



PROJECT BRIEFING

Use of Tax Reliefs for Personal Pensions

Overview

In the tax year 2010/11, people in the UK with income above £100,000 had their personal allowance withdrawn at a rate of 50p for every pound earned above £100,000, until it disappeared at £100,000 + 2x personal allowance.

This produced an effective marginal tax rate of 60% for incomes in the range of personal allowance withdrawal.

There is evidence that high income earners have used personal pension contributions as a form of tax planning which reduces the ability of income taxation to raise revenues and income inequality.

Challenge

Analysis was needed to develop an understanding of what determines individuals' personal pension contribution decisions that will assist in government policy making and to examine the response of personal pension contributions as a result of the withdrawal of the personal allowance for those earning above £100,000.

Analysis

Data sourced from the Self Assessment data held in the HMRC Datalab on people already contributing to personal pensions before the tax change in 2010/11, excluding people with no interest in personal pensions.

The analysis which was carried out for employees and the self-employed, compared the changes in personal pension contributions for people with income between £100,000 and about £113,000 subject to the 60% marginal effective tax rate, between the two years before the tax change and the two years after the tax change, and for people on lower incomes between £80,000 and £100,000, who were not affected by the change.

Research Outcomes

For both **employees** and the **self-employed**, the effects of the higher marginal tax rate was to reduce their income below what it would otherwise have been and to increase their pension contributions.

- For **employees**, the average personal pension contribution was increased by £717 pounds per year, representing an 11% increase over the approximately six and a half thousand-pound average personal pension contribution of employees in the dataset.
- For the **self-employed**, the average personal pension contribution was increased by £1573 pounds per year, about twice that of employees. This represented a 17.5% increase over the approximately nine thousand pounds average personal pension contribution of the self-employed in the dataset.
- **Both groups** increased their pension contributions by a smaller percentage than the reduction in the after-tax cost of contributions (33%). This means that these taxpayers spent less, after tax, on personal pension contributions as a result of the tax change. This might be because the tax change reduced their after-tax income.

The results show that changes to marginal tax rates can have substantial effects on people's pension contributions and should be taken into account in tax policy decisions.