Pension contributions – an overview

Pensions are a uniquely tax-advantaged savings and investment vehicle. As an incentive to save, the government adds tax relief on money paid into a pension at the client's marginal rate of tax. Although there is no limit on the level of contributions members can pay into pensions, there are limits on how much tax relief a person can claim.

Who can contribute to a pension?

Any member of a registered pension scheme can make unlimited contributions. However, to qualify for tax relief a contribution to a registered pension scheme must be 'a relievable pension contribution' made by a relevant UK individual.

- Members – tax relief on member contributions will be available up to the greater of 100% of their relevant UK earnings or £3,600. By paying a contribution of £2,880 (to a pension scheme operating a relief at source tax relief basis – see below) a member can receive tax relief bringing the total amount to £3,600.
- Employers may make contributions in respect of a member. Tax relief is given by allowing contributions to be deducted as a business expense, so reducing the amount of an employer's taxable profit.
- Other parties can also make pension contributions in respect of a member. These parties can be an individual, a corporate body or other legal entity. For example, a grandparent could pay into a child's pension account. These contributions will be regarded as if they have been made by the scheme member (who would receive any tax relief due on the contribution), not the person who made the contributions.

Tax relief is only available for members who are under 75 years old.

Relievable pension contributions

A relievable pension contribution is one which qualifies for tax relief. Usually all contributions are 'relievable'. The exceptions are:

- if the member was aged 75 or over when the contribution was made;
- the contribution is paid by the member's employer;
- the payment was an age-related rebate or a minimum contribution paid by HMRC to a contracted-out pension scheme; or
- it is a life assurance premium.

Relevant UK earnings are to be treated as not being chargeable to income tax if, because of a double taxation agreement, they are not taxable in the UK.

Tax relief

Contributions that are paid to a registered pension scheme may receive tax relief, but tax relief is not automatic and can only be claimed for the tax year in which the contribution is paid.

A member who wishes to contribute £100 would pay £80 to a pension scheme operating relief at source and receive basic rate tax relief of £20. The scheme administrator will then claim the £20 from HMRC and will credit the member with a contribution of £100.

There are two methods of tax relief

Relief at source – used primarily by contract-based schemes (such as Sipps and GPPS). Contributions are paid from earnings which have already been subject to tax. The pension scheme provider then reclaims basic rate tax relief from HMRC on the member's behalf. Higher and additional rate tax payers have to claim further tax relief via their self-assessment tax returns.

Net pay method – used primarily by trust-based occupational pension schemes. The employer deducts the gross member contribution from the employee's earnings before it deducts income tax and passes the contribution to the pension scheme. Neither the member nor the scheme administrator needs to take any action. The member receives tax relief at their marginal rate of income tax.

Relief at source and devolved taxes

The Scottish government introduced in April 2018 two new rates of income tax for Scottish residents – starter and intermediate rates. For relief at source pension schemes, tax relief of 20% will continue to be reclaimed from HMRC. Anyone who pays a higher rate of tax – including intermediate rate taxpayers who pay 21% – will have to claim further tax relief either by contacting HMRC direct or via their self-assessment tax returns.

The Welsh government now has the freedom to vary rates of income tax but has chosen to keep them the same as England and Northern Ireland.

Scottish and Welsh residents can be identified as they have a 'S' or a 'C' before their tax code. They will keep their devolved status for an entire tax year even if they move to another part of the UK midway through the tax year.

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Pension contributions – an overview

Earnings that attract tax relief

For most people the amount of tax relief they can receive on their pension contributions is limited to 100% of their relevant UK earnings that are chargeable to income tax for the tax year.

Examples of UK relevant earnings are:

- employment income - such as pay, bonus, overtime, or commission - including:
  - the part of a redundancy payment above the £30,000 tax exempt threshold
  - benefits in kind which are taxable
  - profit related pay, including the part which is not taxable
  - statutory sick pay (SSP) and statutory maternity pay (SMP) if paid by the employer and taxable
  - permanent health insurance (PHI) payments paid by the employer whilst the member is still in employment
  - pay paid by way of government securities
  - pay in the form of units in an authorised unit trust if taxed on the person receiving it
  - amounts taken off pay to buy partnership shares in a share incentive plan
- income from a trade, profession or vocation;
- income from a UK and/or EEA furnished holiday lettings business; and
- patent income.

A pension is not classed as earnings and cannot be included in the definition of relevant UK earnings.

Non-UK individuals

An individual who ceases to be UK tax resident can make tax relievable contributions of up to 100% of their relevant UK earnings (or £3,600 if higher) in the tax year they become non-resident and then £3,600 for a further five tax years. Tax relief is available, provided they were a member of a registered pension scheme operating relief at source before becoming non-UK resident.

The annual allowance

There is no limit on the amount an individual can save in a pension scheme, but there is a limit on the amount they can benefit from tax relief each year.

The annual allowance is the maximum amount of pension saving an individual can make each year that benefits from tax relief. This includes the member's own pension contributions plus any made by someone else on behalf of the member – for example, their employer.

If a member's pension saving is more than the annual allowance they will pay a tax charge on the amount over the annual allowance. This tax charge is called the annual allowance charge, and can be paid via the individual's self-assessment or by asking the pension scheme to pay the charge.

The annual allowance for 2018/19 and for 2019/20 is £40,000.

However, there are circumstances where an individual may have a lower annual allowance than £40,000 – if they have triggered the money purchase annual allowance (mpaa) or if they are a higher earner and their annual allowance is tapered.

Tax year	Annual allowance	MPAA	Tapered AA*
2010/11	£255,000		
2011/12	£50,000		
2012/13	£50,000		
2013/14	£50,000		
2014/15	£40,000		
2015/16	£40,000	£10,000	
2016/17	£40,000	£10,000	£40,000 - £10,000
2017/18	£40,000	£4,000	£40,000 – £10,000
2018/19	£40,000	£4,000	£40,000 – £10,000

The amount of tapered annual allowance depends on the member's earnings, the minimum tapered annual allowance is £10,000 (for individuals who earn £210,000 or more).

How does the money purchase annual allowance (MPAA) affect contributions?

If a client take a retirement income – for example, withdraws a flexi-access drawdown income – then they trigger the MPAA, and the amount they can pay and receive tax relief on drops. When it was introduced (in April 2015) the MPAA was £10,000. But in April 2017, it fell to £4,000.

The factsheet 'The Money Purchase Annual Allowance' gives more information about when the MPAA is triggered and how clients have to report it.

The full £40,000 annual allowance still applies to any defined benefit scheme, but reduces for each pound of MPAA used. The factsheet 'Defined benefits pension savings and the money purchase annual allowance' explains more.

Pension contributions – an overview

The tapered annual allowance

Individuals with earnings of over £150,000 will have their annual allowance gradually reduced (or tapered) on a sliding scale to a minimum of £10,000. The rules are complicated. The factsheet 'Tapered Annual Allowance' explains more.

Carry forward

If the full annual allowance is not used in a tax year, then it is possible to carry forward any unused amount to a subsequent tax year. This allows the individual to pay in a higher contribution and still receive tax relief on the full amount.

The factsheet 'Carry forward of unused annual allowance' gives more information.

Pension input periods (Pips)

A pension input period (Pip) is the period over which the amount of pension saving (pension input amount) under an arrangement is measured against the annual (or other) allowances. Originally, it was the period of 12 months (and one day!) from the date of the first post April 2006 contribution, and the level of annual allowance used was the amount for the tax year in which the Pip ended.

From April 2016, all Pips were aligned to the tax year. Moving to this new approach meant introducing a set of complicated rules for the tax year 2015/16. The factsheet 'Pension input periods in 2015' gives more information.

Refund of contributions

Generally, pension contributions cannot be refunded. Instead, there are certain circumstances where a refund may be allowed where:

- an individual has paid a contribution which is more than their relevant earnings then the excess amount can be refunded;
- a genuine error has been made – for example if the client instructed their bank to cancel a direct debit and the instruction was not carried out in time. In this circumstance the pension scheme is not entitled to the contribution; or
- an individual opts out of automatic enrolment within the 30-day deadline.

If an individual pays more than their annual allowance then they cannot have a refund of the excess – instead they would have to try to reabsorb it through using carry forward of unused annual allowance (although carry forward cannot be used if the MPAA has been triggered) or pay an annual allowance tax charge.

If you only read one thing…

- Any member of a registered pension scheme can make unlimited contributions. However, to qualify for tax relief a contribution to a registered pension scheme must be 'a relievable pension contribution' made by a relevant UK individual.
- There are two methods of tax relief. Under relief at source, contributions are paid from earnings that have already been subject to tax. The pension scheme provider then reclaims basic rate tax relief. Under the net pay method, the contribution is deducted from the member's earnings before it deducts income tax.
- For most people, the amount of tax relief they can have on their pension contributions is limited to 100% of their relevant UK earnings that are chargeable to income tax for the tax year.
- Examples of UK relevant earnings include employment income (such as pay, bonus, overtime and commission), income from a trade or profession, and patent income. A pension is not classed as earnings and cannot be included in the definition of relevant UK earnings.
- There is no limit on the amount an individual can save in a pension scheme, but there is a limit on the amount they can benefit from tax relief each year – the annual allowance (which is currently £40,000). There is also a MPAA and a tapered annual allowance.
- Generally, pension contributions cannot be refunded. However, a refund may be paid if the individual has paid in more than their relevant earnings, a genuine error was made or they have opted out of automatic enrolment within the allowable timescales.

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