

# Tax Based Incentives for Private Pensions after AE:

some observations



Dr Micheál Collins, UCD

*ml.collins@ucd.ie*

PPRG CONFERENCE 2019 TCD

1

## Outline

1. Introduction
2. Where we are starting from
3. An affordability perspective
4. An equity perspective
5. A simplicity perspective
6. Policy choices



2



## 1. Introduction

- ▶ Shift to AE is major
  - ▶ a long time coming and building on international experience, SSIA experience, COT work etc
- ▶ Process to date has been a little disjointed
  - ▶ DEASP & DPER
  - ▶ DEASP & DF
- ▶ Difficult policy choices ahead
  - ▶ inevitable winners and losers
- ▶ Attempting to explore some of these issues (briefly) here:

3



## 2. Where we are starting from

- ▶ Private pensions
  - ▶ pillars 2 and 3 (occupational and personal)
  
  - ▶ importance
  - ▶ coverage and participation
  - ▶ marginal tax relief
  - ▶ contributions and adequacy
  - ▶ exchequer support cost

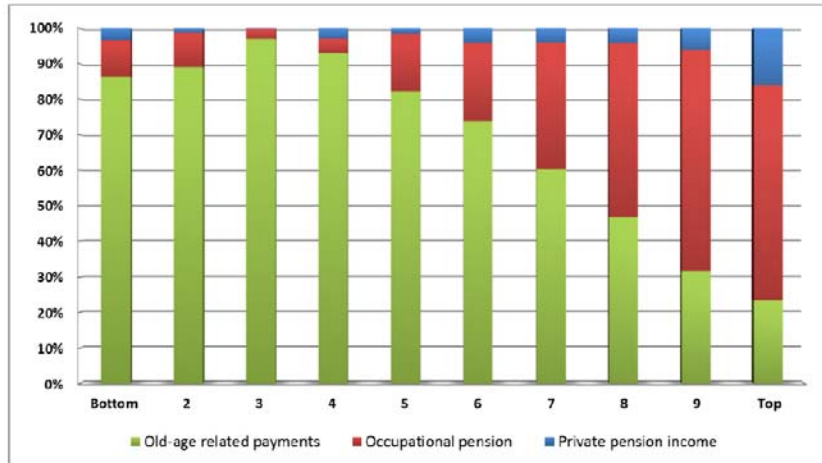
*Collins, M.L and G. Hughes (2017). Collins (2019).*

4



*Importance:*

**Figure 1: The Importance of various Pension Incomes across the Income Distribution, 2014**



Source: Calculated from SILC 2014

5



*Coverage & Participation:*

**Table 1. Pension coverage and participation.**

|                      | Overall | Males | Females | Difference |
|----------------------|---------|-------|---------|------------|
| Pension coverage     | 43.2%   | 43.0% | 43.3%   | -0.3%      |
| Active participation | 33.6%   | 35.7% | 31.2%   | +4.5%      |

Coverage results are similar to those of Foley et al (2016) for 2014. Active participation captures the proportion of earners making any contribution to a pension during the period examined by the survey.  
 Source: Author's analysis of 2014 Survey on Income and Living Conditions.

6



## Marginal Tax Relief:

**Table 5: Profile of Pension Contributors by Marginal Income Tax Rate, 2014**

| Marginal Tax Rate | All with Work Income | Pension Contributors |
|-------------------|----------------------|----------------------|
| Standard (20%)    | 57.8                 | 29.4                 |
| Higher (41%)      | 42.2                 | 70.6                 |
| Total             | 100.0                | 100.0                |

Source: Authors' analysis from SILC 2014.

Note: There are no exempt income earners as income tax is liable from the first € of earnings. However, this may be offset in situations where tax credits exceed income tax liabilities.

7



## Contributions & Adequacy:

**Table 2. Annual pension contributions as a proportion of earnings.**

|                       | Overall | Males | Females | Difference |
|-----------------------|---------|-------|---------|------------|
| less than 1%          | 5.6%    | 4.3%  | 7.2%    | -2.9%      |
| 1% to 4.99%           | 26.7%   | 27.3% | 25.9%   | +1.4%      |
| 5% to 9.99%           | 33.8%   | 32.5% | 35.5%   | -3.0%      |
| 10% to 14.99%         | 20.9%   | 22.0% | 19.5%   | +2.5%      |
| 15% to 19.99%         | 6.0%    | 6.0%  | 6.1%    | +0.0%      |
| 20% to 29.99%         | 4.3%    | 4.9%  | 3.6%    | +1.3%      |
| 30% plus              | 2.6%    | 2.9%  | 2.3%    | +0.7%      |
| Mean contribution %   | 9.3%    | 9.7%  | 8.9%    | +0.8%      |
| Median contribution % | 8.0%    | 8.0%  | 8.0%    | +0.0%      |
| Mean contribution €   | 5,058   | 5,984 | 3,872   | +35%       |
| Median contribution € | 3,340   | 3,840 | 2,724   | +29%       |

Earnings equal the combined value of employment and self-employment income.

Source: Collins and Hughes (2017) and author's analysis of 2014 Survey on Income and Living Conditions.

8



## Contributions & Adequacy:

**Table 2. Annual pension contributions as a proportion of earnings.**

|                              | Overall | Males | Females | Difference |
|------------------------------|---------|-------|---------|------------|
| <i>less than 1%</i>          | 5.6%    | 4.3%  | 7.2%    | -2.9%      |
| <i>1% to 4.99%</i>           | 26.7%   | 27.3% | 25.9%   | +1.4%      |
| <i>5% to 9.99%</i>           | 33.8%   | 32.5% | 35.5%   | -3.0%      |
| <i>10% to 14.99%</i>         | 20.9%   | 22.0% | 19.5%   | +2.5%      |
| <i>15% to 19.99%</i>         | 6.0%    | 6.0%  | 6.1%    | +0.0%      |
| <i>20% to 29.99%</i>         | 4.3%    | 4.9%  | 3.6%    | +1.3%      |
| <i>30% plus</i>              | 2.6%    | 2.9%  | 2.3%    | +0.7%      |
| <i>Mean contribution %</i>   | 9.3%    | 9.7%  | 8.9%    | +0.8%      |
| <i>Median contribution %</i> | 8.0%    | 8.0%  | 8.0%    | +0.0%      |
| <i>Mean contribution €</i>   | 5,058   | 5,984 | 3,872   | +35%       |
| <i>Median contribution €</i> | 3,340   | 3,840 | 2,724   | +29%       |

Earnings equal the combined value of employment and self-employment income.

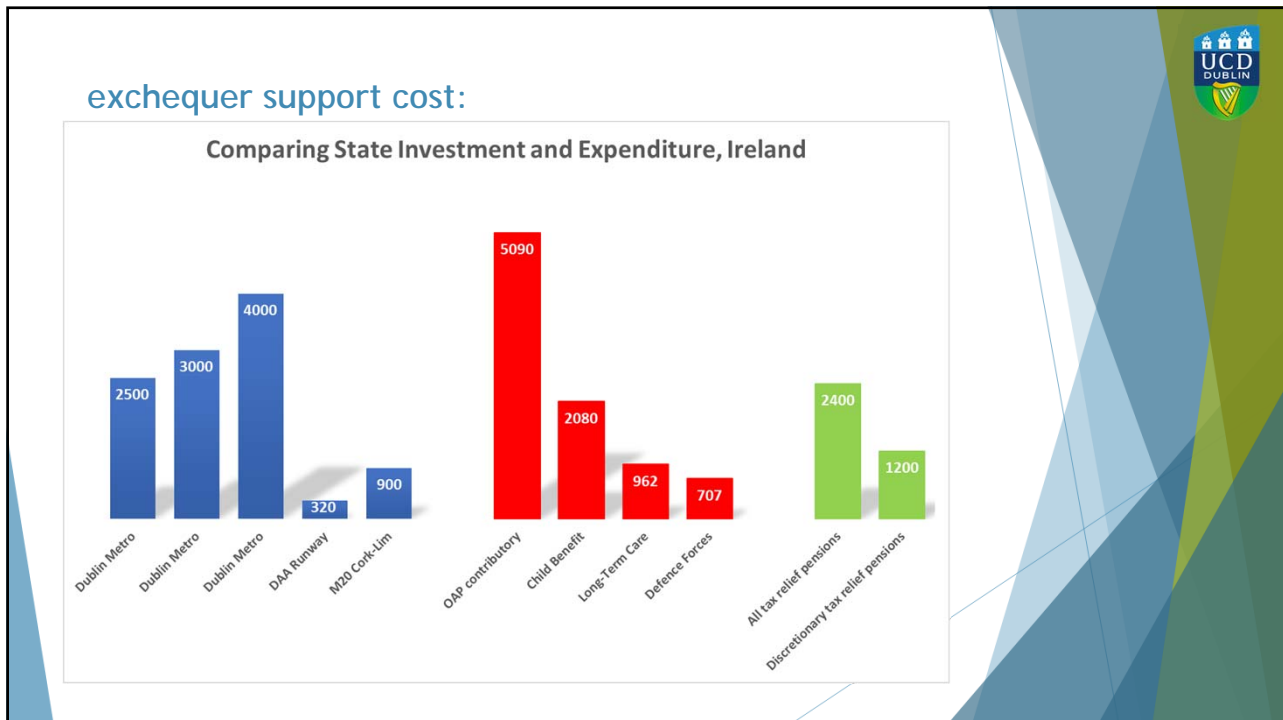
Source: Collins and Hughes (2017) and author's analysis of 2014 Survey on Income and Living Conditions.

9



- ▶ Taking the median contributor (contributions all sources)
  - ▶ €3,340 per annum
  - ▶ for 40 years → pension of €5,200 per annum
  - ▶ Replacement Rate = 37.5%
    - ▶ of this 70% = pillar one pension

10



11

UCD DUBLIN

### 3. An affordability perspective

- ▶ Can we add on cost of AE to existing exchequer supports?
- ▶ Cost of AE top-ups?
- ▶ Cost of AE top-ups + Tax Expenditure on employee and individual contributions?

12



- ▶ Brief estimate using Strawman model - ongoing work
  
- ▶ Baseline assumptions:
  - ▶ no behavioural change ...
  - ▶ no attrition over years
  - ▶ 2014 data, but some attempts to take this into account
    - ▶ employment increased 13.2% 2014-2018

13



- ▶ Just showing one model:
  - ▶ €20,000 entry threshold
  - ▶ capped at €75,000
  - ▶ state top-up of €1 for every €3 saved
  - ▶ builds up over 6 years from 1% to 6%
  - ▶ looking at additional contribution
    - ▶ *i.e. on top of those already being paid by the individual*

14



| Year   | Individual contribution rate | No of individuals | Additional contributions €m | State matching funding €m | State matching funding 2018 €m |
|--------|------------------------------|-------------------|-----------------------------|---------------------------|--------------------------------|
| Year 0 | 0%                           | 674,022           |                             |                           |                                |
| Year 1 | 1%                           | 722,579           | €273m                       | €90m                      |                                |
| Year 2 | 2%                           | 777,938           | €573m                       | €189m                     |                                |
| Year 3 | 3%                           | 833,699           | €898m                       | €296m                     |                                |
| Year 4 | 4%                           | 879,223           | €1,247m                     | €412m                     |                                |
| Year 5 | 5%                           | 934,187           | €1,620m                     | €535m                     |                                |
| Year 6 | 6%                           | 976,636           | €2,022m                     | €667m                     |                                |

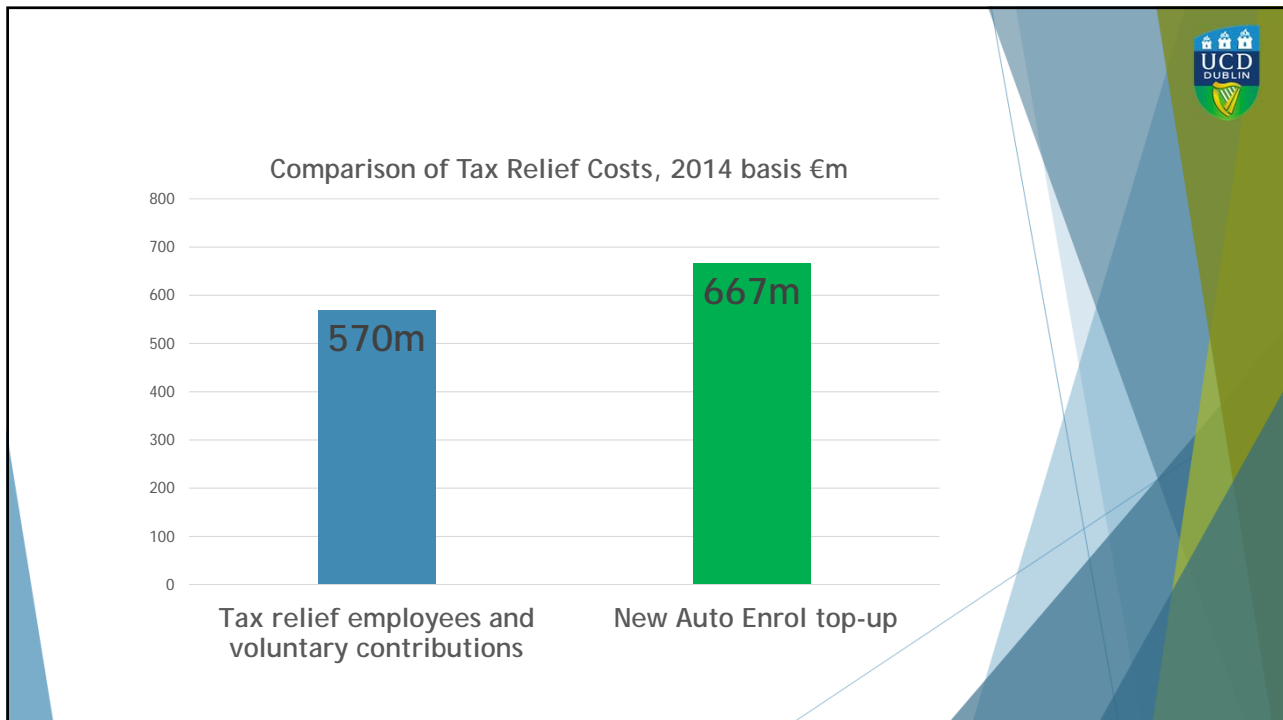
15



| Year   | Individual contribution rate | No of individuals | Additional contributions €m | State matching funding €m | State matching funding 2018 €m |
|--------|------------------------------|-------------------|-----------------------------|---------------------------|--------------------------------|
| Year 0 | 0%                           | 674,022           |                             |                           |                                |
| Year 1 | 1%                           | 722,579           | €273m                       | €90m                      | €102m                          |
| Year 2 | 2%                           | 777,938           | €573m                       | €189m                     | €214m                          |
| Year 3 | 3%                           | 833,699           | €898m                       | €296m                     | €335m                          |
| Year 4 | 4%                           | 879,223           | €1,247m                     | €412m                     | €466m                          |
| Year 5 | 5%                           | 934,187           | €1,620m                     | €535m                     | €605m                          |
| Year 6 | 6%                           | 976,636           | €2,022m                     | €667m                     | €755m                          |

16





17

## 4. An equity perspective

- ▶ Tax Expenditure structure:
  - ▶ in-built inequity with marginal relief approach
  - ▶ tax expenditures have adjusted
    - ▶ post COT 2009 to single rate relief
      - ▶ standard rate: health expenses etc
      - ▶ hybrid relief: charity donations
  - ▶ removing the inequity is overdue
    - ▶ i.e. a single rate of relief on all contributions is overdue

18



- ▶ Can you have different rates of support for individuals in different systems?
  - ▶ Tax supports @ 20% and 40%
  - ▶ AE top-ups at 33%
- ▶ Such differences are unsustainable
  
- ▶ If both pension support systems are to continue (?) then they should be offering support in the same way to all contributors irrespective of their means and contribution method

19



## 5. A simplicity perspective

- ▶ Pensions are complex
- ▶ They should be simple
  - ▶ to contribute to
  - ▶ to choose between
  - ▶ to enter and to leave
  - ▶ to draw down
  - ▶ to personally monitor
- ▶ Room for improvement
- ▶ But, cannot make more complex with multiple rates and supports
- ▶ Raises other questions...

20

## 6. Policy choices

- ▶ Current system only works for a few
  - ▶ long-term risk as population ages
  - ▶ efficiency, effectiveness and equity issues
- ▶ Bolting on AE is not financially viable
- ▶ Likely that AE cost will need to be principally accommodated within current pension support resources
  - ▶ implies a very different context and set of choices
  - ▶ we should think a little more about these...

