

EET vs TEE

Fiona Tait, 27 August 2015

A number of industry commentators have rejected the idea of ISA-style pensions. Here we give our views and the reasons why we're also against this move.

It is undoubtedly a good thing to review pension tax relief and consider whether the current system is working as intended and whether there are alternatives which may work better.

Just because things aren't obviously broken doesn't mean they're perfect. In this case however we believe that retaining the **Exempt, Exempt, Taxed (EET)** tax regime for long term savings is the better approach.

Tax revenues

In theory the consultation is about incentivising people to save for their own retirement. In practice the issue is much wider with the Government looking to reduce their budget deficit, and to do it without changing tax rates.

A switch to **Taxed, Exempt, Exempt (TEE)** treatment would create a short term saving on tax reliefs being paid into pensions, particularly in an environment where the number of savers is already being increased by automatic enrolment.

However it should not be forgotten that this move would also reduce the receipts from the fastest-growing demographic in the UK - pensioners.

The ageing population is likely to require more and more funding from the state, is this the time to reduce the amount they pay back into it?

Practicalities

The actual move to TEE would be very complicated. Either there would have to be complex transitional arrangements or the two systems would have to run in parallel until the point when the last EET pensioners took their benefits.

During this time we can just imagine how complicated member statements would be.

Alternatively, or possibly in addition, savers could pay a one-off tax charge to move to TEE. The former would take years to implement, the latter would be effective at raising government revenue, but it would have an extremely off-putting effect on future savers - a clear case of not putting the consumer first.

The situation for Defined Benefits (DB) is even more complicated as it would impact on current and future funding levels, which in turn would affect employer costs.

Unless the results are unequivocally better, is TEE worth the pain (and expense) of implementation?

Certainty

Individuals who save in an EET environment are at the mercy of future changes to income tax rates, however so are TEE savers in that taxation policy could be changed at any time (TET).

Anyone with a concern about the effect of future government policy on their saving may prefer to get their tax savings up front rather than waiting until they take the money.

Do we trust future governments not to change tax on pension payments in the future?

Incentive to save

The proponents of TEE say that up front tax relief does not work as an incentive to save. But it is also true that removing it could create a significant dis-incentive, particularly for employers who do tend to appreciate the benefits, and there's no evidence that TEE treatment would provide any additional savings.

As mentioned earlier, DB schemes would lose the benefit of tax relief on new and ongoing investments which would profoundly affect their funding position.

Leaving DB out of any changes would be easier but would significantly reduce any savings for the government; would the level of saving justify the cost of implementation?

Temptation

Despite all the theoretical arguments, in my view the biggest issue is consumer behaviour. The EET regime provides an incentive to keep money invested over the longer term. If the investment is easily accessible and tax-free it is very tempting for people to spend it. This works very well for short term savings but can be very detrimental to future retirement income.

The introduction of pension freedoms led to £1.8 billion being withdrawn in a two-month period, is now the time to make it even easier?

In summary

A long term retirement product should include an immediate reward for saving and for remaining invested long enough to provide a long term income when it's needed.

As that's exactly what we have in the current EET regime, should we really change it?

	EET		TEE	
Contributions	Exempt	Provides an immediate incentive to save for both individuals and - crucially - employers.	Taxed	The "reward" for saving is delayed until money is actually spent.
Growth	Exempt	Encourages savers to leave money invested.	Exempt	Encourages savers to leave money invested.
Withdrawals	Exempt	Encourages savers to stop and think before spending their money.	Exempt	Provides a relatively "easy" source of money which savers are more likely to spend.