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How to design Japan's DC Pension Plan (iDeCo) and the NISA?: A Comparison with the U.S. and the UK

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Abstract

The aging of Japanese society makes it difficult to sustain the payment of public pension benefits at current levels. Therefore, the private pension system is becoming more important as format for asset building post-retirement. The individual-type defined contribution pension plan (iDeCo) provides support for the system from a tax incentive point of view. Japan also has the Nippon Individual Savings Account (NISA) for small tax-exempt savings.

In the U.S., traditional IRAs and Roth IRAs are an additional format for household asset building, alongside public pensions and corporate pension plans, such as 401(k)s. In the UK, the ISA savings program is a supplement to public and private pensions and is the model for Japan's NISA.

This paper compares the systems of Japan, the U.S., and the UK, with a focus on the benefits and income redistribution effects of public pensions and the contribution limits of private pensions and other asset building systems. The following characteristics of the Japanese system stand out from a comparison of these three countries:
(1) The public pension in Japan is positioned to provide support for post-retirement life, but the actual amount of benefits paid is quite low.
(2) The income redistribution effect of public pensions is also limited.
(3) Contribution limits for asset building schemes are lower than those in the U.S. and the UK. The contribution limit for private pensions is particularly low.

Based on these results, this paper points out there is a need for a review of the role of public pensions and the contribution limits of private pensions.

Keywords: Public pension, private pension, iDeCo, NISA, tax-exempt contribution limit

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1. Introduction

The aging of Japanese society has made it increasingly difficult to sustain payments of public pension benefits at current levels. This means that the private pension system is becoming more important as a structure for asset building for retirement. The "individual-type defined contribution pension plan" (iDeCo) provides support for this system in the form of tax-exempt saving. Japan also has the Nippon Individual Savings Account (NISA) for small-scale tax-exempt savings. These schemes need to be considered on an integrated basis to determine the optimal approach to encouraging asset building for retirement.

In the U.S., the role of public pensions is to facilitate income redistribution in retirement. Corporate pensions, on the other hand, help people build assets for their retirement on a self-help basis and offer large tax-exemption benefits. The U.S. also has the IRA program (Individual Retirement Account) for retirement savings, as well as the Roth IRA, which corresponds to the NISA in Japan. However, the tax-exemption limit is much lower than in Japan.

In the UK, public pensions are also structured to facilitate redistribution of post retirement income. Compared to Japan, private pensions have quite radical tax-exemption benefits. The UK also has the ISA (Individual Savings Account), which is a model for Japan's NISA.

This paper compares asset building support programs in Japan, the U.S. and the UK with a focus on the benefits and redistribution effects of public pensions and the contribution limits of private pensions and other asset-building support programs.

The principal results of the comparison of the three countries are summarized in Figs. 13 and 14. The following characteristics of the Japanese system are evident from this comparison.

(1) The public pension in Japan is positioned to provide support for post-retirement life, but the actual amount of benefits paid is quite low.

(2) The income redistribution effect of public pensions is also limited.

(3) Contribution limits for asset building schemes are lower than those in the U.S. and the UK. The contribution limit for private pensions is particularly low.

Based on these results, this paper highlights out the need for a review of the role of public pensions and the contribution limits of private pensions.

Chapters 2-4 describe the structure of the pension systems in Japan, the U.S., and the UK. Chapter 5 includes a comparison of the three countries and examines the Japanese approach to support for asset building for retirement. In the UK, there is a common contribution limit for both defined contribution (DC) and defined benefit (DB) private pensions. For DB pensions it is necessary to calculate an annual contribution equivalent amount. This calculation method is explained in the appendix.

2. The Japanese Pension System

2.1 Public Pensions

Fig. 1. shows the general structure of Japan's pension system: the system has both private pensions, including corporate pensions, as well as public pensions. The overall pension system can be said to have a "three-tier structure."

Fig. 1: Structure of Japan's pension system

	Category 1 insured person	Category 2 insured person			Category 3 insured person
		iDeCO			
Tier 3	iDeCO/ National Pension Fund		Corporate pension plans (DB/DC)	Retirement pension benefits	
Tier 2		Employee's Pension			
Tier 1		National Pension (Basic Pension)			

Source: Compiled from Ministry of Health, Labor and Welfare (2023), p. 6

The Ministry of Health, Labor and Welfare (MHLW) (2023) has announced that "Tiers 1 and 2 (public pensions) provide basic support for retirement, and Tier 3 (corporate and private pensions) support the diverse needs of people in retirement." Fundamentally, the concept behind the division of roles between public and private pensions is that public pensions provide basic benefits with private pensions, including corporate pensions, positioned as a supplement to this.

As is well known, Japan's public pension system consists of the National Pension, which covers everyone aged 20 and over, and the Employees' Pension, which covers company employees and civil servants. The key feature is that it is a "universal pension" with a "two-tier" structure. The pensions are funded on a pay-as-you-go basis.

Pension benefits are funded by social insurance premiums. Category 1 insured persons, which include self-employed workers and non-full-time workers, pay a fixed premium (¥16,590 per month in FY2022). Category 2 insured persons, such as company employees and civil servants, pay a fixed rate (18.3% of monthly standard remuneration in FY2022). Dependent spouses of Category 2 insured persons do not have to pay premiums (that is, Category 3 insured persons, such as housewives whose spouses are company employees or public employees). To qualify for a pension, a person must have paid the Japanese national pension contributions for at least 10 years. Those who meet this condition receive the National Pension, and office workers and civil servants also receive the Employees' Pension. The starting age for receiving benefits is 65 years old and the value of benefits for the National Pension is determined in accordance with the period over which premiums are paid. In FY2022, the full amount was ¥64,816 per month, so the monthly benefit is the full amount multiplied by the number of months in which premiums were paid divided by 480 months (40 years). For the Employees' Pension, the amount of benefits is determined in accordance with the income earned by the insured person during their working life (average standard remuneration) and the insured person's period of coverage.

According to the Ministry of Health, Labor and Welfare (2022), the average value of benefits under the National Pension in FY2021 was ¥56,000 per month, and the average value of benefits under the Employees' Pension (including the National Pension) was ¥146,000 per capita per month. The government conducts a fiscal review of the status and outlook of public pension finances at least every five years. Depending on the outlook for economic growth and other factors, further cuts in benefits may be expected.

2.2 Private Pensions

Fig. 2 provides an overview of private pension plans in Japan. The tax treatment of private pensions is on an "EET" basis: contributions are tax-exempt, investment income and gains are tax-exempt, and benefits are taxed. For DB contributions, employer contributions are treated as fully tax-deductible, while employee contributions are deductible as life insurance premiums. For corporate DC and individual DC (iDeCo) plans, employer contributions are fully tax-deductible, while employee (individual) contributions are deductible as small-scale enterprise mutual aid premiums.

Fig. 2: Overview of private pensions in Japan (2023)

	DB	Corporate DC	Individual DC (iDeCo)
Tax treatment	EET	EET	EET
Contribution method	Employer, employee	Employer, employee	Individual (in principle)
Starting age for receiving benefits	At the time of reaching age 60-70 as stipulated in the regulations or at the time of retirement at age 50 or older (if stipulated in the regulations)	At the time of claiming benefits from age 60-75	
Tax treatment of contributions	Employer contributions are deductible Employee contributions are deductible as life insurance premiums	Employer contributions are deductible Employee (individual) contributions are deductible as small-scale enterprise mutual aid premiums	
Tax treatment of investment income/gains	Special corporate tax (suspended until March 2026)		
Tax treatment of payment of benefits	Miscellaneous income (eligible for public pension deduction) Lump sum payment (eligible for retirement income deduction)		

Source: Ministry of Health, Labor and Welfare (2023), Japan Securities Research Institute (2022) and other sources

Fig. 3: Revision of DC contribution limits for Category 2 insured persons

	(1) Enrolled in corporate DC plan only Corporate DC	(2) Enrolled in a corporate DC and a DB plan Corporate DC	(3) Enrolled in DB plan only iDeCo	(4) Not enrolled in either a corporate DC or DB plan iDeCo
From 01/01/2017	¥55,000 per month of which, iDeCo is ¥20,000	¥27,500 per month of which iDeCo is ¥12,000	¥12,000 per month	¥23,000 per month
From 12/01/2024	¥55,000 per month – DB equivalent contribution Of which iDeCo is ¥55,000 - (employer's corporate DC contribution + DB equivalent contribution) (Maximum ¥20,000)		Same as on left	¥23,000 per month

Note: iDeCo contribution limit for Category 1 insured persons is ¥68,000 per month when combined with the National Pension Fund. iDeCo contribution limit for Category 3 insured persons is ¥23,000 per month.
Source: Ministry of Health, Labor and Welfare (2023), p. 93.

Corporate DC plans allow employees to make matching contributions. Individual DC plans are, in principle, eligible for matching contributions, but there is also a contribution system for small- and medium-sized companies (iDeCo Plus).

In terms of the tax treatment of investment income or gains, the accumulated reserve fund is subject to a special corporate tax, which is currently suspended until March 31, 2026. Pension benefit payments are subject to income tax as miscellaneous income in the case of regular pensions and as retirement income in the case of lump-sum payments, with the public pension credit and retirement income tax credit applying respectively.

Next, Fig. 3 shows the contribution limits for private pension plans, which have been revised several times since the establishment of the DC contribution system. If we look at the contribution limits after January 2017, it can be seen that the contribution limits vary depending on the type of corporate pension plan in which a Category 2 insured person is enrolled. This makes the system quite complicated.

In terms of specific amounts for Category 2 insured persons, for those in "(1) Enrolled in a corporate DC plan only," it is ¥55,000 per month, which is ¥660,000 per year. For those in "(2) Enrolled in a corporate DC and a DB plan," the monthly DB equivalent contribution is assessed to be ¥27,500, so the corporate DC plan limit overall is ¥660,000 per year, the same as in (1). However, the iDeCo contribution limits vary for (1) and (2). For "(3) Enrolled in DB plan only" and "(4) Not enrolled in either a corporate DC or DB plan", the iDeCo monthly contribution limits are ¥12,000 and ¥23,000, respectively.

On the other hand, from December 2024 onwards, the annual DC contribution limit will be ¥660,000 for both (1), (2) and (3). In addition, the iDeCo contribution limit will be ¥20,000. Furthermore, the monthly DB-equivalent contribution will no longer be deemed to be ¥27,500 but will reflect the actual payments made. However, the iDeCo contribution limit for (4) will remain at ¥23,000 per month, and the contribution limit for private pensions is not a uniform amount.

2.3 NISAs

The NISA (Nippon Individual Savings Account) tax-exemption program for small investments was launched in Japan in January 2014. The Junior NISA was introduced in January 2016, followed by the Tsumitate NISA in January 2018. The original NISA is referred to as a General NISA. The tax-exemption under the General NISA covers income from dividends and capital gains for stocks, mutual funds and similar instruments. The annual tax-exempt investment limit is ¥1.2 million, with a maximum tax-exempt period of 5 years. Therefore, the maximum tax-exempt investment limit is ¥6 million.

The Junior NISA is for minors (under age 20) and offers tax-exempt income from dividends and capital gains for stocks, mutual funds and similar instruments, similar to the general NISA. The annual investment limit is ¥800,000 over a maximum period of five years, so the maximum tax-exempt investment limit is ¥4 million. Investments are made either by a parent or guardian, or with their consent, and withdrawals are restricted until age 18.

The Tsumitate NISA (installment-type) was established to support long-term investment for small amounts on a cumulative diversified basis. The tax-exemption applies to dividends and capital gains from investments in specified mutual funds. The annual investment limit is ¥400,000, and the maximum tax-exempt period is 20 years, so the maximum tax-exempt investment limit is ¥8 million. Account holders must choose between holding a Tsumitate NISA or a General NISA: they cannot hold both.

In accordance with tax reforms in 2020, the investment term of the General NISA and the Tsumitate NISA was increased by five years with the General NISA relaunched as a two-tier product. It was decided to phase out the Junior NISA by the end of 2023. However, in the FY2023 tax reform, the NISA is being drastically revised under the Kishida administration's Doubling Asset-based Income Plan as part of an effort to shift household assets from savings to investments. The revised NISA is shown in Fig. 4. The main feature is the permanence of the system. In addition, a Tsumitate framework and a Long-Term Investment Framework will be established, with annual investment limits of ¥1.2 million and ¥2.4 million, respectively. Both products can be held simultaneously. Furthermore, the tax-exempt investment limit is ¥18 million (of which up to ¥12 million can be applied to the Long-Term Investment framework). These investment limits apply on a lifetime basis.

2.4 Characteristics of Japanese Public and Private Pensions

The previous paragraphs provide an overview of the pension structure in Japan. The key features of the Japanese pension system can be summarized as follows.

- The public pension provides basic support for retirement, with private pensions positioned as a supplement to public pensions.

Fig. 4: NISA structure from 2024

	Tsumitate framework	Long-Term Investment framework
Combined use of both systems	Permitted	
Annual limit	¥1.2 million	¥2.4 million
Total tax-exempt investment limit	¥18 million (of which up to ¥12 million can be applied to the Long-Term Investment framework)	
Tax-exempt holding period	Indefinite	Indefinite
Account opening timeframe	Permanent	Permanent

Source: Compiled from FSA data

- However, depending on the outlook for economic growth and other factors, the amount of public pension benefits is expected to decline. In addition, the national pension system, in which self-employed people are enrolled, has fixed premiums and benefits, with a limited income redistribution effect.
- Public and private pensions are taxed on an EET basis, but certain deductions apply depending on the type of benefit.
- The annual contribution limit for private pensions is generally considered to be approximately ¥660,000. However, this varies depending on the pension schemes to which one is enrolled, making the system more complicated.
- The 2023 tax reform makes the NISA system permanent and significantly expands it.

3. The U.S. Pension System

3.1 Public Pensions

The three major sources of retirement income in the U.S. – (often called the “three-legged chair”) – are public pensions (social security), corporate pensions, and independent retirement accounts (IRAs).

Public pension benefits in the U.S. are paid under the Old Age, Survivors, and Disability Insurance (OASDI) program, which is often referred to as “social security.” All employees and self-employed persons with annual income over a certain limit qualify for this program. Funding is on a pay-as-you-go basis, and where revenues from social security taxes exceed outgoings, the surplus is accumulated in the OASDI Trust Fund.

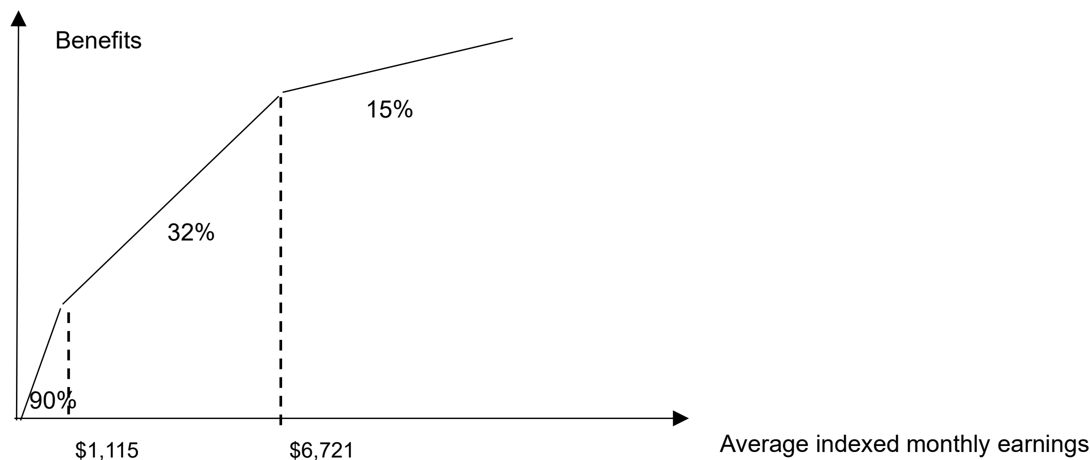
Social security taxes, which fund pensions, are collected by the Internal Revenue Service (IRS) and benefits are paid by the Social Security Administration. The social security tax rate is 12.4% and is capped at $160,200 per annum for 2023 (for employees, this is split 50-50 between employer and employee)[1].

To be eligible for the pension, a worker must have accumulated 40 quarters (10 years) of employment. In principle, the starting age for receiving pension benefits was originally 65, but is being raised to 67 in stages from 2003 to 2027. The amount of pension benefits is determined according to average indexed monthly earnings (AIME).[2]

Specifically, as shown in Fig. 5, the benefit amount is broken down as follows: 90% of the first $1,115 of the AIME; plus 32% of any amount over $1,115 up to $6,721; plus 15% of any amount over $6,721.

1. In addition, there is a 2.9% Medicare tax (for employees, this is split between employer and employee).
2. The total is obtained by taking the 35 highest earning years of indexed annual earnings and dividing by 420 (35 years x 12 months).

Fig. 5: Structure of U.S. public pension benefits



Source: Compiled by authors

The benefit structure is designed to give preferential treatment to those on lower incomes, to ensure that the social security system redistributes income after retirement. According to Social Security Administration (2022), the number of workers (employees and self-employed) enrolled in the OASDI program in 2021 was 179.3 million, the total number of beneficiaries was 65.2 million, and the total amount of benefits paid was $1,133.2 billion. The average monthly retirement pension benefit in December 2021 was $1,658. According to another Social Security Administration document[3], as of June 30, 2022, nearly nine out of 10 individuals over the age of 65 receive benefits, and those benefits represent about 30% of total income to older Americans.

3.2 Corporate Pensions

Corporate pension plans in the U.S. are divided into DB and DC schemes. DC plans are typically 401(k) plans. A 401(k) plan is a personal pension savings account that was launched in 1978, as defined in subsection 401(k) of the Internal Revenue Code. Fig. 6 shows an overview of corporate pensions. Both DB and DC plans work on an "EET" basis: contributions are tax-exempt, investment income and gains are tax-exempt, and benefits are taxed.

401(k) participation is voluntary, with contributions consisting of employee contributions and employer contributions. The 401(k) employee contribution limit is $22,500 per year in 2023, or $66,000 per year when combined with employer contributions. Participants aged 50 and over can make a catch-up contribution of $7,500 annually, so for these older participants, the annual limit, including employer contributions, is $73,500. The value of benefits is determined by the participant's own investment choices. The starting age for receiving benefits is 59½ years old, and there is a minimum withdrawal obligation (Required Minimum Distribution (RMD)) that participants must start making withdrawals by April 1 of the calendar year after turning 72.[4] In principle, withdrawals before the age of 59½ are not permitted,

3 (https://www.ssa.gov/news/press/factsheets/basicfact-alt.pdf)
4 The SECURE 2.0 Act of 2022 sets the age of Required Minimum Distribution at 73 from 2023 and at 75 from 2033.

Fig. 6: Overview of corporate pensions in the U.S. (2023)

	DB	Corporate DC (401(k))
Tax treatment	EET	EET
Contribution method	Employer, in principle	Employer and employee
Starting age for receiving benefits	Generally, at 65	59½
Treatment at time of contribution	- Contribution by employer in principle (tax deductible) - Generally, employees do not contribute (no deduction for contributions) - Benefit payment may not exceed the lower of $265,000 per year or the average of the highest three consecutive years of compensation.	- Employee contribution limit is the lower of $22,500 per year or total annual compensation. - Employer contribution limit is $66,000 per year when combined with employee contributions. - The maximum deduction for employer contributions is 25% of total annual compensation. - Participants aged 50 and over can make catch-up contributions of $7,500 annually.
Carry over unused allowances	Not permitted	
Treatment at the time of payment of benefit		Required Minimum Distribution applies from age 72 or retirement, whichever is later

Note: The SECURE 2.0 Act of 2022 sets the age of Required Minimum Distribution for 401(k) plans at 73 from 2023 and at 75 from 2033.
Source: Compiled from the Joint Committee on Taxation (2021), IRS website

and a penalty tax of 10% is imposed except in certain cases, such as death or disability of the account owner. Some plans also allow participants to take loans from their 401(k).

3.3 IRAs (Individual Retirement Account)

An IRA is a savings account created under the Employee Retirement Income Security Act of 1974 (ERISA) for workers who are unable to participate in a qualified retirement pension scheme provided by their employer. Currently, there are several types of IRAs. The original account that was launched is called the traditional IRA. The other main type is the Roth IRA which was created by the Taxpayer Relief Act of 1997 to help boost workers' savings. IRAs work on an "EET" basis: contributions are tax-exempt, investment income and gains are tax-exempt, and benefits are taxed. Roth IRAs, however, are on the "TEE" basis: contributions are taxed, while investments and benefits are tax-exempt. In addition, one of the important aspects of IRAs is that assets such as corporate pensions can be transferred into them (rollover).

As shown in Fig. 7, the combined contribution limit for IRAs in 2023 is $6,500 per year for traditional IRAs and Roth IRAs, with an additional $1,000 per year in catch-up contributions allowed for participants aged 50 and older. Contribution limits are lower compared to 401(k) plans. However, as stated previously, IRAs are often used to transfer assets from company pension plans when changing jobs or retiring. According to the Investment Company Institute (2022), IRA assets at the end of 2021 were estimated to be $13,913 billion, much higher than the $7,725 billion invested in 401(k) plans. According to the same data, total retirement assets (excluding public pensions) are $39,277 billion, so IRAs and 401(k)s account for 35% and 20%, respectively, of total retirement assets (excluding public pensions). For traditional IRAs, the contribution amount that is deductible from income is reduced if the plan participant is also enrolled in a company pension plan. For example, if a single person in a company pension plan has an income (MAGI: Modified Adjusted Gross Income) of less than $73,000, they can make a full deduction up to the contribution limit; if their income is between $73,000 and $83,000, they can make a partial deduction; if their income is $83,000 or more, no deduction is permitted.

Fig. 7: Overview of Individual Retirement Accounts in the U.S. (2023)

	Traditional IRA	Roth IRA
Tax treatment	EET	TEE
Contribution method	Individual contributions	Individual contributions
Starting age for receiving benefits	59½	Must be at least 59½
Tax treatment at time of contribution	Total contribution limit is $6,500 per year or taxable salary for the year, whichever is lower Participants over age 50 can make a catch-up contribution of $1,000 per year. For IRAs, the maximum amount of tax deduction is reduced or eliminated depending on the level of income if the participant is also a member of a company pension plan. For Roth IRAs, the contribution limit is reduced or eliminated based on income.	
Carry over unused allowances	Not permitted	
Treatment at the time of payment of benefit	Taxed in full Required Minimum Distribution applies from age 72 or retirement, whichever is later.	Tax-exempt (if more than 5 years have passed since the account was opened)

Note: The SECURE 2.0 Act of 2022 sets the age of Required Minimum Distribution for 401(k) plans at 73 from 2023 and at 75 from 2033.

Source: Compiled from the Joint Committee on Taxation (2021), IRS website

Contribution limits for the Roth IRA also decrease according to income. A single person with MAGI of less than $138,000 can contribute up to the maximum amount. The contribution limit is reduced if MAGI is more than $138,000, but less than $153,000. No contributions can be made if MAGI is over $153,000. The age from which withdrawals can be made is 59½. For traditional IRAs there is an RMD condition that withdrawals must begin no later than April 1 after reaching the age of 72[5]. There is a penalty tax of 10% for early withdrawals, except for certain cases such as death, disability, high medical expenses, first home purchase, and higher education expenses (for Roth IRAs this applies to the earnings portion of investments only).

According to Joint Committee on Taxation data[6], in 2019, there were 28,615 individuals with traditional IRA and Roth IRA balances exceeding $5 million, and 24,251 individuals with traditional IRA balances exceeding $5 million. These large IRAs are called mega-IRAs. For traditional IRAs, tax equity is maintained by the RMD and taxation at the time of withdrawal.

3.4 Characteristics of Public and Private Pensions in the U.S.

The previous paragraphs provide an overview of the U.S. pension system. The characteristics of the system can be summarized as follows.

- Public pensions, corporate pensions, and IRAs form a “three-legged chair” and play an important role in asset building for retirement.
- Public pensions are financed by a social insurance tax determined according to income level, and benefits are more generous for those with lower lifetime average earnings. This has the effect of redistributing income in old age.
- Corporate pension (401(k)) contribution limits are high ($22,500 per year for employees, $66,000 per year in combination with employer contributions).
- The Roth IRA is the equivalent of Japan’s NISA, but with lower contribution limits and some restrictions on earnings. Therefore, the asset formation support system is focused primarily on asset building for retirement.

5 The SECURE 2.0 Act of 2022 sets the age of Required Minimum Distribution for 401(k) plans at 73 from 2023 and at 75 from 2033.

6 (https://www.finance.senate.gov/imo/media/doc/7.28.21%20JCT%20Mega%20IRA%20Data1.pdf)

4. The UK Pension System

4.1 Public Pensions

The UK's asset building support system consists of public pensions, private pensions, and ISAs. Regarding public pensions, a new system was introduced in April 2016 to replace the previous system. The old system consisted of a fixed Basic State Pension and an earnings-related Additional State Pension. Opt-out from the Additional State Pension is allowed for members of private pension schemes subject to certain requirements. The new system, on the other hand, is called the New State Pension and is a fixed amount. Both the old system and the new system are pay-as-you-go schemes.

The pension is funded by National Insurance contributions, with the National Insurance contribution rates for FY2022/23 shown in Fig. 8. National Insurance also covers other benefits such as maternity, unemployment and industrial accident payments as well as contributions for public pensions.[7] Ten years of membership is required in order to be eligible for benefits. The starting age for benefits is 66, but will be raised to 68 in future. The full amount of the new State Pension is £185.15 per week.[8]

The new system is characterized by the fact that the contribution rate is based on the remuneration of the employee and the income of the self-employed, whereas the benefits are fixed. With the launch of the new system, the redistribution function of the public pension system is effectively strengthened since the structure of national insurance contributions remains unchanged. The UK public pension is not a universal pension; for those without a pension, a benefit is available in the form of the Pension Credit (funded by tax).

4.2 Private Pensions

Since the new public pension system is a fixed benefit scheme with no compensation-related variable element, the importance of private pensions is increasing. An overview of private pensions in the UK is shown in Fig. 9. These consist of occupational pensions (DB and DC corporate pensions), along with private pensions.

Fig. 8: National Insurance contribution rates in the UK (2022/23)

Class	Applies to	Contribution rate
1	Employees earning more than £123 per week	Employees: 0% on income between £123 and £242 per week; 12% on income between £242 and £967 per week; 2% on income over £967. Employers: 13.8% on income from £175 per week
2	Self-employed with annual profits between £6,725 and £11,909	£3.15 per week
3	Low-income earners who are exempt from Class 1 and Class 2 payments, unemployed and students (voluntary)	£15.85 per week
4	Self-employed with an annual profit of £11,909 or more	In addition to Class 2 contributions, 9.73% on annual profit between £11,909 and £50,270 and 2.73% on annual profit above £50,270.

Source: HMRC website

7 The National Health Service (NHS) is separate to National Insurance. Part of the National Insurance contributions contribute towards the costs of the NHS.

8 The basic state pension under the old system was £141.85 per week.

Fig. 9: Overview of private pensions in the UK (2022/23)

	Corporate DB pension	Corporate DC pension	Private pension
Tax treatment	EET	EET	EET
Participants	Employees Automatic enrollment for those with annual salaries of £10,000 or more.		Every individual
Contribution method	Employer	Employer, employee	Individuals
Starting age for receiving benefits	Between 55 and 75		
Tax on contributions	- Upper limit of income deduction for employees is based on combining all contributions from employers and employees (individuals) - Annual contribution limit: gross annual income or £40,000 per year, whichever is lower - Lifetime cumulative allowance: £1,073,100		
Carry over unused allowances	3-year carryover is permitted		
Tax on benefits	Up to 25% of pension assets can be withdrawn as a tax-exempt lump sum		

Source: Compiled from Pensions Policy Institute (2022), UK government website

The tax treatment is on the EET basis: contributions are tax-exempt, income and gains from investments are tax-exempt, and benefits are taxed. While overall benefits are taxed, up to 25% of pension assets can be withdrawn as a tax-free lump sum. However, early withdrawals are not permitted in principle and a penalty tax of 55% of the amount withdrawn is levied in the event of an early withdrawal.

Pension contributions are subject to an annual allowance of £40,000. The approach is that employer and employee (individual) contributions are pooled with a common limit applied to the combined DB and DC schemes. The calculation method for the annual DB contribution equivalent amount is explained in the Appendix. As shown in Fig. 10, for higher earners (individuals with adjusted incomes above £240,000 in 2022/23), the annual allowance is tapered and drops by £1 for every £2 increase in adjusted income, down to a minimum of £4,000. Therefore, for individuals with adjusted incomes in excess of £312,000, the annual allowance is £4,000.

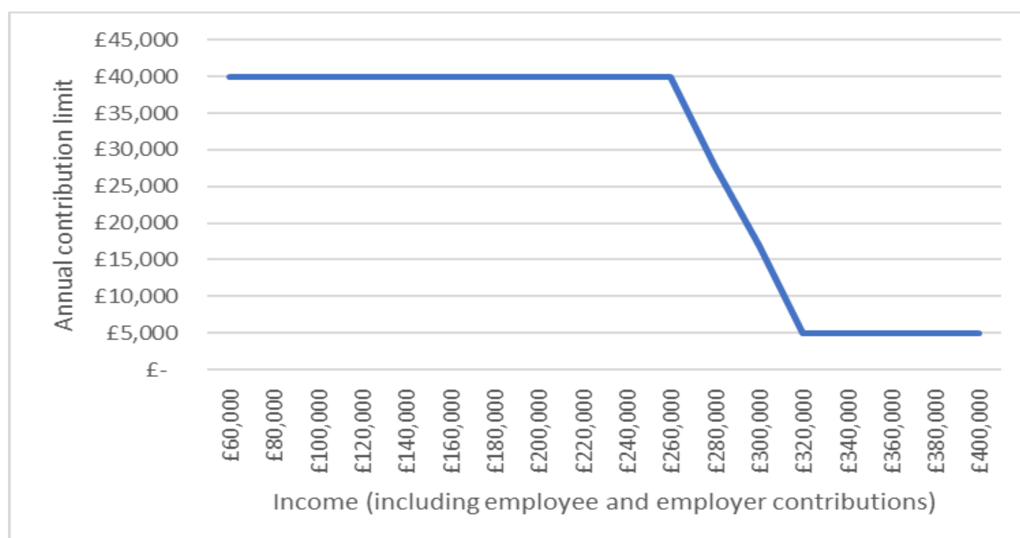
There is also a lifetime aggregate limit on contributions. This is a limit on the total amount that can be built up in pension benefits (i.e., pension that has been contributed and invested) and is set at £1.0731 million for 2022/23.

For DC pensions, the lifetime limit is the total pension fund accumulated, and for DB pensions, the lifetime limit is calculated as 20 times the annual pension amount. If a pension exceeds the lifetime allowance limit, there is an additional tax of 25% if the benefits are received as an annuity or 55% if they are paid as a lump sum.

In October 2012, an automatic enrollment system was introduced for corporate pensions. This obliges employers to automatically enroll employees with an annual salary of at least £10,000 (£8,105 at the time of introduction) into a workplace pension provided by the employer. Alternatively, the employee may choose to opt out of this pension. In addition, since not all employers operate a workplace pension scheme, a new DC pension called NEST (National Employment Savings Trust) has been set up by the UK government alongside the introduction of automatic enrollment.

The UK government announced its new budget for the year on March 15, 2023. The Chancellor of the Exchequer, Mr. Hunt, proposed a significant boost for private pensions, including an increase in the annual contribution allowance for private pensions from £40,000 to £60,000, the abolition of the lifetime allowance and the modification of tapering of annual contribution limits for high earners, on the basis that "No one should be pushed out of the workforce for tax reasons."

Fig. 10: Annual contribution limit for high-income earners



Source: Institute for Fiscal Studies 2021

With regard to tapering of the allowance for higher earners, there is no change to the mechanism whereby the annual allowance drops by £1 for every £2 increase in adjusted income over a certain threshold. However, the actual threshold is increased from adjusted income of over £240,000 to adjusted income of over £260,000 and the minimum allowance is also increased from £4,000 to £10,000. Therefore, the minimum amount now applies to adjusted income over £360,000, up from £312,000 previously.

The government has indicated that this is to remove the reason why high-income earners, such as NHS doctors, might retire early due to tax on their pensions. It should be noted that increasing attention is being paid in the UK to the relationship between taxation and asset building for retirement and different workstyles (HM Treasury, 2023).

4.3 ISAs

Previously in the UK, there were two schemes to support asset building: the Personal Equity Plan (PEP), which covered listed shares and investment trusts, and the Tax-exempt Special Savings Account (TESSA), which covered deposits in banks, building societies and other financial institutions. ISAs were launched to address these institutional imbalances and to promote asset building by consolidating and merging the two systems. They were originally intended as a temporary initiative but are now available on a permanent basis. Currently, there are several types of ISAs, including Cash ISAs, Stocks and Shares ISAs, Innovative Finance ISAs and Lifetime ISAs.[9] The tax treatment for ISAs is TEE, namely contributions are paid from taxed income, while investment growth and withdrawals are tax-exempt.

Fig. 11 provides an overview of the first three of these. In terms of the tax-free investment allowance, the total for 2022/23 is £20,000, including Lifetime ISAs. Fig. 12 provides an overview of Lifetime ISAs.

9 Junior ISAs are also available. These were introduced as an alternative to the Child Trust Fund.

Fig. 11: Overview of ISAs in the UK (2022/23)

	Cash ISA	Stocks and Shares ISA	Innovative Finance ISA
Account holders	16 years and over	18 years and over	18 years and over
Tax-exempt period	Indefinite		
Contribution limit	£20,000 per year across Cash ISA, Stocks and shares ISA, Innovative Finance ISA and Lifetime ISA (incl. £4,000 limit on for Lifetime ISA)		
Investment in	Cash	Equities, bonds, investment trusts, etc.	Peer-to-peer loans, etc.

Source: HMRC website

Fig. 12: Overview of Lifetime ISA (2022/23)

Account holder	Aged between 18-40 years old
Investment period	Up to 50 years
Tax-exempt period	Up to 60 years
Contribution limit	£4,000 per year (with a 25% bonus on contribution (up to a maximum of £1,000 per year) from the government)
Investment in	Cash, equities, bonds, investment trusts, etc.
Tax on withdrawals	Withdrawals are tax-free for purchase of first home or after account holder's 60th birthday. Withdrawals for any other reason, a fee of 25% of the amount withdrawn is payable.

Source: HMRC website

Lifetime ISAs have some similarities to pensions in so far as withdrawals are tax-free after the account holder's 60th birthday or when they purchase their first home.

4.4 Characteristics of Public and Private Pensions in the UK

The previous paragraphs provide an overview of the UK system. The characteristics of the system can be summarized as follows.

- Both public and private pensions are used for asset building for retirement.
- Public pensions are redistributive since they are subject to a fixed rate of contribution for employee remuneration and self-employment income, with fixed benefits paid.
- Private pensions are taxed on an EET basis, but with certain deductions at the time of benefits.
- Private pensions have a high contribution limit (with an annual contribution limit of £40,000 and a lifetime aggregate allowance of £1,073,100). The government has proposed an increase in the annual contribution limit to £60,000 and the abolition of the lifetime aggregate limit in the 2023 budget.
- ISAs provide an additional support for asset building in addition to public pensions and private pensions.
- The availability of Cash ISAs means that ISAs can be used for savings as a whole, not just risk assets.
- The contribution limit for private pensions (£40,000) is set at twice the level of the ISA's tax-free allowance (£20,000). The contribution limit in the recent 2023 budget proposals (£60,000) is three times higher.

5. Implications for the Corporate Pension Plan (iDeCo) in Japan and the NISA

This paper has reviewed the systems for supporting asset building in Japan, the U.S. and the UK.

Fig. 13: Comparison of national pensions (public)

	Japan	U.S.	UK
Pension	Social insurance premiums Category 1 insured person: Fixed amount Category 2 insured person: Fixed rate (Employer/employee split) Category 3 insured person: No contribution	Social security payroll tax Employees: Wages and salaries Self-employed: Business income	National insurance premiums See Fig. 8.
Conditions for receipt of benefits	10 years of contributions	40 quarters of contributions (equivalent to 10 years)	10 years of contributions
Starting age for receiving benefits	65	65 (rising to 67 in future)	66 (rising to 68 in future)
Benefits	National pension: ¥56,000 per month Employees' pension: ¥146,000 per month (including National Pension)	¥216,000 per month ($1,658 per month)	¥118,000 per month (£185.15 per week)
Redistributive function	Low	High	High

(Notes)
1) For Japan, average benefit in 2021; for U.S., average benefit amount in December 2021; for UK, full amount of the new state pension in 2022/23.
2) Exchange rate $1= ¥130 and £1= ¥160.
Source: Compiled by author from various sources.

Fig. 13 summarizes the key points from the comparison of the public pension systems in these countries. To start with the value of benefits, in Japan, the monthly benefit for the National Pension is ¥56,000 (average), and the full amount in 2022 was ¥65,000. In the UK, the state pension is a fixed benefit, and the full amount of the new state pension is equivalent to ¥118,000 per month. In addition, the Employees' Pension in Japan is ¥146,000 per month (average), while in the U.S. the social security benefit is equivalent to ¥216,000 per month (average). Although the pricing environment in each country needs to be taken into account, it is clear that public pension benefits in Japan are comparatively low.

In terms of the redistributive effects, in the U.S., benefits are more generous to low-income earners, which indicates that social security benefits do have an income redistribution effect. Biggs (2020) points out that the U.S. social security system is highly redistributive in terms of the income replacement rate and proposes a flat rate benefit as a reform for public pensions. In this way, there is a debate in the United States that the redistribution function should be further enhanced. In the UK, the introduction of a new national pension has increased income redistribution.

In the case of Japan, the Employees' Pension consists of a fixed benefit and a remuneration-based portion, which is redistributive to a certain extent. However, although there is an exemption for contributions for low-income earners, the basic concept of the national pension is fixed contributions and fixed benefits. Therefore, the redistribution effect of the national pension in Japan appears to be particularly low on a comparative basis.

Fig. 14 compares the tax-free contribution limits of private pensions, along with other asset building support schemes. In the U.S., the contribution limit for 401(k) plans is set at a high level of ¥8.58 million, whereas the Roth IRA, by contrast, has a much lower limit at ¥845,000. IRAs are useful as a vehicle for the rollover of 401(k) contributions, although the contribution limit itself is small. In the UK, the private pension contribution limit is ¥6.4 million (proposed increase to ¥9.6 million in the 2023 budget) and the ISA allowance is ¥3.2 million. Thus, the contribution limit for private pensions is set at a high level, while for ISAs it is half of this level (one-third of the level on the basis of the 2023 budget). Moreover, the ISAs cover all savings, not just stocks. This shows

Fig. 14: Comparison of annual contribution limits for private pensions, tax-free savings accounts, etc.

	Japan	U.S.	UK
Private pension (EET)	¥660,000	¥8,580,000 ($66,000)	Pre- April 2023 ¥6,400,000 (£40,000)
			2023 budget proposal ¥9,600,000 (£60,000)
Tax-free savings accounts, etc. (TEE)	¥3,600,000	¥845,000 ($6,500)	¥3,200,000 (£20,000)

Notes
1) Japan: Contribution limit shown for tax-free savings accounts is for NISAs from 2024 onwards.
2) U.S.: Contribution limit shown for private pensions is for 401(k); for tax-exempt savings, Roth IRAs.
3) UK: Private pensions in the UK have a lifetime allowance of ¥171.7 million (£1.0731 million); the 2023 budget proposes an abolition of the lifetime allowance.
4) Exchange rate $1= ¥130 and £1= ¥160.
Source: Compiled by author from various sources.

that the focus for asset building for retirement in both the U.S. and UK is on private pensions.

Japan, on the other hand, is the opposite of the U.S. and the UK, with a low contribution limit for private pensions (¥660,000) and a high limit for NISAs (¥3.6 million). In terms of private pensions and tax-free savings accounts, the combined contribution limits for Japan and the UK are ¥4.26 million and ¥9.6 million respectively (¥12.8 million in the 2023 budget proposal). In the U.S., 401(k) and Roth IRA limits cannot be aggregated, but the limit for 401(k) plans alone is ¥8.58 million.

This paper has examined the taxation of public and private pensions and savings in Japan, the U.S. and the UK with a focus on asset building for retirement. In terms of public pensions, as Fig. 13 shows, the level of benefits in Japan is low, as is the redistributive effect. As the birthrate declines and the population ages, it is becoming increasingly to sustain public pensions as the basis of income in retirement, and a fundamental rethink of the role of public and private pensions is long overdue.

With regard to private pensions, Fig. 14 shows that the tax-free contribution limit for private pensions in Japan is low while the tax-free investment allowance for NISAs is high.

The first pillar of the Doubling Asset-based Income Plan is to radically expand NISAs and make them permanent, while the second pillar is the reform of the iDeCo system. The 2023 tax reform has resolved to expand the NISA system and to make it a permanent scheme. However, it is a priority for Japan's tax system that there is a review of the contribution limits for private pensions, including iDeCo, in order to strengthen the framework for asset building for retirement. It is important not simply to expand the contribution limits, but also to develop a template for income security in old age, including a target income replacement ratio as the basis for this review.[10]

Appendix: Method of calculating annual DB contributions in the UK

The combined annual contribution limit for private pensions in the UK (DB and DC) is £40,000. For DC pensions, the annual contribution is the sum of the contribution of the individual and of the employer. For DB pensions, it is necessary to calculate the pension input amount or annual contribution equivalent.

10 The design of private pensions in Japan is discussed in Tajika and Yamada (2023).

The calculation method is explained based on Llanwarne (2010) and an HMRC document, "Pension Tax Manual 053320"[11]. The deemed increase in DB benefits over a year is referred to as the DIP (Deemed Increase in Pension) and is defined as follows:

$$DIP = A1 - \{A0 \times (1 + r)\}$$

where A1 is the annual DB benefit at the end of the year, A0 is the annual DB benefit at the end of the year, and r is a coefficient based on the inflation rate.

If inflation is zero and annual income is £80,000, with 32 years of pension membership to retirement and an annual benefit multiplier of 1/60th, then

A1 = £80,000 x (32 x 1/60) = £42,666
A0 = £80,000 x (31 x 1/60) = £41,333

From this, DIP = A1 - A0 = £1,333, which is the pension benefit obtained from a year's contribution to a DB pension.

This amount multiplied by a set valuation factor (Valuation Factor) is called the Pension Input Amount (PIA) and is deemed to be the amount equivalent to an annual contribution to a DB pension.

For example, if the valuation coefficient is 16, then PIA = DIP x 16 = (£42,666 - £41,333) x 16 = £21,333.

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