 or more in 'non-disregarded' form; whereas amounts treated as income could impact on the universal credit assessment period in which they are drawn.

Further clarity on these issues in relation to pensions freedom ought to be given in the guidance for both decision-making Department for Work and Pensions staff and for claimants, as there is a potentially significant difference in impact between the two types of treatment.

***Lifetime ISA***

The Lifetime ISA was launched from April 2017. As noted in the pension discussion above, there has been much suggestion that savers might find the ISA 'wrapper' preferable to pensions – for example because they have the great benefit of being tax-free on withdrawal. Although pensions are now much more accessible than they previously were, the discussion above highlights the pitfalls of pensions freedom in terms of the tax consequences – particularly when taking a lump sum.

In any event, ISA withdrawals benefit from not having the tax concerns attached to pensions. There are, however, other pitfalls to be wary of – for example, the penalty on withdrawals in circumstances other than a qualifying property purchase or from age 60.

*Penalty on non-qualifying withdrawals*

Savers might be lulled into thinking that there is effectively no 'penalty' on early withdrawal from a Lifetime ISA, believing that they merely lose the government bonus.

That is, you get a 25% bonus when you put the money in and suffer a 25% charge if you take the money out other than for a qualifying purpose.

In many people's minds, this will equate to the same thing. However, we can see that it is not, as illustrated below:

> *Example – Lifetime ISA penalty*
>
> John is self-employed. He opens a Lifetime ISA and saves £4,000 into it. A government bonus of £1,000 is added to it (£4,000 x 25%). A year later, John has an unexpected family emergency and has to withdraw the full balance. In so doing, his provider has to deduct a 25% charge. On the £5,000 balance, this is £1,250. John has therefore suffered an early withdrawal penalty of £250.

It is unfortunate that guidance for the public on GOV.UK about the Lifetime ISA[38] does not explain that the 25% charge is more than the 25% bonus. I would therefore recommend including in that guidance a worked example similar to that above.

*Capital treatment for universal credit*

The problem with the Lifetime ISA being accessible at any time is that the capital is assessable for universal credit purposes (as outlined in the chapter 2A table, column L, line 19).

This means that if someone has chosen to save into a Lifetime ISA but then suffers a reduction in income such that they need to claim universal credit, their claim will be affected by the level of their savings. They may not qualify for support at all (savings of £16,000 or more), or their award might be curtailed due to the inclusion of tariff income (savings of £6,000 or more). As explained on RevenueBenefits: 'For example

[38] GOV.UK, *'Lifetime ISA'*, < https://www.gov.uk/lifetime-isa >, accessed 13 October 2017

capital of £6,250 gives monthly tariff income of £4.35. Capital of £6,250.01 gives a monthly tariff income of £8.70.'[39]

The Regulations[40] do not mention ISAs specifically, but the Department for Work and Pensions' staff guidance says that ISAs are included as capital[41].

Also, the Financial Conduct Authority instructs those advising on Lifetime ISAs to give 'a warning that… the retail client's current and future entitlement to means tested benefits (if any) may be affected'[42].

The amount of Lifetime ISA capital to be included in the means test is understood to be the amount after deducting any withdrawal charge. This was noted in the government's Lifetime ISA technical note[43] as follows:

> '1.42 Funds held in a Lifetime ISA will be treated like funds held in an ISA in cases where an individual's capital needs to be assessed. Such assessment will recognise the need to deduct the 25% charge to access the funds where appropriate. This includes:
>
> - **welfare and social care means tests, which will take the surrender value of Lifetime ISA funds into account as individual capital** [emphasis added]

[39] RevenueBenefits, *'Universal credit: Capital rules'*, Tariff income rules, updated 7 March 2016, < http://revenuebenefits.org.uk/universal-credit/guidance/entitlement-to-uc/capital-rules/#Tariff income rules >, accessed 9 October 2017
[40] SI 2013/0376 – The Universal Credit Regulations 2013
[41] Department for Work and Pensions, *'Advice for decision making: staff guide'*, Chapter H1: Capital, H1020 – item 3, third bullet, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/618960/admh1.pdf >, accessed 26 September 2017
[42] Financial Conduct Authority, *'COBS Handbook',* Annex 1 *'Lifetime ISA information',* para 2.2, < https://www.handbook.fca.org.uk/handbook/COBS/14/Annex1.html >, accessed 25 September 2017
[43] HM Treasury, *'Lifetime ISA: updated design note'*, para 1.42, September 2016 < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/553333/Lifetime_ISA_technical_note_September_2016_update.pdf >, accessed 26 September 2017

- divorce, where Lifetime ISA funds will be treated as a normal asset
- bankruptcy, where Lifetime ISA funds will be treated as a normal asset

direct recovery of debt, where the existing rules for stocks and shares ISAs will apply.'

The inclusion of Lifetime ISA capital in the means test for universal credit and other benefits seems to be disjointed policy. For instance, the Lifetime ISA treatment is in contrast to pensions, which – as previously discussed – are generally disregarded while untouched. As one of the purposes of the Lifetime ISA is to save for later life, why apply a different capital treatment as compared to pensions?

The other purpose of the Lifetime ISA is to incentivise saving for a first property purchase. As explained in the Department for Work and Pensions staff guidance, there are disregards from capital assessment for claimants' own homes[44] and, subject to the following conditions, for an 'amount to be used to purchase premises':

> 'H2119 Where a person has received an amount within the past 6 months which is to be used to purchase premises that the person intend to occupy as their home, that amount can be disregarded from the calculation of that person's capital where it
>
> 1. is attributable to the proceeds of the sale of premises formerly occupied as their home or
>
> 2. has been deposited with a housing association (see H2045) or

[44] Department for Work and Pensions, *'Advice for decision making: staff guide',* Chapter H2: Capital disregards, H2031, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/651004/admh2.pdf >, accessed 13 October 2017

3. is a grant made to the person for the sole purpose of purchasing a home[1].

*[1] UC Regs, Sch 10, para 13'*[45]

Similarly, if a claimant has received funds from an insurance policy relating to loss or damage to their home, this is disregarded for at least six months[46].

It therefore seems illogical and contrary to the policy intentions behind the scheme to bring into the means test funds held in a Lifetime ISA destined for access either later in life or on purchase of a home. I therefore recommend that the universal credit regulations are altered so that they disregard capital in Lifetime ISAs.

*Tax and benefits treatment on withdrawal*

The Lifetime ISA has the benefit of being tax-free on withdrawal. Therefore, there is no need to concern oneself about marginal rates of income tax on taking money out, nor staging withdrawals to avoid a tax bill as might be the case with a pension.

Similarly, as capital is already assessed for universal credit purposes, the Lifetime ISA saver is treated no differently in terms of the means test whether or not they leave the funds in the scheme or take them out.

The main impact therefore to be considered on withdrawal is the penalty if the funds are accessed other than in the qualifying circumstances laid out in the chapter 2A table (column L, lines 7 and 8).

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[45] Department for Work and Pensions, *'Advice for decision making: staff guide',* Chapter H2: Capital disregards, H2119, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/651004/admh2.pdf >, accessed 13 October 2017

[46] Department for Work and Pensions, *'Advice for decision making: staff guide',* Chapter H2: Capital disregards, H2121, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/651004/admh2.pdf >, accessed 13 October 2017

### ***Help to Save***

As noted in the chapter 1 introduction, my comments on the Help to Save scheme are based in part on draft legislation – we have primary legislation in place but draft regulations are under consultation until 27 October 2017. Nevertheless, we know enough about the scheme to compare it (in chapter 3) against pensions and the Lifetime ISA.

*General concerns regarding Help to Save*

The Low Incomes Tax Reform Group has raised some quite significant concerns over the wording of draft legislation, which – without repeating them – I would support[47]. I hope that many of these issues are addressed prior to the regulations being laid later this year, or in early 2018.

The aim of the scheme is to help those of low means to build up a 'rainy day' fund, though interestingly, research by the Institute for Fiscal Studies raised concerns that the scheme's design does not necessarily accurately target those with little or no savings[48].

From a strict 'tax' point of view, there is perhaps little of interest to say about Help to Save – except to note that if any interest were to be paid on the accounts, there is nothing to exempt this specifically from income tax. As noted in the chapter 2A table (column H, line 11), the bonus is specifically income tax exempt.

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[47] Low Incomes Tax Reform Group, *'Technical consultation on draft secondary legislation relating to Help-to-Save accounts: Response'*, 17 October 2017, < https://www.litrg.org.uk/sites/default/files/files/171017-LITRG-response-Help-to-Save-FINAL.pdf >, accessed 17 October 2017

[48] Institute for Fiscal Studies, *'Who will 'Help to Save' help to save?'*, 15 August 2016, < https://www.ifs.org.uk/publications/8423 >, accessed 13 October 2017

*Capital treatment for universal credit*

The capital held in a Help to Save account is not disregarded for the purposes of universal credit. The Low Incomes Tax Reform Group called for the regulations to be changed to specifically disregard it from means-tested benefit assessment[49], so as not to discourage people from saving (by thinking that having savings might mean they lose future entitlement to state support, should they need it).

The rationale for not disregarding Help to Save funds would appear to be that the maximum savings, including bonus, that one might amass over the account's four year life would be £3,600. Considering that the minimum capital a claimant needs to have is £6,000 before universal credit is affected, in theory this should not be a problem.

This neglects, however, to take into account that where a claim to universal credit is made by a couple as a single unit, both partners might be able to open a Help to Save account. Therefore, if **both** were to save the maximum over the four year period, the total would amount to £7,200 and therefore would put the couple into a position where their joint capital would create a tariff income assessment (chapter 2A table, column H, line 19; and as discussed above in relation to the Lifetime ISA).

Therefore, if this capital is not to be disregarded for universal credit (though I would recommend in fact that it **should be** disregarded via a change to universal credit regulations), claimants need to be aware of this issue so that they can ensure, when the time comes, that their claim takes the capital into account.

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[49] Low Incomes Tax Reform Group, *'Help to save – consultation on implementation: response',* 11 July 2016, para 10.5.2, < https://www.litrg.org.uk/sites/default/files/files/160711-LITRG-response-HelpToSave-FINAL.pdf >, accessed 13 October 2017

### *Summary*

So far, pensions have dominated the discussion, as above. This is largely because pensions are given their government incentive in two ways – first, by means of tax relief; and second (for eligible workers) by way of employer contributions. Payment of pension contributions may also offer an enhancement in welfare benefits entitlement.

For these reasons, and because of the complexity of 'tax relief' being given rather than a flat-rate bonus, pensions therefore warranted more detailed exploration in this chapter than the other two schemes.

In chapter 3, the complexities of the Lifetime ISA and Help to Save are set in the context of how they compare to pensions, illustrated by way of some example calculations.

## 3. Comparing the financial benefits of savings schemes

Chapter 2 showed just how difficult it is for individuals to sift through each savings scheme. Not only does an individual have to grapple with the qualifying criteria and rules as to what they can and cannot do with the money, but also they have to understand how those fit with their life circumstances – both now and in the future. For some, it is difficult to predict what might happen over the course of a week or month, let alone a year or as far ahead as retirement.

This chapter compares the financial differences of saving into defined contribution pensions, the Lifetime ISA and Help to Save. However, financial return is not the only consideration. For example, some savers will view access to funds as the key priority, so Help to Save (or indeed entirely unrestricted savings such as an ordinary savings account or an instant access ISA) may be the obvious choice regardless of the financial benefit. Nevertheless, it is crucial for savers to understand the different financial consequences of each savings plan so they are able to make an informed choice about their options.

The savings schemes under consideration have different target audiences: pensions are aimed at getting people to save for retirement; the Lifetime ISA is for a house purchase or retirement but with accessibility in the meantime (subject to a penalty); and Help to Save is aimed at helping people with little or no savings to build up a 'rainy day' fund. Yet it is easy to see the potential crossovers and conflicts. Someone might opt out of an employer pension scheme in favour of Help to Save, preferring easy access to their savings. Or they might opt out of a pension to put money into the Lifetime ISA, hoping to get on the housing ladder but then fall on hard times and have to draw on the funds (in which case, they might have been better to save into a

pension as their savings would then be disregarded in means-tested benefits capital assessments).

Using examples, this chapter will compare the basic financial 'return' from each scheme, taking into account tax relief (or other government incentives) and the impact on benefits. The examples will project forward from April 2018, as Help to Save will launch from April 2018.

Three scenarios are used. The first two will be based upon employees, one of whom is employed in a single job (examples 1 and 1a) and the other has two concurrent jobs (examples 2 and 2a). The third will be a self-employed person (example 3).

All examples will assume total earnings of the same level and personal circumstances will be the same. This allows for the best comparison between the three different working scenarios, and to illustrate how the individual's working situation changes the financial benefits of the different savings options for each. It is assumed that the saver can afford to set aside £50 a month out of their own pocket – that is, net savings out of taxed income.

For pension purposes, the financial return on saving is different depending on whether the individual claims universal credit or tax credit as in-work support, so both possibilities are compared. This will also help to illustrate that a further variable over the coming years – the move from tax credits to universal credit – will impact on individuals' savings choices (not only from an income perspective, but also in terms of capital saved). Note, however, that the impact on moving from tax credits to universal credit might not be as straightforward as moving from the 'tax credits' column to the 'universal credit' column for pensions in the example calculations below. Nor is it as simple as moving in the chapter 2A table from line 16 (all savings capital being

disregarded for tax credits purposes) to line 19 (pensions capital usually being protected from the universal credit means test, but Lifetime ISA and Help to Save capital being included in the means test). This is because of the possibility of transitional protection for tax credits claimants who are migrated across to universal credit, as described in the chapter 2A table, line 19.

It is not helpful that the details of the transitional protection for those moved from tax credits to universal credit are not yet known. Further work would need to be done, following on from this paper, to understand the full impact of such migration and protection on savings when those details are confirmed.

***Examples – assumptions and facts applied***

In each example, the following assumptions and facts apply:

- The saver is aged 31, working 30 hours a week
- They are single
- They have one child, aged 13, but they incur no childcare costs as the child goes to school or is looked after by a family member while the parent works
- Housing costs are nil, as they live with family
- They earn £1,000 a month, gross
- They can afford to save £50 a month in total, out of their own pocket – that is £50 a month of net savings out of taxed income
- They are saving the £50 a month into a single type of account, rather than splitting it. In order to make a clear comparison of return, if automatic enrolment applies, it is assumed in columns B and C that the employee has opted out in favour of saving into a Lifetime ISA or Help to Save instead

- The savings period is four years from April 2018, as that is when Help to Save first becomes available, and four years is the maximum savings period for that scheme
- The pension is assumed to be a relief at source scheme
- Universal credit is being claimed as in-work support in column A; tax credits is being claimed as in-work support in column B
- They are all British citizens, living in England

All examples leave out investment return, as the exercise is to examine the financial benefits of the 'government' incentive – from employer contributions (which the law obliges them to pay under automatic enrolment rules) or from tax relief (or similar government 'bonuses').

At the time of writing, tax, national insurance and national minimum wage rates together with benefits allowances and taper rates (such as the work allowance and taper rate for universal credit, and taper rate for tax credits) are not confirmed for 2018/19 onwards. Therefore, all calculations are based upon 2017/18 figures, with no uprating for the future. The one exception to this is that it is assumed that increases to automatic enrolment minimum contributions will go ahead as planned, as shown in chapter 2B.

Note that the employee pension contributions in examples 1 and 2 do not increase as, even when the minimum rate increases to 5% gross (4% net of basic rate tax) of earnings above the lower earnings limit, the £50 a month net payment meets the minimum requirement.

***Example 1 – Julie, an employee in a single job***

| **Savings for four years from 2018/19** | A<br>**Pension (universal credit claimant)**<br>**£** | B<br>**Pension (tax credits claimant)**<br>**£** | C<br>**Lifetime ISA**<br>**£** | D<br>**Help to Save**<br>**£** |
|---|---|---|---|---|
| Total savings – paid out of net income, £50 a month for four years | 2,400 | 2,400 | 2,400 | 2,400 |
| Employer pension contribution (columns A and B):<br>- 2018/19: (£12,000 - £5,876) x 2%<br>- 2019/20: (£12,000 - £5,876) x 3%<br>- 2020/21: (£12,000 - £5,876) x 3%<br>- 2021/22: (£12,000 - £5,876) x 3% | <br>123<br>184<br>184<br>184 | <br>123<br>184<br>184<br>184 | | |
| Tax relief or government bonus added<br>- Column A/B, £2,400 x 100/80 x 20%<br>- Column C, £2,400 x 25%<br>- Column D, £2,400 x 50% | <br>600 | <br>600 | <br><br>600 | <br><br><br>1,200 |
| Universal credit increase from making personal pension contributions (column A) | | | | |

| | | | | |
|---|---|---|---|---|
| - £2,400 x 100/80 x 63%<br>Tax credits increase from making personal pension contributions (column B) – applies from second year only, due to the disregard for falls in income[1]<br>- £1,800 x 100/80 x 41% | 1,890 | 923 | | |
| Total value of investment at the end of four years, including all tax and benefits 'relief' | £ 5,565 | £ 4,598 | £ 3,000 | £ 3,600 |

***Example 2 – Lilyanna, an employee working two jobs***

Additional background: Lilyanna has two jobs. In job X, she earns £9,000 a year (£750 a month) and in job Y, she earns £3,000 a year (£250 a month). It therefore follows that she will not be automatically enrolled into an employer pension. She can, however, opt in to her job X employer's pension scheme and qualify for an employer contribution on earnings above the lower earnings limit. In job Y she could opt in to the employer's scheme, but would not qualify for an employer contribution.

[1] Low Incomes Tax Reform Group, *'Tax credits: What income will be used to calculate my claim? > Which year's income is used?'*, updated 5 April 2017, < https://www.litrg.org.uk/tax-guides/tax-credits-and-benefits/tax-credits/what-income-will-be-used-calculate-my-claim#toc-which-year-s-income-is-used- >, accessed 19 October 2017

| Savings for four years from 2018/19 | A<br>**Pension (universal credit claimant)**<br>**£** | B<br>**Pension (tax credits claimant)**<br>**£** | C<br>**Lifetime ISA**<br>**£** | D<br>**Help to Save**<br>**£** |
|---|---|---|---|---|
| Total savings – paid out of net income, £50 a month for four years | 2,400 | 2,400 | 2,400 | 2,400 |
| Employer pension contribution (column A and B): | | | | |
| - 2018/19: (£9,000 - £5,876) x 2% | 63 | 63 | | |
| - 2019/20: (£9,000 - £5,876) x 3% | 94 | 94 | | |
| - 2020/21: (£9,000 - £5,876) x 3% | 94 | 94 | | |
| - 2021/22: (£9,000 - £5,876) x 3% | 94 | 94 | | |
| Tax relief or government bonus added | | | | |
| - Column A/B, £2,400 x 100/80 x 20% | 600 | 600 | | |
| - Column C, £2,400 x 25% | | | 600 | |
| - Column D, £2,400 x 50% | | | | 1,200 |
| Universal credit increase from making personal pension contributions (column A) | | | | |
| - £2,400 x 100/80 x 63% | 1,890 | | | |

| | | | | |
|---|---|---|---|---|
| Tax credits increase from making personal pension contributions (column B) – applies from second year only, due to the disregard for falls in income<br>- £1,800 x 100/80 x 41% | | 923 | | |
| Total value of investment at the end of four years, including all tax and benefits 'relief' | £ 5,235 | £ 4,268 | £ 3,000 | £ 3,600 |

***Example 3 – Stephanie, self employed***

Additional background: Stephanie is gainfully self-employed and therefore subject to the universal credit minimum income floor. No exceptions from the minimum income floor apply here (for example, she is not within an initial business start-up period). For Stephanie, the minimum income floor is therefore likely to be calculated as 35 hours a week, multiplied by the national minimum wage (living wage rate, due to her age), minus an assumed amount of tax and national insurance. The minimum income floor applies only to the self-employed. As Stephanie's net income is below it, she cannot take any further deduction from her universal credit income for pension contributions paid.

For tax credits, there is no minimum income floor. Stephanie will be able to claim tax credits as long as she is in 'qualifying remunerative work', though HMRC might raise a

compliance investigation if they believe the trade is not being carried out on a commercial basis (as explained on 'RevenueBenefits'[2]).

| **Savings for four years from 2018/19** | A<br>**Pension (UC claimant)**<br>**£** | B<br>**Pension (WTC/CTC claimant)**<br>**£** | C<br>**Lifetime ISA**<br>**£** | D<br>**Help to Save**<br>**£** |
|---|---|---|---|---|
| Total savings – paid out of net income, £50 a month for four years | 2,400 | 2,400 | 2,400 | 2,400 |
| Tax relief or government bonus added | | | | |
| - Column A/B, £2,400 x 100/80 x 20% | 600 | 600 | | |
| - Column C, £2,400 x 25% | | | 600 | |
| - Column D, £2,400 x 50% | | | | 1,200 |
| Universal credit increase from making personal pension contributions (column A) | | | | |
| - Minimum income floor applied (see note below) | 0 | | | |
| Tax credits increase from making personal pension contributions (column B) – applies from second | | | | |

[2] RevenueBenefits, *'Tax Credits: Understanding Self-employment'*, updated 10 April 2017, < http://revenuebenefits.org.uk/tax-credits/guidance/how-do-tax-credits-work/self-employed/, accessed 9 October 2017

| | | | | |
|---|---|---|---|---|
| year only, due to the disregard for<br>falls in income<br>- £1,4800 x 100/80 x 41% | | 923 | | |
| Total value of investment at the end of four years, including all tax and benefits 'relief' | £ 3,000 | £3,923 | £ 3,000 | £ 3,600 |

*Note clarifying universal credit calculation in example 3:*

To calculate the impact on universal credit entitlement, it is necessary to compare net monthly income before pension contributions with the MIF. If net income is already beneath the MIF, Stephanie will not get any 'relief' in her universal credit calculation for pension contributions (that is, she will not be allowed any deduction for pension contributions from her income). As previously noted, 2017/18 rates are used in the calculation and assumed to remain unchanged for all years under comparison. Therefore, the calculations are as follows:

| Actual net monthly income calculation: | £ | **Annual totals**<br>**£** | **Monthly totals**<br>**£** |
|---|---|---|---|
| *Income tax* | | | |
| Gross income: £1,000 x 12 | 12,000 | 12,000 | |
| Less: personal allowance | (11,500) | | |
| Taxable | 500 | | |

| | | | |
|---|---|---|---|
| Tax thereon: £500 x 20% | 100 | (100) | |
| *National insurance*<br>Class 2 - £2.85 a week x 52<br>Class 4<br>Gross income<br>Less: lower profits limit<br>NICable<br><br>Class 4 NIC thereon: £3,836 x 9% | <br>148<br><br>12,000<br>(8,164)<br>3,836<br><br>345 | <br>(148)<br><br><br><br><br><br>(345) | |
| Actual net monthly income therefore annual total, divide by 12 | | £ 11,407 | £ 951 |

This result must be compared to the result of the following:

| Minimum income floor (MIF) calculation: | £ | Annual totals £ | Monthly totals £ |
|---|---|---|---|
| Gross minimum income<br>35 x £7.50 x 52 | | 13,650 | |
| *Notional income tax*<br>Gross income<br>Less: personal allowance<br>Taxable | <br>13,650<br>(11,500)<br>2,150 | | |

| | | | |
|---|---|---|---|
| Tax thereon: £2,150 x 20% | 430 | (430) | |
| *Notional national insurance*<br>Class 2 - £2.85 a week x 52<br>Class 4<br>Gross income<br>Less: lower profits limit<br>NICable<br><br>Class 4 NIC thereon: £5,486 x 9% | <br>148<br><br>13,650<br>(8,164)<br>5,486<br><br>494 | <br>(148)<br><br><br><br><br><br>(494) | |
| Minimum income floor therefore annual total, divide by 12 | | £ 12,578 | £ 1,048 |

The above calculation is confirmed on the Revenuebenefits website in the following example of Jack (although the calculation of notional tax and national insurance is not spelled out on that website, so has been clarified above):

> *'Example*
>
> Jack is a 30 year old window cleaner who works full time in his trade. His individual earnings threshold (ie the minimum wage for the number of hours the claimant is expected to work) is based on the national minimum wage of £7.50 an hour for a 35 hour week:
>
> £7.50 x 35 = £262.50 per week

His minimum income floor for any assessment period, using current figures, should therefore be:

(£262.50 x 52)/12 = £1,137.50 minus notional tax and NI (say £90.54) = £1,046.96'[3]

Therefore, as Stephanie's actual self-employed income for universal credit is already below the minimum income floor, she is assumed to have income equal to that (instead of actual income), and her universal credit is calculated on that basis. She can take no further deduction for pension contributions.

***Discussion of the above examples***

*Which scheme is the 'winner'?*

The above calculations look at only a very limited range of circumstances, in order to attempt a 'like with like' comparison. Otherwise, it would be impossible to draw any conclusions as to the comparative direct financial benefits from the three schemes.

Yet even these pared-back calculations, devoid of variations even in the basic figures such as changes to tax and benefits rates and allowances, do not demonstrate a clear 'winner' for all savers if one is considering saving for the longer term.

The simple variation of working pattern for an employee, or the type of work carried out (as a self-employed business rather than being employed) gives different results. In examples 1 and 2 (employees), it is the pension scheme that is the clear favourite. Whereas for the self-employed individual in example 3, Help to Save seems to offer the best result (if the saver is a universal credit claimant who is subject to the

[3] Revenuebenefits, *'Self-employment: minimum income floor',* updated 17 May 2017, < http://revenuebenefits.org.uk/universal-credit/guidance/entitlement-to-uc/self-employment/minimum-income-floor/ > accessed 21 September 2017

minimum income floor), or a pension if they are a tax credits claimant. This helps to highlight concerns raised – for example by the Low Incomes Tax Reform Group[4] – that those in self-employment can be worse off under universal credit than employees in otherwise similar circumstances.

Furthermore, if we take the employee in example 2 and assume perhaps that they have three jobs instead of two, each below the lower earnings limit, this creates yet a further scenario. In that case, the calculation would have tax relief and universal credit or tax credits enhancement as a result of the contribution, but there would be no employer contribution. This would put such an employee in the same position as a self-employed person who claims tax credits, or who claims universal credit but does not have the minimum income floor applied (for example, because an exemption applied, such as being within the 12-month start up period).

Of course, it is also possible that an employer, even if not obliged to do so under automatic enrolment, might offer a pension contribution to all employees. Moreover, employer contributions may be higher than the statutory minimum if they so choose. It therefore could not be assumed that no contribution would be due in terms of making a comparison. It is necessary to take full account of the actual details of an individual employer's scheme rather than to generalise using the minimum figures.

Nevertheless, it is possible to see that pension contributions generally offer the best return overall in terms of tax relief or bonus and benefits 'relief' where someone is:

- an employee;

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[4] Low Incomes Tax Reform Group, *'Press release: Campaigners back MPs' urgent please for a change to universal credit'*, 3 May 2017, < https://www.litrg.org.uk/latest-news/news/170503-press-release-campaigners-back-mps%E2%80%99-urgent-pleas-change-universal-credit >, accessed 10 October 2017

- entitled to at least the minimum employer pension contributions through automatic enrolment into a relief at source scheme (see below for comparison with net pay arrangements); and
- a claimant of tax credits or universal credit.

Anyone choosing a pension does, however, have to understand that they are making a long term investment and it will not be accessible to them until the minimum qualifying age. This may not be an attractive proposition for many at the low-income end. However, an important consideration is that saving into a pension means that any capital accrued is disregarded for the purposes of means-tested benefits assessment while the pension remains uncrystallised. This is in direct contrast to the Lifetime ISA and Help to Save, for which no carve out is made in the means-tested benefits capital assessment rules (as described in chapter 2). While this is perhaps not such a problem for Help to Save, where funds can be accessed at any time without penalty (except for a reduced ability to accrue bonuses), Lifetime ISA savers may find they are forced to access capital, lose their government bonus and incur a penalty.

Another problem with the very general conclusion that pensions are best in the above ‘bulleted’ circumstances is that the assumptions set out in making the comparison are in fact variables. A change in one of those variables might therefore change the result.

Let’s say someone is a universal credit claimant and loses entitlement to it. Perhaps they start off in April 2018 as a universal credit claimant (and they qualify for Help to Save at the time so can make a comparison between the three schemes) but in the same month they get a better paid job which means they are no longer entitled. In examples 1 and 2 above, this would mean for Julie and Lilyanna that we wipe out the

‘universal credit increase’ line of the pension calculation. The results would then look as set out below.

Note that the tax credits column has been removed in these revised examples, as we are examining the impact of losing universal credit entitlement. For consistency with the previous examples, columns continue to be labelled A, C and D (with column B, pension (tax credits claimant), removed).

***Example 1a, Julie, having lost entitlement to universal credit***

Julie gets a job in April 2018 earning £20,000 a year and loses entitlement to universal credit.

For the calculation in column A, it is assumed that she is enrolled into her employer’s pension scheme and contributions begin immediately.

For columns C and D, it is assumed she has opted out of her employer’s pension scheme. Column D assumes she opened a Help to Save account before her universal credit claim ended.

| **Savings for four years from 2018/19** | A<br>**Pension**<br>**£** | C<br>**Lifetime ISA**<br>**£** | D<br>**Help to Save**<br>**£** |
|---|---:|---:|---:|
| Total savings – paid out of net income, £50 a month for four years | 2,400 | 2,400 | 2,400 |
| Employer pension contribution (column A):<br>- 2018/19: (£20,000 - £5,876) x 2% | 283 | | |

| | | | |
|---|---|---|---|
| - 2019/20: (£20,000 - £5,876) x 3%<br>- 2020/21: (£20,000 - £5,876) x 3%<br>- 2021/22: (£20,000 - £5,876) x 3% | 424<br>424<br>424 | | |
| Tax relief or government bonus added<br>- Column A, £2,400 x 100/80 x 20%<br>- Column C, £2,400 x 25%<br>- Column D, £2,400 x 50% | 600 | 600 | 1,200 |
| Total value of investment at the end of four years, including all 'tax relief' | £ 4,555 | £ 3,000 | £ 3,600 |

Note that from 2019/20 onwards, the minimum Julie must pay into her employer scheme (assuming her employer pays only the minimum required of them) will increase from 3% to 5% (gross, which equates to 2.4% and 4% net of basic rate tax respectively for a relief at source scheme). As this is on earnings above the lower earnings limit only, Julie's £50 a month net will still satisfy the minimum contribution (which will be (£20,000 – 5,876) x 4% = £565 per annum, or £47 a month).

***Example 2a, Lilyanna, having lost entitlement to universal credit***

In the original comparison, Lilyanna had two jobs. In job X, she earned £9,000 a year (£750 a month) and in job Y, she earned £3,000 a year (£250 a month). In this revised example, Lilyanna again earns the same amount as Julie, £20,000, but across two jobs. Job X still pays £9,000 a year (£750 a month) and in job Y, she earns £11,000 a year (£917 a month) from April 2018 so loses entitlement to universal credit.

For the calculation in column A, it is assumed that she is automatically enrolled into employer Y's pension scheme and contributions begin immediately (from April 2018), and that she also opts in to employer X's scheme. In total, she contributes £50 a month, but she will split this contribution between the two schemes to satisfy the minimum payment for each.

For columns C and D, it is assumed she has opted out of her employer's pension scheme. Column D assumes she opened a Help to Save account before her universal credit claim ended.

| **Savings for four years from 2018/19** | A<br>**Pension**<br>**£** | C<br>**Lifetime ISA**<br>**£** | D<br>**Help to Save**<br>**£** |
|---|---|---|---|
| Total savings – paid out of net income, £50 a month for four years | 2,400 | 2,400 | 2,400 |
| Employer X pension contribution (column A): | | | |
| - 2018/19: (£9,000 - £5,876) x 2% | 63 | | |
| - 2019/20: (£9,000 - £5,876) x 3% | 94 | | |
| - 2020/21: (£9,000 - £5,876) x 3% | 94 | | |
| - 2021/22: (£9,000 - £5,876) x 3% | 94 | | |
| Employer Y pension contribution (column A): | | | |
| - 2018/19: (£11,000 - £5,876) x 2% | 103 | | |
| - 2019/20: (£11,000 - £5,876) x 3% | 154 | | |

| | | | |
|---|---|---|---|
| - 2020/21: (£11,000 - £5,876) x 3%<br>- 2021/22: (£11,000 - £5,876) x 3% | 154<br>154 | | |
| Tax relief or government bonus added<br>- Column A, £2,400 x 100/80 x 20%<br>- Column C, £2,400 x 25%<br>- Column D, £2,400 x 50% | 600 | 600 | 1,200 |
| Total value of investment at the end of four years, including all 'tax relief' | £ 3,910 | £ 3,000 | £ 3,600 |

As can be seen from the above two calculations, there are two factors which help make pensions more favourable than Help to Save. First, there is the enhancement to the universal credit claim that comes from deducting pension contributions from universal credit income. Second, there is the employer contribution. As income increases, entitlement to universal credit diminishes or stops completely. Conversely, as income increases, the level of employer pension contribution increases. Employer pension contributions are, however, calculated by employment rather than by total income. Therefore, although both Julie and Lilyanna in the above examples lose the universal credit boost resulting from their pension contributions when their pay jumps up, Lilyanna gains less than Juile in employer pension contributions due to two lower earnings limits being deducted in the calculation of her contributions (one per employment).

Reality also tends to be much more difficult to plan for in black and white terms – particularly where, for example, people might move jobs frequently and move in and out of entitlement to universal credit. Employer pension contributions may be erratic where a person moves jobs frequently, as an employer has the option of deferring enrolment of new staff members into the workplace pension for three months.[5] It is easy to see, therefore, that someone who moves jobs every six months, say, might only benefit from employer contributions for every three of those months, if each new employer adopts a deferred period.

*Fluctuating earnings / seasonal workers*

The example calculations also assume a stable level of earnings, accruing evenly throughout the year. Seasonal workers would therefore need to understand the impact on the calculations for them.

For example, fluctuating earnings will not only affect pension contributions (as described above in the case of erratic working patterns), but are likely to impact adversely on those using the Help to Save scheme. This is for two reasons. First, because the £50 a month savings limit works on a 'use it or lose it' basis – so in less productive periods, the £50 cannot be carried forward. This bears particularly hard on those with fluctuating earnings (as well as of course those with fluctuating outgoings). Second, if a seasonal worker puts money into a Help to Save account in their productive months but then needs to draw on the balance in leaner times, this affects their ability to increase their bonus (this being based on the highest balance achieved).

[5] The Pensions Regulator, *'Postponement'*, < http://www.thepensionsregulator.gov.uk/postponement.aspx >, accessed 21 September 2017

I would therefore recommend that, when savings schemes are promoted, there is some guidance highlighting issues for those with fluctuating and seasonal earnings. To help savers identify with the guidance, some worked examples – for instance showing the difficulty that seasonal workers might have accruing the full bonus under the Help to Save scheme – would be helpful.

*Pensions: net pay arrangements*

The above calculations assume that the pension scheme provides for tax relief to be given on a relief at source basis. As described in chapter 2 (chapter 2A table, column P, line 11), this means that the saver pays the contribution to the pension plan net of basic rate tax and the scheme then claims the tax relief on it.

Some employer schemes are, however, operated on a net pay arrangement basis. This means that the gross contribution is deducted from the individual's pay and put into the scheme. The scheme does not claim any tax relief as the individual should have already benefited from relief when the contribution was deducted from their gross pay.

To recap from the discussion in chapter 2B, for those earning below, or at the margins of, the personal allowance, net pay arrangements can cause an unfairness as against employees who are members of a relief at source scheme. This is because if the employee is a non-taxpayer, or only paying a small amount of tax, a net pay arrangement scheme member will not benefit from the same relief as someone who is a member of a relief at source scheme.

The above example calculations for employees would therefore be altered if the employer's scheme was run on a net pay basis. The difference is illustrated below,

again (as in employee examples 1 and 2 above) assuming our taxpayer earns £12,000 a year and pays £50 net (or £62.50 gross) per month into an employer scheme.

| | **Net pay arrangement**<br>**£** | **Relief at source**<br>**£** |
|---|---:|---:|
| Gross pay | 12,000 | 12,000 |
| Less: gross employee pension contribution<br>- £62.50 per month x 12 | (750) | n/a |
| | 11,250 | 12,000 |
| Less: personal allowance | (11,500) | (11,500) |
| Taxable income | 0 | 500 |
| Tax thereon, at 20% | 0 | 100 |
| Tax reclaimed by pension fund<br>- £50 per month x 12 x 100/80 x 20% | n/a | (150) |
| Therefore total tax suffered/(saved) | £ 0 | £ (50) |

The employee who is a member of the net pay arrangement pension therefore loses the benefit of £50 of tax relief compared to an employee who is a member of a relief at source scheme, though they are in otherwise identical circumstances.

*Split savings*

The above example calculations assume that the saver picks one of the options and puts the entire £50 a month they can afford to save into that. In reality, however, it is possible that someone might choose to split their savings. For example, they might be

automatically enrolled into an employer's pension scheme and paying minimum contributions, then save the balance of their £50 into a Help to Save account.

This leads to a number of additional complexities, which will depend again on the circumstances of the individual. For example, if part of the savings were put into a Help to Save account, the question then arises as to what the individual will do at the end of the account's four-year term? If they did not need access to the funds, might they put it into the pension scheme as a single premium?

There is not time within the confines of this paper to explore these issues in great detail. However, as I will later conclude, the very fact that there are different schemes to choose from (each with their different incentives and rules) drives complexity and creates the risk of making a choice which turns out, with hindsight, to have been a poor one.

If an individual does wish to split their savings, for example between pension contributions and the Help to Save scheme, they have to be extremely careful of the interaction between the two. Perversely, a universal credit claimant can disqualify themselves from Help to Save by contributing to a pension (for instance, by opting into an employer pension scheme). This is because – as noted in the chapter 2A table (column H, line 9) – the qualifying criteria for universal credit claimants to open a Help to Save account is that they have to be earning net income of at least 16 times the national living wage hourly rate. As earned income is calculated as being net of tax, national insurance and pension contributions, it follows that anyone making pension contributions who is working 16 hours at national living wage will not qualify.

*People who do not qualify for Help to Save, but who qualify for the Lifetime ISA*

If a saver is not eligible for Help to Save, but they are eligible to open and save into a Lifetime ISA, they are left comparing this latter scheme with pension saving (in terms of the 'government-incentivised' savings schemes under review in this paper). While it is understood that the immediate return for a basic rate taxpayer is the same for pension contributions as it is for the Lifetime ISA, leaving aside employer contributions, the complexity arises when comparing the other rules for both schemes.

For example, if viewed as a retirement savings scheme, there is a difference in when pensions and the Lifetime ISA can be accessed. Subject to any legislative changes relating to the minimum age to access pensions, it is a pity that the Lifetime ISA is accessible at age 60 whereas pensions are accessible from age 55 currently (planned to increase to age 57). Perhaps the intention is eventually to align both to age 60? Or that both will creep up in future in line with the state pension age? Such suspicions might put people off pensions (and similarly the Lifetime ISA), given the rules have changed so much in recent years – a factor leading many to mistrust pension saving, as discussed in chapter 2B.

If the government do not intend to increase the minimum pension access age to 60 in line with the Lifetime ISA, then decreasing the Lifetime ISA accessibility age to 57 (to align with the future plans for pensions) would seem to make some sense. This would at least eliminate one area for confusion in terms of people's savings choices. However, it must be acknowledged that reducing this age for the Lifetime ISA might also have the effect of encouraging more people to opt out of pensions in favour of a Lifetime ISA. Therefore, it might be that policymakers deliberately chose a slightly

higher age for accessing the Lifetime ISA to act as a slight disincentive to opt out of pensions.

The Lifetime ISA also carries the advantage of being 100% tax-free on withdrawal, rather than only 25% tax-free for pensions. Therefore, for a basic rate taxpayer, though the 'tax relief' might effectively be the same at the point of accrual, the greatest benefit will be seen at the time of withdrawing funds. There will not, for example, be any need to consider the level of other income and therefore any tax liability on withdrawing Lifetime ISA funds. Currently, withdrawals from personal pensions – especially if the individual takes a large lump sum, for example to pay off a mortgage – can trigger large and unexpected tax liabilities. This could even include a high income child benefit charge for those still entitled to claim that particular benefit[6] (as discussed under the heading of 'Pension withdrawals' in chapter 2).

There is a serious trap, however, for the unwary in saving into a Lifetime ISA as compared to a pension. This is that funds held within the Lifetime ISA may be assessed as capital for the purposes of universal credit entitlement, whereas funds in an uncrystallised pension are not.

This may not be a problem if the saver never has to claim welfare benefits. But let's say a self-employed individual has £30,000 saved in a Lifetime ISA, and then trade takes a turn for the worse and they can no longer make the business competitive. On closing the business down, the individual takes a low-paid agency position to make ends meet, but seeks to claim universal credit as further support. Someone in this situation will

[6] Low Incomes Tax Reform Group, *'Could taking money out of my pension affect my child benefit claim?'*, updated 25 April 2017, < https://www.litrg.org.uk/tax-guides/pensioners-and-tax/what-tax-position-when-i-take-money-my-pension-flexibly#toc-could-taking-money-out-of-my-pension-affect-my-child-benefit-claim- >, accessed 21 September 2017

find that their Lifetime ISA savings are included in the assessment of capital and they will therefore have to draw on them to support day-to-day living costs before state support is available. As the Lifetime ISA has a penalty for accessing the funds outside of the permitted use of funds, the individual will not only have to use their savings (whereas a pension would have been protected) but also suffer an additional penalty for doing so.

Ideally, therefore, the government would amend benefits regulations so as to disregard other government-incentivised savings plans (Help to Save and the Lifetime ISA) from the universal credit capital assessment. This is as I recommended in chapter 2B, and indeed as was previously recommended by the Low Incomes Tax Reform Group in October 2016, as follows:

> '5.2 For those using Help to Save, this could truly encourage regular saving, without fear that it could later give rise to loss of other support. The assessment of 'tariff income', in UC for example, begins when a claimant has capital of £6,000 or more (unless that capital is otherwise disregarded). Whilst even the maximum saved into Help to Save plus bonuses would not exceed this amount, a specific disregard would mean that the Government could promote the scheme as not being counted for restriction of means-tested benefits – a selling point that could encourage maximum take up.
>
> 5.3 We recommend that the Government also disregards savings in the Lifetime ISA from the assessment of capital for means-tested benefits purposes. Otherwise someone who is saving towards a first home deposit, or choosing to save into a Lifetime ISA rather than a pension, could find they have to draw on those monies if, for example, they lose their job. This would be a

serious disadvantage to someone who has chosen to save into a Lifetime ISA over a pension, given that untouched pension savings are usually entirely disregarded when assessing entitlement to UC. This disregard could apply until Lifetime ISA savers have reached age 60, such that they are able to draw on those savings without penalty.'[7]

***Summary***

This chapter has aimed to draw out some key comparisons between the three savings schemes under review, and highlight the problems that savers would have in arriving at a clear choice as to which is best for them.

As all three types of investment are government-incentivised at the point of saving, either by tax relief dependent on the saver's marginal rate or other flat-rate bonus, one obvious question that arises is why there should be different tax treatment on withdrawal. The pension saver, although now free to access their defined contribution pot under pensions freedom, is faced with a confusing array of tax and benefits consequences on withdrawal, whereas the Lifetime ISA saver who keeps their funds invested to age 60 or over can access their pot tax-free.

Similarly, what is the rationale for largely protecting pensions from capital assessment for means-tested benefits during working age, but forcing the Lifetime ISA saver to call upon their funds (and suffer a penalty in the process) if they fall onto harder times? These questions, and others arising from the above comparisons, point to a lack of cohesion in savings policy and lead me on to the conclusions and possible strategies for change outlined in chapter 4.

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[7] Low Incomes Tax Reform Group, *'LITRG Briefing: Savings (Government Contributions) Bill 2016-17'*, 24 October 2016, paras 5.2 and 5.3, < https://www.litrg.org.uk/latest-news/submissions/161031-savings-government-contributions-bill-2016-17 >, accessed 21 September 2017

## Chapter 4 – Conclusions

The preceding chapters have drawn out various points by examining individual scheme complexities, and then compared those schemes to each other. Some specific recommendations have been interwoven which are not repeated here (all recommendations are summarised in appendix A).

This final chapter examines complexity more broadly and how it might be addressed. It therefore overlays and rounds off the previous discussions as to complexities arising in the detail of individual savings schemes.

In chapter 1, I speculated that it would likely prove to be impossible to draw clear conclusions about which type of savings will be best for certain groups of people. Having explored the different schemes under consideration in detail in chapters 2A, 2B and 3, this has largely proved to be the case and has led me to consider complexity (and solutions to it) more generally.

The authors of a Harvard Business Review article entitled 'Learning to Live with Complexity'[1] set out a number of interesting factors in this context. While referring to managing a business, many of the theories discussed in that article (referred to in this chapter as 'the Harvard article') resonate with the complexity seen in this paper. The relevant areas are:

- Complicated versus complex
- Unintended consequences
- Making sense of a situation

[1] Gökçe Sargut and Rita Gunther McGrath, Harvard Business Review, *'Learning to live with complexity'*, September 2011, < https://hbr.org/2011/09/learning-to-live-with-complexity >, accessed 17 October 2017

- Limit or even eliminate the need for accurate predictions

I have divided this chapter into the above sub-headings, as they provide neat themes under which my conclusions fall.

***Complicated versus complex***

The Harvard article considers the difference between what is complicated and what is complex, noting that it is 'easy to confuse' the two. Complicated systems, the authors note, have 'many possible interactions, but they usually follow a pattern'. They go on to say: 'Complex systems, by contrast, are imbued with features that may operate in patterned ways but whose interactions are continually changing.'

So is the system of tax-incentivised savings in the UK merely complicated or is it truly complex?

Perhaps slightly over-simplifying matters, but if the key deciding factor is continual change in the interactions of systems, it seems that the answer is that the savings tax system is both complicated and complex. This means to say that:

- it is complicated at any one point in time – there are labyrinthine interactions to consider in the tax and benefits systems when choosing a savings scheme, but these are largely finite (leaving aside the unpredictable nature of the future and changes in circumstances); but
- it is also complex, in that the law – the rules on the savings schemes, income tax rates and allowances, and benefits legislation – keeps changing. These continual changes arguably make matters more complicated than they need to be.

I outlined in chapter 2B that continual changes to pensions generate mistrust and difficulty for people to understand their options. I would argue that continual change also creates further problems. For instance, it creates a barrier to both financial education and the development of guidance.

'Saving Our Financial future'[2], The Savings and Investments Policy Project report, argued that there should be more financial education. While this is clearly a sensible recommendation, it is extremely difficult to educate people about a system that is constantly changing. By way of analogy, if a 40-year-old person were to plan to travel the world using as their map the globe they had as a child, they could get hopelessly lost – especially if travelling to, for example, eastern Europe or Africa. Therefore, if we are going to have a system that is based upon short term, continual change, financial education needs to be couched in terms of how people find the information they require at the time, and equipping them with the skills to understand it, rather than teaching them how pensions work or what other savings products are available at that particular point in time.

The alternative is to get away from short term change. Such change drives complexity, as noted for example in 'Taxation in the UK: A Citizen's View'[3] where the 'jury' taking part '… felt that the system is made more complex because politicians make decisions

[2] Tax Incentivised Savings Association and Others, *'The Savings and Investments Policy Project: Saving our financial future – Policy recommendations*', 2015, < http://www.tisa.uk.com/downloads/TSIP%20Policy%20Proposal%20Report%202015.PDF >, accessed 2 August 2016

[3] Britain Thinks, *'Taxation in the UK: A citizens' view – Report from a Citizens' Jury to look at the UK Tax system, held in June 2014, for PwC'*, 1 June 2014, < http://britainthinks.com/pdfs/Taxation-in-the-UK-A-Citizens-View.pdf >, accessed 15 October 2017

with an eye to short term electoral risk and reward, rather than a set of enduring principles that the system as a whole should deliver.'

If the government, both now and in the future, were committed to stability in terms of incentivised savings products, it would be possible both to educate people in an enduring, meaningful way as to their options and to allow time for smart tools to be designed to help 'mask' the complexity of those products (and their tax and benefits interactions, as explored earlier).

In this respect, it is interesting that the Office of Tax Simplification noted in its Complexity Index Methodology paper[4] that complexity can be divided into 'the underlying complexity' and 'the impact of complexity' – noting that the two are not one and the same. In fact, a law can be complex, but its impact can be to simplify.

Perhaps therefore the impact of the various different incentivised savings schemes and their consequent complexity could be made to feel much simpler by having comprehensive guidance and calculators available to savers to help them make the best choice for them. The key, however, is to ensure that such guidance covers all aspects of the individual's situation – that is, taking full account of any impacts on their tax position and state benefits entitlement.

It would be interesting to research how much productive time is spent (across government, the private sector and not-for-profit or voluntary organisations) in updating guidance materials purely because changes have been made in the law. The value of this updating time must be enormous – and would surely be far better

[4] Office of Tax Simplification, *'OTS complexity index methodology'*, June 2015, page 4, < https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/439470/ots_complexity_index_version2.pdf >, accessed 15 October 2017

invested in innovation to help provide people with the best possible guidance and tools.

Naturally, if considering harnessing technology to help people make savings choices, one eye has to be kept on 'digital exclusion' in terms of the low-income saver having access to any guidance and tools on offer. The government therefore needs to bear this in mind in its Digital Inclusion strategy[5]. Figures from this on GOV.UK showed that, in 2013, 85% of the population had used the internet to compare products online, and 73% reported saving money online[6]. It is the 15% to 27% of the population that might not be using this technology that could be excluded from further use of digital tools as a means of helping to compare savings products. They might therefore require support to access those tools, or alternative channels to equivalent information.

In summary, it seems that the incentivised savings system could be downgraded from 'complex' to merely 'complicated' by removing the variables created by continually changing the system, and that this would free up resources to enable development of better guidance and tools. In turn, such improved guidance would mean that the choices could be put to the potential saver more simply – that is, the underlying systems influencing the choice would still be complicated, but could be made simpler to navigate.

***Unintended consequences***

In the Harvard article, the section on 'unintended consequences' is introduced by saying: 'In a complex environment, even small decisions can have surprising effects.'

[5] Cabinet Office, Government Digital Service and The Rt Hon Lord Maude of Horsham, *'Government Digital Inclusion Strategy'*, 13 April 2014, < https://www.gov.uk/government/publications/government-digital-inclusion-strategy >, accessed 17 October 2017
[6] GOV.UK, *'Dashboard – Digital inclusion'*, April 2014, < https://www.gov.uk/performance/digital-inclusion >, accessed 17 October 2017

One situation in which this is likely to happen is said to be ‘when events interact without anyone meaning them to’.

It seems that much of the complexity illustrated in this paper could fall under this theme. For example, we can see from the earlier chapters that for low-income savers, interactions between different systems are key in determining which choice might deliver the best return for them in terms of overall government incentive. Yet when, for example, making a decision to delay the timetable for rolling out universal credit, do ministers consider the impact on people who are saving into pensions? Or whether such a delay means that some people’s eligibility to open a Help to Save account might be delayed? The answer is largely that such issues are not considered.

For this reason, I would support calls made by others (for example, The Savings and Investments Policy project[7] and, more recently, Zurich[8]) for there to be a Savings Minister, whose job it would be to ensure that actions taken across government do not impact adversely on savings policy. Or, at the very least, a Savings Minister could ensure that such impacts are identified and, if it is not possible to address them completely, to mitigate them as far as possible and to ensure that they are properly communicated to savers.

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[7] Tax Incentivised Savings Association and Others, *‘The Savings and Investments Policy Project: Saving our financial future – Policy recommendations*’, 2015, < http://www.tisa.uk.com/downloads/TSIP%20Policy%20Proposal%20Report%202015.PDF >, accessed 2 August 2016

[8] Tom Ellis, Professional Adviser, *‘Zurich calls for new ‘savings minister’ role’*, 27 April 2017, < https://www.professionaladviser.com/professional-adviser/news/3009150/zurich-calls-for-new-savings-minister-role >, accessed 17 October 2017

A Savings Minister could also be tasked with ensuring that government communications about savings are joined up, avoiding savers suffering 'tunnel vision' – a risk outlined in the next section.

Also on the subject of joining up, a Savings Minister could ensure that savings schemes are properly reviewed. This is perhaps particularly in the context of Help to Save, which has a finite 'shelf life' of four years (in terms of opening new accounts – see chapter 2A, column H, line 2) and will require review both throughout its life and when it comes to an end, so that its results can inform future savings policy.

With or without a Savings Minister at the helm, there should be a thorough review of Help to Save at various stages of its existence. To fully understand its success (or indeed failure), I would recommend that such a review should explore the comparison issues with other schemes and benefits interactions described in this paper. That is to say, in order to fully gauge whether Help to Save has been a success, it is necessary not only to look at how many people have taken up the scheme, what balances savers have achieved and what bonuses they have earned, but also to take a sample of account holders and review whether the choice they made was in fact right for them. Questions could be asked, such as: Did the saver consider other options before opening the account? Would they have been better to have chosen a different savings vehicle, for example a pension? Did they opt out of a pension into which they had automatically been enrolled in order to put money into Help to Save? (This final question, together with others on the same theme, would also inform whether Help to Save increases automatic enrolment opt-out rates.)

***Making sense of a situation***

Staying with the Harvard paper, it is worth considering their comment that: 'It is very difficult, if not impossible, for an individual decision maker to see an entire complex system.' This strengthens the argument above that guidance must be comprehensive, and complexity should be minimised by providing tools and calculators to get savers to the answers they need without having to wade through the minutiae of the legislation.

The Harvard article then goes on to talk about how 'focusing on one thing can prevent us from seeing others', quoting a study documenting '"inattentional blindness"' – the inability of subjects 'even to notice dramatic events going on around them' when they 'had been instructed to concentrate on a task'.

This brings us to the issue of government 'campaigns' that promote savings schemes to the public. For example, there is a campaign website for the Lifetime ISA[9], which includes a video giving an overview of the scheme's benefits in terms of saving for a home purchase, or for later in life – but without mentioning at all in the latter context the alternative of saving into a pension.

It is possible that the government will engage in a similar campaign to promote Help to Save. While not directly comparable to pensions or the Lifetime ISA in terms of the objectives of the scheme (being to build up a rainy day fund, rather than saving for a particular objective such as house purchase or retirement), I would recommend that any such campaign draws savers' attention to other possibilities. This is especially considering that the scheme comparisons in chapter 3 show that saving into a pension

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[9] HM Government, *'Lifetime ISA',* < https://lifetimeisa.campaign.gov.uk/#home >, accessed 17 October 2017

could provide savers with a better financial return in terms of government incentive overall (when taking into account employer contributions and the impact on benefits).

So while the headline 50pence-in-the-pound bonus makes Help to Save an ‘easier sell’ than describing the full potential benefits of pension saving, this simple message should not be pushed by government without risk warnings – for example, highlighting the consequences of opting out of automatic enrolment to instead use the Help to Save scheme.

If savers are not directed to consider all of their options, there is a serious risk of them falling victim to ‘inattentional blindness’ as described above.

***Limit or even eliminate the need for accurate predictions***

Borrowing a final theme from the Harvard article, the following paragraph is of interest:

> ‘In an unpredictable world, sometimes the best investments are those that minimize the importance of predictions. Take product design. In a conventional system, manufacturers must guess which configuration of features customers will purchase, and at what price. They run a high risk of being wrong, especially when the product is complex.’

Applying this same principle – to limit or eliminate the need for accurate predictions – to savings choices, it might be argued that, in an ‘ideal world’, there would be only one form of government-incentivised savings scheme.

Such a single scheme should perhaps combine the merits of each of the schemes discussed previously – for example, the ‘easier sell’ of a Xpence-in-the-pound incentive rather than the more complicated ‘tax relief’ currently applied to pensions.

To appeal, a single scheme would have to have flexibility within it to take savings out in the short term as well as incentivising longer term savings, so there would have to be some parameters for being able to make withdrawals. Such flexibility would eliminate, or at least reduce, the risk attached to choosing the 'wrong' savings product – which currently can usually only be accurately judged with the benefit of hindsight.

This suggestion echoes similar recommendations by others, for example in a recent paper by Michael Johnson, Centre for Policy Studies[10]:

> 'This paper makes some proposals to help maintain the low rate of AE [automatic enrolment] opt-out. It is crucial that individuals are provided with a stronger sense of personal ownership over their savings.
>
> This can be achieved by introducing highly personalised Lifetime and Workplace ISAs into the AE arena. With simplicity in mind, the latter could reside within the Lifetime ISA: a single savings vehicle to serve until death requiring only one line of communication (with the provider). AE-generated savings should be as personal as one's bank account.'

Care would have to be taken that any such single savings vehicle does not suffer from effectively being a host of different types of savings scheme within one wrapper, with 'mini scheme' rules governing each part. This would merely bundle all of the complexity up in one place, rather than to simplify matters. However, if those issues could be overcome (together with other problems such as the creation of winners and losers on introducing a new regime), a key advantage of a single scheme would be to

[10] Michael Johnson, Centre for Policy Studies, *'Reinforcing Automatic Enrolment: A response to the DWP's consultation'*, 14 July 2017, < http://www.cps.org.uk/publications/reinforcing-automatic-enrolment >, accessed 16 October 2017

avoid sending out mixed messages, as is the problem currently by having different schemes with different incentives (and ways of describing those incentives).

### *Summary*

This paper has its limitations, as noted in the scope set out in chapter 1. It has been necessary to confine the study to what could be termed the three 'main' government-incentivised savings schemes, in terms of obvious immediate returns on investment and beneficial treatment for tax and welfare benefits.

Nevertheless, it provides an important contribution to this subject area – exploring the interaction of tax and benefits with savings – and demonstrates how these systems together make it extremely difficult for savers with limited means to understand the impacts of their choices.

The above conclusions, together with the recommendations listed in appendix A, unfortunately do not provide any obvious or easy answers to the problems. They do, however, provide a range of possibilities for policymakers to consider. Finally, by demonstrating the complexities that arise in the way that I have, those developing future savings guidance (such as the new single financial guidance body) should be able to draw upon this paper to provide improved materials and tools for low-income savers.

**Appendix A – Recommendations list**

[Listed in the order in which they feature in this paper.]

- The pensions money purchase annual allowance should be reviewed in three years' time (6 April 2020), following its reduction to £4,000 from 6 April 2017. This review should consider the impact that pensions freedom, which will then have been in place for five years, has had on people's savings patterns and ensure that the money purchase annual allowance does not conflict with minimum pension savings under automatic enrolment.
- To redress the balance between workers contributing to different types of pension scheme, some of whom will be receiving tax relief and others not, I recommend using Pay As You Earn real time information data. HMRC could match pension contributions deducted via the payroll to individuals' records and reconcile where those in a net pay arrangement have not received tax relief but would have done so under a relief at source scheme. The relief they have lost out on could then be paid into their pension.
- The possibility of salary sacrifice for those on the lowest incomes should be reviewed, looking at interactions with the national minimum wage. While not allowing people to reduce earnings below the lower earnings limit and therefore jeopardising their contributions record, this could enable some people to save more for their future by reducing their liability to class 1 primary national insurance contributions.
- The Department for Work and Pensions and HM Revenue and Customs should work together to review how the universal credit regulations interact with pensions legislation in terms of contributions to be deducted from universal credit

claimants' income. This review should: confirm the intention of the regulations in terms of what figure should be deducted; review whether any amendment is required; and ensure that the universal credit software is programmed to give the correct result when using real time information data. Online benefits calculators and guidance (provided by both government and third parties) will also require review.

- When reviewing and bringing together existing pensions guidance, the new single financial guidance body should put some resource into improving the information and help that is available for people taking funds from pensions, for example to create more accurate calculators and give more thorough guidance on the benefits impacts of decisions (including tax credits).
- Further clarity on the impact on means-tested benefits of pension withdrawals under pensions freedom ought to be given in guidance for both decision-making Department for Work and Pensions staff and for claimants, as there is a potentially significant difference in impact between a payment being treated as income or as capital.
- It is unfortunate that guidance for the public on GOV.UK about the Lifetime ISA[1] does not explain that the 25% charge on unauthorised withdrawal is more than the 25% government bonus. I recommend including in that guidance a worked example showing how both the bonus and charge are calculated.
- When savings schemes are promoted, I recommend that there is specific guidance highlighting issues for those with fluctuating and seasonal earnings. To help savers identify with the guidance, some worked examples – for instance showing the

[1] GOV.UK, *'Lifetime ISA'*, < https://www.gov.uk/lifetime-isa >, accessed 13 October 2017

difficulty that seasonal workers might have accruing the full bonus under the Help to Save scheme – would be helpful.

- I recommend that the universal credit regulations are altered so that they disregard capital in Lifetime ISAs.
- Similarly, the universal credit regulations should be altered so that they disregard capital in Help to Save accounts. If such an alteration is not made, clear guidance must be made available to universal credit claimants opening a Help to Save account, spelling out that their future entitlement to state support might be affected. This is especially important for those who make a joint claim to universal credit with another person who also saves the maximum in a Help to Save account (meaning that joint savings eventually exceed the lower £6,000 capital threshold).
- As long as the law on government-incentivised savings schemes and their tax and benefits impacts keeps changing, financial education initiatives must be based upon getting people to understand how they find the information and tools they need when required, and the skills to understand and use them, rather than teaching them in detail about particular products. Otherwise, there is a risk of decisions being made based upon out-of-date knowledge.
- The choice between government-incentivised savings schemes needs to be made clearer for people through improved guidance, including calculators and tools, which cover all relevant tax and benefits interactions. In order to allow resources to be dedicated to the development of such innovative guidance, the government should commit to a period of stability – minimising changes in the law should reduce complexity.
- A cross-departmental Savings Minister role should be created to ensure that, when tax and benefits law changes, interactions with savings policy are fully

considered and that adverse impacts are mitigated. This role could also encompass oversight of savings guidance to make sure communications are joined up, and cover reviews of savings products – to ensure that individual schemes are not reviewed in isolation, but that their broader impacts are considered.

- Government ‘campaigns’ or other promotional material should not push the benefits of a single savings product in isolation – people must always be made aware of other options open to them.
- Consideration should be given to having a single form of government-incentivised saving.

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