## Lifetime ISA:

## Inquiry into whether the Lifetime Individual Savings Account is still an appropriate financial product

Submission by Prospect

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### Introduction

Prospect is an independent trade union representing over 159,000 employees and freelancers across a range of different industries, in both the public and private sectors.

We welcome the committee’s inquiry into whether the Lifetime Individual Savings Account (Lifetime ISA) is an appropriate financial product.

Lifetime ISAs have the potential to play a particularly important role in retirement planning for freelancers (or any type of worker who is not eligible for automatic enrolment).

Consequently, our responses to the committee’s questions focus on the potential role Lifetime ISAs could play for freelancers in the current retirement savings market.

These responses are informed by the experiences of our freelancer members, particularly those in TV and film production who are organised by our Bectu sector.

* **Tax benefit of Lifetime ISA and workplace pensions**

To understand why Lifetime ISAs can be particularly relevant for freelancers, it is important to understand the net tax position for savers using the main long-term savings products.

(1) The end-to-end tax benefit of a workplace pension for a 20% taxpayer

An £800 contribution to a workplace pension by a 20% taxpayer would be made up to £1,000.

In retirement £250 of that could be taken tax-free, the remaining £750 would be taxable.

If the member remained a 20% taxpayer in retirement, then £150 of the remaining £750 would be deducted as tax, leaving £850 overall.

Therefore, the end-to-end tax benefit of a workplace pension for a 20% taxpayer is 6.25% (ie £50 / £800).

(2) The end-to-end tax benefit of a workplace pension for a 40% taxpayer

A £600 contribution to a workplace pension by a 40% taxpayer would be made up to £1,000.

In retirement £250 of that could be taken tax-free, the remaining £750 would be taxable.

If the member remained a 40% taxpayer in retirement, then £300 of the remaining £750 would be deducted as tax, leaving £700 overall.

If the member became a 20% taxpayer in retirement, then £150 of the remaining £750 would be deducted as tax, leaving £850 overall.

Therefore, the end-to-end tax benefit of a workplace pension for a 40% taxpayer who remains a 40% taxpayer in retirement is 16.67% (ie £100 / £600).

The end-to-end tax benefit of a workplace pension for a 40% taxpayer who becomes a 20% taxpayer in retirement is 41.67% (ie £250 / £600).

(3) The end-to-end tax benefit of a Lifetime ISA

An £800 contribution to a Lifetime ISA would be made up to £1,000.

In retirement the £1,000 would be tax-free.

The end-to-end tax benefit of a Lifetime ISA is 25% (ie £200 / £800).

* **Lifetime ISA versus workplace pensions**

The above analysis only compares the tax treatment of workplace pensions and Lifetime ISAs for different types of savers.

In practice, workplace pensions will be a more appropriate retirement savings vehicle for workers eligible for automatic enrolment (at least up to a certain level of contribution).

This is because employers are required to contribute to workplace pensions on behalf of workers who are eligible for automatic enrolment.

On the other hand, many types of freelancers (eg the self-employed, those operating through personal services companies) do not benefit from employer contributions.

That means that these types of freelancers should be more inclined to choose a retirement savings product mainly based on the tax treatment that applies.

The other implication of the lack of an employer contribution for these groups is that, overall, their retirement outcomes will generally be much worse than average.

This is supported by research from the Institute for Financial Studies[[1]](#footnote-1) and is the basis for many of the recommendations in a report by the Fabian Society[[2]](#footnote-2) for Prospect and others.

* **Lifetime ISA’s role in retirement planning for freelancers**

The tax treatment of Lifetime ISAs means this product could play an important role in retirement planning for certain types of freelancers.

Freelancers who pay income tax at the basic rate, and who are not eligible for employer contributions into a workplace scheme, might particularly benefit from Lifetime ISAs.

As retirement outcomes are particularly poor for this group of workers, there is a strong policy interest in ensuring these products are appropriate for this segment of the market.

But there is little evidence that Lifetime ISAs are currently being used for retirement planning by freelance workers.

In our experience, freelance members in our Bectu sector have very low awareness of Lifetime ISAs and little or no knowledge of their tax treatment.

Several features of Lifetime ISAs would need to be refined to make them a suitable retirement savings product for freelancer workers.

However, we believe that this is the single most appropriate role that these products could continue to play in the future, and we ask the committee to recommend these changes.

A suitably refined Lifetime ISA, targeted at an informed population of freelance workers could play an important role in tackling the poor retirement outcomes of this group.

* **Lifetime ISA’s other main roles**

The committee will need evidence from Lifetime ISA providers and HMRC about the main current uses of Lifetime ISAs.

Data is necessarily incomplete due to the time it will take before Lifetime ISAs begin to be accessed for retirement savings.

But existing data suggests the principal use of Lifetime ISAs is for the purchase of a first home.

It is for the committee to decide whether the net impact of Lifetime ISAs on the property market is desirable.

The large number of unauthorised withdrawals from Lifetime ISAs strongly suggest significant problems with the current design and use of these products.

It is very unlikely that Lifetime ISAs are a suitable retirement savings product for the vast majority of workers who are eligible for automatic enrolment.

### Questions

Prospect’s responses to the committee’s questions are set out below.

1. **Is the Lifetime ISA fit for purpose in its current design, including as a combined product for house purchase and pension saving?**

For the reasons given above, Prospect believes that the most suitable role for Lifetime ISAs is as a retirement savings product for a section of the freelance workforce.

The answers to the following questions highlight several ways that Lifetime ISAs could be reformed to be more suitable for this purpose.

These include:

* Returning the withdrawal penalty to a neutral rate of 20%.
* Increasing the limit to a level that would allow a typical freelancer to save sufficient funds for a comfortable retirement.
* Allow Lifetime ISAs to be opened after members’ 40th birthdays.
* Allow savers to continue contributing to Lifetime ISAs until they retire.
* Allow withdrawals from Lifetime ISAs for the purpose of investing in members’ underlying businesses.

Prospect does not take a position on the use of Lifetime ISAs for savings towards house purchases.

It is unlikely that the Lifetime ISA will be a suitable retirement savings product for workers who are eligible for automatic enrolment.

1. **How well do consumers transition between using the Lifetime ISA as a product for house purchase, to then a product for pension saving?**

Prospect does not hold any relevant information on this question. The committee will need data from Lifetime ISA providers about this transition.

1. **Given its policy purposes, is the Lifetime ISA value for money for the Government?**

Prospect does not hold any relevant information about this question.

The government has a legitimate policy interest in promoting better retirement outcomes for workers and the incentives for this could well represent value for money.

The return to government for the impact of Lifetime ISAs on the property market is much less certain.

1. **Is the Lifetime ISA a suitable pension savings product?**

Automatic enrolment workplace pensions will be the most suitable pension product for the vast majority of workers.

But the Lifetime ISA could be a suitable pension saving product for a large proportion of freelance workers (ie freelancers who are basic rate taxpayers).

Several reforms, outlined in answers to other questions posed by the committee, will be needed to make Lifetime ISAs appropriate for this purpose.

1. **Should the Lifetime ISA be abolished?**

If Lifetime ISAs can be reformed to play a significant role in improving retirement outcomes for freelance workers, they should not be abolished.

**6. Should the Lifetime ISA be reformed to remove the withdrawal penalty?**

Statistics on the significant numbers of unauthorised withdrawals show that this penalty is either insufficiently understood, or insufficiently considered, when taking out Lifetime ISAs.

The withdrawal penalty is unnecessary for the purpose of encouraging retirement savings or saving for house purchases.

Prospect would support a return to a neutral withdrawal penalty of 20%.

1. **Should the Lifetime ISA be restricted to those with no access to a workplace pension?**

It is unlikely that the Lifetime ISA will be a suitable retirement savings product for workers who are eligible for automatic enrolment.

This is because workers who are eligible for automatic enrolment can benefit from a significant employer contribution.

There is very little evidence that any employers are offering contributions towards Lifetime ISA products.

There is a potential risk that workers who would benefit more from automatic enrolment could opt out order to contribute to a Lifetime ISA instead.

An appropriate solution could be to restrict access to Lifetime ISAs to those workers who are not eligible to join workplace pension schemes.

1. **Should the Lifetime ISA house price cap be raised in line with inflation, or removed?**

This question is intrinsically linked to the use of Lifetime ISAs for house purchases.

Prospect does not have a view on whether this is an appropriate use for Lifetime ISAs. Obviously, if the committee takes the view that it is an appropriate use, then it would follow that the cap should be increased.

1. **Should the annual Lifetime ISA limit be raised from £4,000?**

Yes.

Clearly a frozen limit will become less and less appropriate over time. The committee will want to consider both the most appropriate current limit and a mechanism for maintaining its value over time.

Some increase would be appropriate just to allow for the time value of money since the original limit was set.

It is not possible to draw appropriate conclusions from a simple comparison of the maximum tax-relieved contribution that a basic rate taxpayer could contribute to a workplace pension scheme with the contribution that can be made to a Lifetime ISA.

However, such a comparison would indicate that far more tax relief is available to those using workplace pensions as a retirement savings product, and that an increase to the Lifetime ISA limit would be appropriate.

An increase to the Lifetime ISA would also be appropriate from the point of view of an analysis of the amount a typical freelancer would have to save for an appropriate level of income in retirement.

All the above factors suggest that a large increase to the Lifetime ISA limit, and a mechanism for maintaining its value in real terms, would both be appropriate.

1. **Should the Lifetime ISA be reformed in any other way?**

Lifetime ISAs can currently only be opened by workers aged between 18 and 39 and contributions can only be made until the member’s 50th birthday.

Freelance workers have atypical careers that often involve becoming freelance relatively late (including after their 40th birthday).

If Lifetime ISAs are to be suitable retirement products for freelancers, it should be possible to open them after workers’ 40th birthdays and continue to contribute to them until retirement.

Freelance workers would also likely benefit from the ability to make withdrawals from Lifetime ISAs for the purpose of investing in their underlying business.

1. [Private pensions for the self-employed: challenges and options for reform | Institute for Fiscal Studies](https://ifs.org.uk/publications/private-pensions-self-employed-challenges-and-options-reform) [↑](#footnote-ref-1)
2. [Microsoft Word - Working for you - a manifesto for the self-employed - FINAL 17 Jul.docx](https://fabians.org.uk/wp-content/uploads/2023/07/Working-for-you-a-manifesto-for-the-self-employed-FINAL-17-Jul.pdf) [↑](#footnote-ref-2)