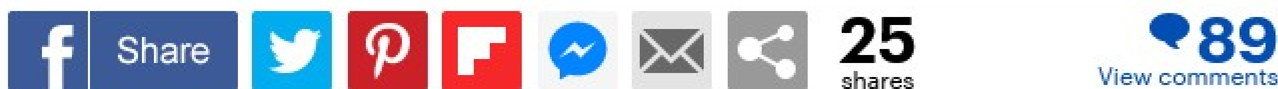
An injustice to last a lifetime: How private sector workers' pensions are being taxed far harder than public sector schemes

- **The lifetime allowance dictates how big a pot can be before you have to pay tax**
- **It is capped at £1.07m and workers face a 25% tax bill on savings over that limit**
- **But public sector workers with 'defined benefit' pensions are not hit as badly**

By BEN WILKINSON FOR THE DAILY MAIL
PUBLISHED: 22:01, 6 July 2021 | **UPDATED:** 09:30, 7 July 2021



Private sector workers only get half the amount of pension pay that those in the public sector do before they are hit with punishing tax bills, a Money Mail investigation reveals.

The lifetime allowance dictates how big a pension pot can be before savers have to pay tax on contributions.

It is capped at about £1.07 million and workers face a 25 per cent tax bill on savings over that limit — as well as the usual income tax on the cash that comes out.

© Alamy Stock Photo

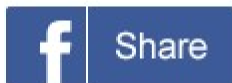
+3

Lopsided: Private sector workers only get half the amount of pension pay that those in the public sector do before they are hit with punishing tax bills

But the tax allowance is far more damaging to private sector workers with simple pension pot savings than it is to those in the public sector who have salary-linked deals known as defined benefit (DB) pensions.

This is because of the outdated way the taxman calculates the value of salary-linked pensions. As DB pensions are not simply a pot of money, HM Revenue & Customs multiplies the annual income the scheme will pay out by 20.

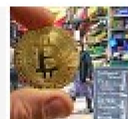
SHARE THIS ARTICLE



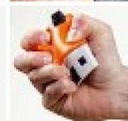
25 shares

RELATED ARTICLES

Pension freedom is costing savers £2bn because their pots...


Could a cryptocurrency save YOUR High St? From Bristol to...

Could you strike black gold or profit from palladium? As the...


Squeezing you for every penny: Equity release lenders are...

HOW THIS IS MONEY CAN HELP

Pension Calculator | This is Money

This formula was devised before the lifetime allowance was introduced in 2006 and was based on annuity rates at the time.

Annuities are insurance products that can be bought with pension savings and guarantee an income rate until death.

But rates have plummeted in recent years — so savers can no longer get as much for their retirement savings.

Money Mail calculations today show that a 65-year-old with a £1.07 million defined contribution (DC) pension pot could now secure an annuity paying just £25,000 a year without breaching the lifetime allowance. The pension rises with inflation and would still pay an income to their partner after they die.

But a public sector worker could have a pension paying £53,000 a year with the same benefits before they breached the allowance, according to figures from financial adviser William Burrows.

In comparison, when the lifetime allowance was brought in 15 years ago, a retiree could buy an annuity income of £55,500 without being hit with a tax bill.

© Shutterstock / JWPhotoworks

Pension tax: The lifetime allowance is capped at about £1.07m and workers face a 25 per cent tax bill on savings over that limit

Savers with salary-linked pensions could have an annual income of £75,000 without busting the allowance, which was then £1.5 million.

Tom Selby, senior analyst at AJ Bell, says: 'This is yet another example of the yawning divide in pensions provision that exists between the private and public sectors.

'This quirk in the rules means defined benefit members could enjoy up to double the lifetime allowance of their defined contribution counterparts.'

Mr Burrows, of the Retirement Planning Project, says: 'The reduction in lifetime allowance is now affecting more and more people, not just fat-cat directors but ordinary middle-class professionals and business owners.'

The findings come after Money Mail last week revealed how public sector workers can expect to get more than £10 for £1 saved into their pension scheme, while private sector savers could get as little as £3.

How much do you need to save for retirement?

£
Calculate

Salary-linked pensions are offered by major public sector employers such as the NHS or the civil service. Yet they are rarely available in the private sector where basic auto-enrolment pensions are the norm.

The Treasury is reportedly considering slashing back the lifetime allowance to as little as £800,000 to pay for a fix to the social care crisis and recovery from the pandemic.

© Shutterstock / Dean Clarke

Biased: The lifetime allowance is far more damaging to private sector workers with simple pension pot savings than public sector workers with salary-linked 'defined benefit' deals

Cutting the allowance to £800,000 would leave DB workers with £40,000-a-year pension, and a DC saver with an £18,500 annuity.

Baroness (Ros) Altmann, a former pensions minister, says: 'The whole lifetime allowance has never made sense. This is another example. It is penalising people largely in the private sector who cannot hope to achieve as good a pension as those in the public sector.'

Baroness Altmann says the cap on saving punished those in the private sector who saved hard and invested well, while those in the public sector were allowed generous pensions. She adds: 'It is one rule for them and one for everyone else.'

She says a move to cut the allowance further would be an 'absolutely dreadful' policy decision.

Workers are already only allowed to save a maximum of £40,000 into their pension every year before they lose tax relief. Baroness Altmann suggests that this annual allowance should be the only restriction on DC savers.

The lifetime allowance peaked at £1.8 million in 2011, but was gradually cut down before hitting a low of £1 million in 2016. It has now been frozen for five years.

Figures published last week show 7,130 savers breached the lifetime allowance in a year, up 1.4 per cent on the year before and handing HMRC £283 million, 5 per cent more than the previous year.

Jamie Jenkins, director of policy at Royal London, says: 'When these calculations were originally set, annuity rates were higher and a £1 million pension pot may well have provided an annuity close to £50,000 each year.

'However, annuity rates have fallen substantially over the years and that's contributed to this anomaly.

If the lifetime allowance was further reduced it would most likely apply to both DC and DB pensions, unless the rules were changed, but this could add even further complexity for savers.'

Nigel Peaple, director of policy at the Pensions and Lifetime Savings Association, says the discrepancy did not have a substantial impact as few DC savers reached the lifetime allowance.

He says: 'Nevertheless, this is another good reason why the Government should not reduce the lifetime allowance or, indeed, reduce the level of fiscal support for pension saving.

'Most people, especially those in defined contribution schemes, are not saving enough for retirement so they need more, not less, support.'

b.wilkinson@dailymail.co.uk