Is a flat rate scheme coming to pension tax relied?

The prospect of a flat rate of tax relief on pension contributions has resurfaced in the national press.

The cost of pension relief has been chipped back in recent years, mainly by reducing the annual allowance. However, a report in The Times in early July suggested the Treasury is looking at flat rate tax relief, which would give the same rate of tax relief on contributions, regardless of personal income tax rates. The Times reported a flat rate of 25% is being considered, meaning a gross pension contribution of £100 would require a net outlay of £75 instead if the current £80.

The 25% rate would be an effective tax cut for the majority of pension contributors, who pay basic rate tax, but would potentially save the Exchequer about £4 billion a year. It is estimated that a flat rate of 28% would cost the Treasury the same as today's mix of 20%, 40% and 45% reliefs.
It is hardly surprising that the Treasury is re-examining pension tax relief, given it is looking for an extra £20.5 billion for NHS funding. Tax relief on pension contributions cost the Exchequer £38.6 billion in 2016/17 according to HMRC's latest estimate, as well as over £16.2 billion of national insurance contribution (NIC) relief on employer contributions.

It remains to be seen if such a change will be announced in the Budget. Currently, the politics of such a move seem between difficult and impossible, and the Chancellor will remember the backlash he faced when he attempted to raise NICs. A proposal to end higher rate tax relief could meet with similar resistance, especially as it would likely coincide with the next rise in automatic enrolment pension contributions. However, a recent Treasury Select Committee report recommended the Government give "serious consideration" to the introduction of flat rate relief.

In the longer term, a switch away from full tax relief is beginning to look inevitable. George Osborne, Mr Hammond's predecessor, almost made the change in 2016. Mr Hammond, or his successor, may finally do so, if only for the extra revenue. In the meantime, if you are a higher or additional rate taxpayer, maximising pension contributions is a strategy to consider.

The value of your investment can go down as well as up and you may not get back the full amount you invested.
Past performance is not a reliable indicator of future performance. The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice.