FOCUS

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PENSION SAVINGS & TAX RELIEF – ARE YOUR EMPLOYEES GETTING THEIRS?

- Millions of workers potentially missing out on free money
- Net pay pension schemes costing workers up to £720 every tax year
- Tax relief anomaly affects the lowest paid workers
- Pension schemes using net pay tax relief or operating under a salary sacrifice scheme are affected
- Do you know how your automatic enrolment pension scheme operates?
- Are your workers losing out?
- Have you selected the right pension scheme for them?
- How will you answer their concerns (or compensate them) if they are losing out?

Do you operate a defined contribution pension scheme - if so, you could be affected by this

Pensions automatic enrolment is largely seen as a great success with over 1.5m employers going through the process and around 10m workers starting to save for their future for the first time.

But, all is not rosy in the automatic enrolment garden.

Most people are aware that saving into a pension scheme can be done free of tax. However, few are aware that the government currently gives 'free money tax relief' to some lower earners when they save for a pension but not others.

Are your employees getting their free money?

What tax relief is given?

Contributions to pension saving attract tax-relief - this is a great incentive to save.

When a worker pays a pension contribution through their employer's payroll (such as under auto-enrolment) the tax relief will be given in one of two ways (these are named rather confusingly):

- The 'net pay' basis; the full amount of the pension contribution is taken from a worker's gross pay before the assessment for and deduction of tax. The amount of pay which is then used to calculate any tax due is lower, meaning that tax relief is granted at the worker's highest rate.
- The 'relief at source' basis; the contributions are taken from pay after tax has been deducted. To allow for this, just the 'net' amount of the contribution is deducted (the contribution *minus* basic rate tax). The government (HMRC) then pays the basic rate tax amount to the pension scheme and it is added back onto the pension contribution. This is the tax relief – note however that this only covers basic rate tax; workers must claim any higher or additional rate tax relief separately through their tax return or coding.

This seems straightforward, so what's the issue?

Net pay tax relief can lead to a loss of tax relief for low earners.

Yes, you read that correctly. If you have a worker who earns less than the personal allowance (currently £11,850) and you have automatically enrolled them into a pension scheme which uses the 'net pay' tax relief basis, the worker is missing out on free money from the government.

How this happens

Under the net pay basis, the full amount of the contribution is taken from a worker's pay before any tax is deducted. <u>This is the case even if the worker does not pay tax</u>.

Under the relief at source basis, just the net amount of the contribution (the contribution *minus* basic rate tax) is taken from a worker's pay and the basic rate tax amount is added back onto the contribution by the government. <u>This happens ***whether or not*** the worker pays tax</u>.

This means that every 'relief at source' worker receives 20% tax relief on their contribution (up to a total contribution of £2,880 per year), <u>even if they have not paid any tax</u> – effectively free money.

Why has this become a problem now?

Automatic enrolment has brought 10m workers into pension saving over the past six years. The threshold earnings for enrolment were set at £10,000 in 2012 and have not increased. However, the personal allowance (before tax is paid) has risen from £8,105 to its current level of £11,850. This means that increasing numbers of workers who do not pay tax are being enrolled into pension schemes. If the pension scheme operates on a 'net pay' basis, these workers are potentially missing out on 'free money' tax relief.

Most trust-based pension schemes (including the majority of the automatic enrolment master-trusts) operate on a 'net pay' basis. Does your pension scheme? This issue also affects contributions paid under a salary sacrifice / exchange basis, regardless of the type of tax relief or pension scheme.

What actions should you be taking?

If you have workers earning around or below the personal allowance you should:

- check the tax relief basis that is used by your pension scheme
- check whether any of your workers are affected by the tax relief issue
- consider whether your pension scheme remains appropriate.

Need help? We can support you with this, as well as reviewing and providing ongoing monitoring and governance of your workplace pension scheme – contact us for more information and to learn more about our fixed fee, cost-effective solutions.

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