Dear Rachel Reeves: tread carefully on pensions before your budget

With 12 long weeks until Rachel Reeves's next budget, conjecture – potentially harmful to members' experience and outcomes – is already mounting about changes to taxation of pensions.

The Chancellor announced yesterday that she would unveil her budget on Wednesday, 26 November – almost a month later than her first budget on 30 October 2024. As the Financial Times noted, this leaves *"almost three months of speculation about how she intends to fill a gaping hole in the UK public finances"*.

The respected National Institute of Economic and Social Research (NIESR) thinks Reeves is £41 billion short of her fiscal target. NIESR, along with many other economists, argues large tax rises are inevitable.

But the government is sticking to its manifesto pledge not to increase the three biggest sources of funds for the Exchequer – income tax, national insurance and VAT.

Pensions are in the spotlight

That creates room for extensive speculation about Reeves's other options to raise revenue – and pensions, the perennial soft target, are in the spotlight. Even before the Treasury set a date for the budget, press reports raised multiple options supposedly under consideration.

Deputy Prime Minister Angela Rayner kicked things off by suggesting to Reeves, in a leaked memo, that she should restore the lifetime allowance on tax relievable pension savings, which the Conservative government scrapped in part to dissuade doctors from retiring early.

Journalists with high-level Labour contacts have said changes to tax relief on pension contributions are on the agenda. And reports have suggested that Reeves is considering cutting the tax-free lump sum allowance – though a government source played this down.

A report commissioned by HMRC about attitudes to salary sacrifice also spawned suggestions that the Treasury was considering limiting this benefit, which employees can use to boost their pension savings. Although, how this would work in practice is unclear.

And now Pensions Minister Torsten Bell has been appointed to lead Reeves's budget team. As the CEO of a thinktank, Bell proposed that the tax-free lump sum should be cut to £40,000 and he has called for the pensions triple-lock to be replaced.

This has led to headlines about a "pensions tax zealot" running the budget. That portrayal may not be fair to Bell – what he proposed at a thinktank and what he sees as politically feasible in office may be very different. But Bell's role only adds to talk that pensions are on the table for cuts.

We have been here before

Pension schemes and their members went through this process in the run-up to Reeves's first budget after Labour's election victory. Multiple kites were flown in the media, including proposals to harmonise tax relief on

pensions contributions, charge national insurance on employers' contributions, and make cuts to the tax-free lump sum.

After all these rumours, on budget day Reeves's only significant measure affecting pensions was to apply inheritance tax to almost all unused pension pots and death benefits from April 2027.

But the Treasury's apparent testing of options in public had real-world results. Reports that Reeves was considering a drastic cut to the limit for cash-free lump sums triggered a surge in enquiries from pension savers looking to draw their lump sums early.

Some savers withdrew lump sums and then found they couldn't pay the money back into their pensions when the change didn't materialise. This time, Reeves and her team would do well to keep their ideas to themselves until budget day – and to rule out speculation they know to be untrue.

This is because pensions are different from other financial arrangements. Last year's events showed that if stories are allowed to run in the press about changes to pension benefits, some savers will react unless they are convincingly reassured.

More broadly, pensions rely on confidence among scheme members that they are putting their money into a safe, stable fund that will be there when they need it in retirement. Measures that make pensions more complicated or change the rules can erode confidence among savers when we need them to be more engaged.

In June, the government revived the Pensions Commission to examine how to improve outcomes for the current generation of savers who aren't setting aside enough for retirement. This goal is at risk if the government's own actions undermine faith in pension saving.

There are no easy options on pensions taxation

With tax relief on pensions costing the Exchequer a net £52.5 billion a year, it isn't a surprise that Reeves is considering ways to cut the bill. But pensions aren't a soft touch; they are complicated and riven with unintended consequences.

Let's look at three changes that have been mooted:

Reducing **tax relief for higher earners** might seem attractive to a Labour government. In opposition, Reeves proposed a flat rate of tax relief. But the higher rate tax band applies to incomes just over £50,000. Equalising tax relief at, say, 30% would upset the plans of these savers on relatively modest incomes.

Reducing **tax-free cash withdrawals** to less than the current 25% would be horribly complicated – and the government would have to decide if the change would apply to savings already built up, raising questions of fairness. This allowance has already been trimmed several times by previous governments.

Salary sacrifice allows scheme members – and their employers – to pay less national insurance by reducing the member's pay and diverting the money into their pension. This item of tax avoidance might seem like an easy option politically, but abolition would create complications for millions of people whose contributions are effectively collected through salary sacrifice.

There are no easy options for Reeves and Bell to target taxation of pensions. Individual measures present complex choices and could lead to unforeseen results. And sending the message that pensions are up for grabs

could undermine the government’s laudable goal of getting people saving more.

And whatever their plans are, Reeves and Bell should keep them within the walls of the Treasury until budget day.

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