Pension tax relief explained

When your employer is choosing which pension scheme best fits their employees, they'll need to consider the way that pension tax relief is administered. This is because tax relief can affect high and low tax payers in different ways.

How will I benefit from tax relief?

For the majority of workers, when they contribute to their workplace pension they will receive tax relief on those contributions. This means that some of your pay that would have gone to the government as tax, either goes into your pension pot or you don't pay tax on your contribution.

There are two main ways that tax relief is administered, and this will be decided by your employer and pension scheme provider. Employers will choose the method that most benefits the majority of their employees.

A pension scheme can only use one method of tax relief for all of its members within one employer.

The way your pension scheme handles tax relief should be detailed in your pension providers welcome pack.

Let's look at the different ways of administering tax relief.

1. Relief at source

Some pension schemes use 'relief at source'. This is where your pension contributions are deducted from your net pay. The contribution you make will be paid by your employer, directly to your pension provider. Then, for every £4 you contribute, your pension provider will add £1 on top.

Under this system, if you are a higher or additional rate taxpayer, you are entitled to extra tax relief. You will need to claim this via your self-assessment tax return, or by contacting HMRC. You will then benefit through a reduction in your tax liability or change to your tax code.

2. Net Pay Arrangement

Some workplace pension schemes operate a 'net pay' arrangement. Here, pension contributions are calculated and deducted from your gross income. In this scenario, you will only pay tax on your earnings after pension contributions have been deducted. You will automatically receive tax relief at the highest rate of tax applicable to you.

Note: If you are not earning enough to pay income tax, you won't be able to claim tax relief. If you are a higher or additional rate tax payer, you will no longer need to fill out an self-assessment form.

Office: 0117 9323444 Enquiries: enquiries@payrollsolutionsltd.co.uk Web: www.payrollsolutionsltd.co.uk

Cox & Co. Payroll Solutions Ltd | Unit 10 Londonderry Farm, Willsbridge, Bristol, BS30 6EL

3. Salary sacrifice/ salary exchange

In a salary sacrifice arrangement, you agree, with your employer, to ‘give up’ (or ‘sacrifice’) a certain amount of your salary in exchange for payments into your pension. You and your employer will agree how much you wish to ‘sacrifice’, and your gross pay is reduced by this amount. You will then pay less tax and national insurance on your reduced earnings, which in turn increases your take-home pay.