R04 2020/2021
Accumulation Phase
Part 1: Eligibility and tax relief

The milestones for this section are to:

- Understand who is eligible to contribute to a pension and get tax relief.
- Understand how tax relief on members' contributions is given.

Eligibility

Individuals taking out a pension will qualify for tax relief on pension contributions if:

- They under 75 when the contribution is made. There is no minimum age.
- And are UK resident for tax purposes.

The precise wording used by HMRC is that you must be **a relevant UK individual**. This is defined as an individual who:

- has relevant United Kingdom (UK) earnings chargeable to income tax in the tax year.
- OR the individual is resident in the UK at some time during that year.

This means that anyone who is under 75 and is UK tax resident can get tax relief on pension contributions.

If an individual isn't UK tax resident in the current year, they will be eligible for tax relief

- If hey were resident in the UK at some time during the five tax years immediately before that year **and** whilst resident was a member of a pension scheme
- OR the individual, or the individual's spouse, has for the tax year general earnings from overseas Crown employment subject to UK tax.

Emil was contributing to a pension in 2014/15. He then went to work in Canada. As he was resident in the UK in 14/15 and paying into a pension, he can continue to make tax relievable contributions until April 5 2020

Getting tax relief

Tax relief on individual contributions is given in one of two ways.

- For a **Personal Pension**, all contributions are paid **net of basic rate** (20%) tax. Any additional tax relief (20% or 25%) is delivered through self-assessment. This is termed **Relief at Source (RAS)**

- For **Occupational Schemes** tax relief is given by deducting the **gross** contribution from **gross** pay. The member is then taxed on the resulting amount. For example, someone paying 5% on a £2,000 monthly salary will have £100 deducted as a contribution and only be taxed on £1,900 rather than £2,000. Confusingly this is called the **net pay system**.

William and Harry both have an annual income of £30,000 and both contribute 5% of total pay into a pension. Williams is an occupational scheme, Harry pays into a PP.

	William	Harry
Pay	£30,000	£30,000
Less OPS contribution	£1,500	
Taxable Pay	£28,500	£30,000
Less PA	12,500	12,500
	16,000	17,500
Tax all at 20%	3,200	3,500
Net Pay after tax	£25,300	£26,500
Payment to PP		1,200
Pay after tax and pension	£25,300	£25,300

Harry will pay £1,200 as a net payment since the provider will reclaim £300 from HMRC.

If they were higher rate tax payers, William's contributions would reduce his taxable pay and therefore reduce the amount that was in the higher rate band. Relief at 40% will be given at source.

Harry's **gross** contribution would increase the higher rate threshold by the gross contribution and reduce the amount of his income that was taxed at 40%. He would have to claim this additional relief.

Bill is a higher rate tax payer and makes a £10,000 gross contribution to a PP. He pays £8,000 net to receive £2,000 relief at source.

He claims the remaining relief through self-assessment and HMRC increase his Higher Rate Threshold from £37,500 to £47,500. This means he won't pay higher rate tax until his gross income exceeds £60,000

Members' contributions do not reduce their liability to pay National Insurance Contributions even if the net pay system is used. William will still have to pay NIC on £30,000 even though he is only taxed on £28,500

The net pay system is disadvantageous for a non-tax payer.

Gwen works part time and earns £12,000 a year. She has been auto enrolled into a scheme that uses the net pay system paying 4% of her gross pay (£40pm £480 a year)

As her gross pay is below the PA of £12,500, she wasn't paying tax so reducing this to £11,520 effectively means she gets no tax relief on her contributions.

If the scheme operated the Relief at Source system, she would contribute £32 a month (£384 a year) so would get tax relief om her contributions.

If a third party contribution is made to a Personal Pension, as in the case of a parent paying into a child's pension only basic rate relief at source will be given even if the donor is a higher rate tax payer.

In addition to these direct tax benefits a pension contribution can be used to reduce an individual's **Adjusted Net Income (ANI)**. This is the total of non-savings income, savings income, dividend income and chargeable gains under life policies. If this is over £100,000, the Personal Allowance of £12,500 is reduced and is totally lost when ANI is £125,000. Income between these figures is effectively taxed at 60%.

Helen has an income of £100,000 and receives a bonus of £10,000. She will lose £4,000 in tax and £5,000 of her personal allowance. This means she has to pay another £2,000 in tax so only keeps £4,000 of her bonus.

If she pays a gross contribution of £10,000 into her pension, she would get all her personal allowance back. Effectively she has made a £10,000 contribution at a net cost of £6,000.

A gross contribution will also reduce income when calculating the Child Benefit tax charge. This is payable if one parent's income is over £50,000.

Sonia's total income is £53,000 she will be subject to a tax charge of 30% of the Child Benefit she receives. A pension contribution of £3,000 would eliminate the charge.

That concludes this part so you should now know:

- Who is eligible to take out a pension
- How tax relief is given on members' contributions and the difference between relief at source and the net pay system
- How pension contributions give other tax benefits