The NHS funding increase could reduce your pension savings

It is just over two years since the UK voted to leave the European Union (EU), with the prime minister confirming that we will officially leave at 11pm on Friday 29 June 2019. It is still to be determined if the UK will experience a ‘Hard’ or ‘Soft’ Brexit, but the implications of leaving the EU will no doubt impact us all in some way or another.

One of the much talked about elements of the ‘vote leave’ campaign was the now infamous poster that promised, if the UK left the EU, an extra £350 million per week to spend on the NHS. Whilst it remains to be seen if the UK will actually benefit by £350 million per week, Prime Minister Theresa May announced in June that the NHS would receive an extra £20 billion a year by 2023. Clearly, this is a welcome announcement and something that will no doubt represent a much-needed boost to the NHS.

The prime minister stated that this increased spending would be partly funded through a “Brexit dividend”, but also suggested that tax rises might be required. The chancellor, Philip Hammond, subsequently affirmed, during his Mansion House speech (21 June 2018), that the Government remains committed to reducing the UK’s debt and that taxpayers would have to contribute more, in a fair and balanced way, to support this increased NHS spending. Therefore, in broad terms, we fully expect the Chancellor to announce tax increases to fund part, if not all, of this additional spend. An indication of how he aims to achieve this could be provided in the Autumn Budget statement.

It is difficult to guess what any Chancellor will do when it comes to raising taxes, as this can be done in a multitude of ways and is often made with a political slant as the governing party seek to retain support of the voting public ahead of any future General Elections. However, it is possible to get a feel for what the Treasury might be considering by reviewing parliamentary publications, including reports from select committees.

It was therefore with some interest that the influential Treasury Select Committee – a cross-party group of MPs – released their latest report (26 July 2018) with a focus on saving for retirement in the UK. The report states that “**there is widespread acknowledgement that pension tax relief is not an effective or well-targeted way of incentivising saving into pensions. Ultimately, the Government may want to return to the question of whether there should be fundamental reform**”. It also recommends that the Government should give serious consideration to, amongst other things, introducing a flat rate of tax relief on pension contributions and/or reducing the £40,000 annual allowance.

Pension tax relief is a valuable benefit for those saving for their retirement, as any personal contributions made by an individual will typically qualify for basic-rate tax relief at source. In simple terms, this means that if an individual contributed £80 into their pension, this would be increased to £100 as HMRC credit the pension with £20 (20%) to boost the amount invested. Furthermore, higher and additional-rate taxpayers are able to claim a further 20% and 25% tax relief respectively when they submit their annual tax returns. Therefore, the actual cost of investing £100 into a pension would only be £60 for a higher-rate taxpayer and £55 for an additional-rate taxpayer.

So why is this a concern? The Treasury Select Committee's report estimated that the cost of pension tax relief is £41 billion, and, of this relief, it is estimated that 50% goes to the top 10% of income taxpayers. More importantly, only around 10% of the relief goes to the bottom 50% of income taxpayers. When you consider that the Chancellor has stated that any tax increases should be implemented in a fair and balanced way, then reducing pension tax relief to a flat rate of 20%, which would predominantly affect the top 10% of income taxpayers, could offer a solution to funding the additional NHS shortfall. Furthermore, it is likely to be politically more palatable to voters, as it would avoid the need to raise Income Tax to fund the additional NHS spend.

The Government has already shown their willingness to reduce pension tax relief, by reducing the annual allowance from £255,000 in 2011 to the current £40,000 level. Furthermore, for those earning above £150,000, the annual allowance is reduced even further – with only £10,000 available to those earning above £210,000.

The potential removal of higher and additional-rate tax relief in the future means that making use of your annual allowance and carry forward allowances has never been more important, especially as pensions remain one of the most, if not the most tax-efficient method of saving towards retirement. I would encourage those who are either already funding and/or planning to fund pensions, to consider potential future changes to the tax system, and discuss their funding strategy with their financial or tax adviser.