Spotlight on:

Contributions & tax relief

In this Spotlight, we explain how employee pension contributions may receive tax relief.

Inside you will find information on;

- how the tax relief works for each method
- some example calculations
- information on how it may affect you, and,
- a look to the future.

The 2 methods explained:

- Net pay: this requires gross contributions.
- Relief at source: this requires net contributions.
- Welplan Pensions operates the net pay method.

Updated for 2017/18 tax year
Net pay method – gross contributions

Your employer takes your contribution from your pay before it’s taxed. You only pay tax on what’s left. This means you get full tax relief, no matter if you pay basic, higher or additional rate income tax.

The amount you’ll see on your payslip is your contribution plus the tax relief.

You won’t get tax relief if you don’t pay tax, eg because you earn less than your minimum tax threshold.

- The employer deducts the gross member contribution from the employee’s earnings before it deducts income tax via PAYE. The pension contribution doesn’t reduce the amount of earnings subject to NICs.
- So an employee who needs to pay a 1% contribution will see a 1% gross contribution deducted from their before tax earnings.
- As the contribution reduces the amount of taxable earnings, the employee normally receives their full amount of tax relief via PAYE, whether they pay basic, higher or additional rate income tax.

Relief at source method – net contributions

Your employer takes your pension contribution after taking tax and National Insurance Contributions (NICs) from your pay. However much you earn, your pension provider then adds tax relief to your pension pot at the basic rate.

With ‘relief at source’, the amount you see on your payslip is only your contributions, not the tax relief.

You may be able to claim money back if you pay higher or additional rate Income Tax.

- The employer first deducts income tax under PAYE from the employee’s earnings and then deducts the net member contribution from the employee’s post PAYE earnings.
- The pension contribution doesn’t reduce the amount of earnings subject to NICs.
- The employee receives basic rate (20%) tax relief at source when they pay their net contribution.
- So an employee who’s required to pay a 1% contribution will see a 0.8% net contribution deducted from their after tax earnings.
- The pension scheme provider reclaims basic rate tax relief from HMRC on the member’s behalf.
- Higher and additional rate taxpayers have to claim further tax relief via their self assessment tax returns. The extra relief is given by extending their basic rate income tax band by the total of their gross contributions.
Which method is best for me?

If you do not pay tax, then a scheme which operates Relief at Source is most beneficial in terms of the amount of contributions paid to the scheme. This is because, under current arrangements, the government will pay tax relief to the pension scheme, regardless of your tax status.

Under Net Pay arrangements, for non-tax payers, there would be no ‘extra’ payment from the Government.

For Basic Rate tax payers, there is no significant advantage either way. You will receive your government contribution in full.

For higher tax rate payers ‘net pay’ is a more convenient method of achieving tax relief, as it is dealt with directly via the payroll. Under ‘relief at source’ you have to apply for the extra tax relief.

The future

Welplan Pensions operates on a net pay basis at the moment and has no current plans to alter this. The Trustees are monitoring Government announcements and there is a likelihood that the Chancellor may announce changes to pension taxation during March.

Therefore, it is prudent to await Government direction on future arrangements before considering a change.
Example calculations for a basic rate tax payer:

<table>
<thead>
<tr>
<th>Net pay method</th>
<th>£</th>
<th>Relief at source</th>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic pay</td>
<td>2200</td>
<td>Basic pay</td>
<td>2200</td>
</tr>
<tr>
<td>Gross pension contribution (£2,200 x 1%)</td>
<td>-22</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Personal allowance</td>
<td>-958</td>
<td>Personal allowance</td>
<td>-958</td>
</tr>
<tr>
<td>Subtotal</td>
<td>1220</td>
<td>Subtotal</td>
<td>1242</td>
</tr>
<tr>
<td>Income tax (£1,220 x 20%)</td>
<td>-244</td>
<td>Income tax (£1,242 x 20%)</td>
<td>-248.40</td>
</tr>
<tr>
<td>Subtotal</td>
<td>976.00</td>
<td>Subtotal</td>
<td>993.60</td>
</tr>
<tr>
<td>Net pension contribution (£2,200 x 0.8%)</td>
<td>-17.60</td>
<td></td>
<td></td>
</tr>
<tr>
<td>NICs (£2,200 – £709) x 12%</td>
<td>-178.92</td>
<td>NICs (£2,200 – £709) x 12%</td>
<td>-178.92</td>
</tr>
</tbody>
</table>

Net pay: 797.08

Pension:

<table>
<thead>
<tr>
<th></th>
<th>£</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2% employer contribution</td>
<td>44</td>
<td>2% employer contribution</td>
</tr>
<tr>
<td>1% gross member contribution</td>
<td>22</td>
<td>0.8% member contribution (1% net of 20% tax relief)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>20% tax relief</td>
</tr>
</tbody>
</table>

Total contributions: 66

(2017/18 personal tax allowance £958, NIC threshold £672)
Further information

To receive free, impartial guidance from the government, go to www.pensionwise.gov.uk

Pension Wise is a government service that will offer you a range of information on pension schemes.

If you wish to discuss any of this information, please contact Welplan Pensions by email or via the pensions helpline:

Email: pensions@welplan.co.uk
Pensions helpline: 0800 195 8080
Website: www.welplan.co.uk

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