2.3.1 Eligibility for relief on personal contributions

The annual limit for relief is an allowance that applies to personal contributions. Contributions are measured over tax years.

To qualify for this allowance, the member must be a relevant UK individual and an active member. Contributions may be made by someone (other than an employer) on behalf of the member, but it is the member who must be the relevant UK individual and who will attract tax relief.

Law: FA 2004, s. 188

Guidance: PTM 044100

Relevant UK individual

A relevant UK individual is an individual who is under the age of 75 and:

- has chargeable relevant UK earnings in the tax year;
- is UK tax resident at some time in the tax year;
- has been UK tax resident at some time in the previous five tax years and when he or she joined the scheme (which need not have been in the previous five years);
- has for that tax year general earnings from overseas Crown employment subject to UK tax (as defined by ITEPA 2003, s. 28); or
- is the spouse or civil partner of an individual who has general earnings from overseas Crown employment subject to UK tax during the tax year (as defined by ITEPA 2003, s. 28).

There is no tax relief on personal contributions or third party contributions paid by, or in respect of, an individual who has reached age 75.

There is no age restriction for an employer pension contribution, which can be paid on behalf of an employee of any age. However, few pension schemes and providers will accept contributions after age 75 so there are some practical limitations.

In its consultation document "Strengthening the incentive to save: a consultation on pensions tax relief" (8 July 2015), the Treasury started a debate on how tax relief should be allowed on pension schemes. At present, the model is based on "exempt, exempt, taxed" and this describes chronologically the incidence of tax and allowances. The consultation suggested a number of alternatives for the future including allowing no relief on input, but relief on benefits ("tax, exempt, exempt" – resembling an individual savings account) which would be supplemented by the Treasury on crystallisation.

In 2016, the Chancellor did not pursue the option, but instead announced the introduction of a "lifetime ISA" from 6 April 2017. This has been described in **Chapter 1**. The lifetime ISA may provide a cash benefit in later life or the deposit for a first-time house buyer. It may be taken out between the ages of 18 and 40.

The contribution (up to £4,000 a year and part of the general ISA limit of £20,000 in 2022-23) is supplemented by a 25% bonus for contributions paid before the age of 50. This resembles reinvested basic rate tax.

The cash benefit may be withdrawn at any time, but if it is taken before the age of 60 the bonus (and growth on the bonus) will be clawed back and there will be a 5% charge.

The benefit will be tax-free although on death, assets held in the ISA will fall into the investor's estate for IHT purposes.

The 2015 consultation made no mention of withdrawing tax relief although many have speculated that higher rate relief is at risk.

In July 2018, the Treasury Committee recommended that "the Government should give serious consideration to replacing the lifetime allowance with a lower annual allowance, introducing a flat rate of relief, and promoting understanding of tax relief as a bonus or additional contribution". In response, the government said that "no consensus" for reform had emerged since it consulted on the issue in 2015.

In April 2022, the House of Commons released a research briefing entitled "Reform of pension tax relief" which outlines a number of potential areas for reform, including:

- a single rate of pensions tax relief;
- taxing pension contributions; and
- limiting tax-free lump sums.

In 2019-20, an estimated £41.3 billion in tax relief was provided on pension contributions and £19.2 billion was collected on private pensions in payment. Using a net cost figure of tax relief of £22.1 billion may misrepresent the actual cost to the government because of the gap in time between tax relief on contributions and tax collected on pensions in payment. If reform is made to pension tax relief, savings would likely be directed to alternative tax-efficient vehicles (such as ISAs, VCTs, EISs) or spent, so there is no guarantee that the government would achieve the savings it might predict.

As pension tax relief costs continue to rise, reform of the rules remains on the agenda.

Law: FA 2004, s. 189
Guidance: PTM 044100

Relevant UK earnings

Relevant UK earnings are defined as:

- employment income such as salary, wages, bonus, overtime, and commission providing it is chargeable to tax under ITEPA 2003, s. 7(2). Furlough pay, introduced under Covid-19 measures, is also treated as earnings for pension contributions;
- benefits in kind that are taxable;
- any part of a redundancy payment that exceeds the £30,000 tax-exempt threshold under ITEPA 2003, s. 403(1);
- taxable payments in lieu of notice;
- permanent health insurance payments paid by the employer whilst the individual is still in employment;
- pay in the form of government securities;
- statutory sick pay and statutory maternity pay provided it is paid by the employer and chargeable to tax under ITEPA 2003, s. 7(2);
- income chargeable under ITTOIA 2005, Pt. 2, that is income derived from the carrying on or exercise of a trade, profession or vocation (whether individually or as a partner acting personally in a partnership). The self-employed income support scheme (SEISS), introduced under Covid-19 measures, is included in turnover calculations when assessing income for pension contributions;
- income chargeable under ITTOIA 2005, Pt. 3 that is immediately derived from the carrying on of a UK or EEA furnished holiday lettings business (whether individually or as a partner acting personally in a partnership);

- income arising from patent rights and treated as earned income under ITA 2007, Sch. 1, para. 473(3);
- royalties charged to tax under ITTOIA 2005, s. 579 (intellectual property);
- general earnings from an overseas Crown employment which are subject to tax in accordance with ITEPA 2003, s. 28; and
- amounts deducted from salary to purchase partnership shares in a share incentive plan provided they qualify under FA 2000, Sch. 8, para. 83.

Law: FA 2004, s. 189

Guidance: PTM 044100

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

Where relevant UK earnings are not taxable in the UK due to TIOPA 2010, s. 2(1) (double taxation agreements), those earnings are not regarded as chargeable to income tax and so will not count towards the annual limit for relief. There are special considerations to be made for overseas income and income derived from investment companies.

Relievable contributions include contributions paid by the member or on behalf of the member by some person other than an employer where they:

- are paid before age 75; and
- do not represent life assurance premium contributions.

They will *not* include:

- contributions paid when or after the member reaches the age of 75. There is no minimum age;
- payments of age-related rebates or minimum contributions by HMRC to a contracted-out scheme;
- life assurance premium contributions;
- contributions paid by employers;
- transfers of rights to the scheme; or
- pension credits awarded on dissolution of marriage.

Law: FA 2004, s. 188, 195A

Guidance: PTM 044100

2.3.2 Amount of the annual limit

The annual limit for relief restricts tax relief on personal contributions to the greater of:

- 100% of relevant UK earnings; and
- The "basic amount" – currently £3,600 (before tax relief).

There is no facility under the tax legislation to carry forward unused annual limits or to carry back contributions to an earlier tax year.

If the member's chargeable relevant UK earnings are less than £3,600, relief will only be available on a contribution of £3,600 if it is paid on a "relief at source" basis. Relief at source will be examined shortly, but in summary allows the member to pay a contribution which is supplemented by basic rate relief claimed from HMRC and applied to the member's pension.

The facility to contract out of the state second pension on a money purchase basis was abolished on 6 April 2012. Until that date, minimum contributions recovered from the employee by the employer as part of the contracting-out process were not measured against the annual limit.

Law: FA 2004, s. 190
Guidance: PTM 044100

2.3.3 Effect of personal contributions on allowances

If a member is entitled to an age related personal tax allowance their total income for the purposes of section ITA 2007, s. 36 and 37 (level of income where age related personal allowance may be reduced) is reduced by the amount of the grossed up contribution paid to a scheme operating tax relief at source (RAS: see **2.3.7**). In other words, the age allowance will not be jeopardised by income allocated to a pension contribution in these circumstances.

Similarly, where a personal contribution is paid by an individual who has adjusted net income of between £100,000 and £125,140 (2022-23), the grossed up contribution may be deducted from the net adjusted income for the purposes of "reinstating" the personal allowance (at a rate of £1 for every £2 of contribution). This will usually mean that relief is being claimed at an effective rate of 60%.

Example – contribution of £10,000

	£
Net adjusted income before contribution is paid	110,000
"Reinstated" personal allowance	5,000
Reduction in tax (at 40%) from reinstated personal allowance	2,000
Marginal rate relief on contribution	4,000
Total tax relief	6,000 (60%)

2.3.4 Tax relief at source (RAS)

There are three different ways in which personal contributions can be allowed tax relief. The appropriate means is determined by the scheme or plan provider.

Under this method, personal contributions are paid to the scheme or plan after deduction of basic rate tax. The basic rate tax is then claimed from HMRC by the provider and used to supplement the "net" contribution. If the member is a higher or additional rate taxpayer, he or she will make a claim for higher or additional rate relief from the local inspector, usually through the self-assessment process or adjusting the individual's PAYE code.

The provider may invest the "gross" contribution value immediately the net contribution is received and in anticipation of receiving the basic rate relief from HMRC, but this is not a legal necessity (and is unlikely to be the case in respect of providers with more limited resources).

Example

Sophia has relevant UK earnings of £20,000 and no other taxable income. She has savings and wants to use them to pay £20,000 into her pension. For a relief at source scheme, she would pay a net contribution of £16,000 and the scheme would claim a full £4,000 basic rate relief and add this to the fund to give a gross amount of £20,000.

Higher rate relief is given by expanding the basic rate tax band by the amount of the gross contribution. The effect is to reduce the higher (or additional) rate band by a corresponding amount, or less where the amount straddles the bands.

RAS must be used when a member wishes to pay a contribution of £3,600 (or less) because earnings are lower than that figure or there are no earnings at all.

Law: FA 2004, s. 192

Guidance: PTM 044230

2.3.5 Net pay arrangement

This method has a longer history than RAS and was originally confined to occupational schemes. Under this process, the employer deducts the gross contribution from the employee's pay before tax is applied, but after the National Insurance contribution has been determined. So, the contribution attracts no relief from National Insurance, but it does reduce the income tax liability for the member. This is not the same as salary sacrifice, where pay is actually reduced in advance of entitlement.

The employer then passes the personal contribution to the pension arrangement.

The employer may offer RAS or the net pay arrangement, but not both in respect of the same scheme. Most occupational schemes offer the net pay arrangement for reasons of history (they offered it before RAS was introduced in 1987).

There are no significant advantages and disadvantages of the two methods. However:

- only RAS can provide tax relief for the non-taxpayer (an unusual set of circumstances); but
- higher and additional rate relief is available more quickly under the net pay arrangement.

Example

In the example at **2.3.4** above, if Sophia makes a contribution into a scheme operating on a net pay basis, it would be seen as a deduction from her earnings, reducing them to zero and stopping any tax liability. She would only pay tax on earnings between the personal allowance and £20,000. This will limit the amount of tax relief she receives and the amount of tax she actually pays. In 2022-23 the personal allowance is £12,570 and her relief is limited to £1,486, which is the tax she would have paid if the contribution had not been made.

Law: FA 2004, s. 193

Guidance: PTM 044230

In October 2021, the government announced that it will “resolve the anomaly by introducing a system to make top-up payments directly to low-earning individuals saving in pension schemes using a net pay arrangement from 2024-25 onwards”. Under the proposed system, the first top-up payments will be made in 2026-27 and will be based on contributions made in 2024-25.