

Why do pension contributions attract tax relief?

The government is aware that the State Pension alone is likely to be insufficient for most people to live on in their retirement. As a result, they encourage individuals to make provision for supplementing their retirement income. They do this by allowing individuals to claim tax relief on contributions they pay in—thereby ‘topping up’ the pension pot.

KEY ISSUES

Pension plans are a very tax-efficient means of saving, allowing most individuals to top up their contributions by up to 45% (for the highest earners).

Tax relief is strictly limited to ensure that the wealthiest people don't benefit disproportionately.

You'll usually pay tax if your contributions exceed £40,000 in any tax year or if the total value of your pension pots exceeds £1,073,100.

You should keep a close eye on your contributions and the value of your pension pots if you feel you may be close to these figures.

Expert advice can help you to make the most of tax allowances and avoid unexpected tax charges.

Who is entitled to tax relief?

Your private pension contributions are tax-free up to certain limits. This applies to most pension schemes such as workplace pensions, personal and stakeholder pensions and overseas pension schemes that qualify for UK tax relief (ask your pension provider if it's a 'recognised overseas pension scheme').

You usually pay tax if savings in your pension pot go above:

- 100% of your earnings in a year (personal/employee contributions only) - this is the limit on the tax relief you get.
- £40,000 a year—[check your annual allowance](#).
- £1,073,100 this is the lifetime allowance for the 2021/22 tax year.

You also pay tax on your pension contributions if your pension provider isn't registered with HM Revenue & Customs (HMRC), or doesn't invest your pension pot according to HMRC's rules.

How does pension contribution tax-relief work?

In some cases, tax-relief is applied automatically. This happens if:

- Your employer takes workplace pension contributions out of your pay **before** deducting Income Tax.
- Your pension provider claims tax relief for you at a rate of 20% and adds it to your pension pot ('tax relief at source').
- You get tax relief at source in all personal and stakeholder pensions and some workplace pensions.

What if I pay tax at a rate above 20%?

If you pay income tax at 40% or 45%, you may need to use a Self-Assessment Tax Return to claim your tax relief. If your pension provider claims the first 20% for you (relief at source) you'll need to claim the balance yourself. Those paying tax at 40% but who don't complete a tax return can call or write to HMRC to make their claim. If you pay tax at 45% though, you'll need to use your Tax Return to claim the balance of your tax relief.

You may also need to use a Self-Assessment Tax Return to claim tax relief if your pension scheme isn't set up for automatic tax relief or if someone else pays into your pension (a spouse, parent or grandparent for example).

You can't claim tax relief if your pension provider isn't registered with HMRC.

What if I don't pay income tax?

You'll still automatically get tax relief on up to 100% of your earnings (or £3,600 if greater) that you pay into your pension each tax year (6 April to 5 April) if you don't pay Income Tax (because you're a low earner for example) and your pension provider claims tax relief for you at 20% (relief at source).

More about the Annual Allowance:

You'll usually pay tax if savings into your pension pots go above the annual allowance (£40,000 a year). You can top up your allowance for the current tax year with up to £40,000 of allowance you didn't use from the previous 3 tax years. The annual allowance was £50,000 for tax years between 6 April 2011 and 5 April 2014 (although some people had an annual allowance of £80,000 in 2015/16). The HMRC has a useful [annual allowance calculator](#) to help you work out if you can top up your allowance.

It's your responsibility to make sure your own total gross contributions don't exceed 100% of your annual earnings - HM Revenue & Customs (HMRC) can ask you to pay back tax relief on any personal contributions over this limit.



Lower annual allowance if you take money flexibly from your pension pot

Sometimes it's possible to keep paying in after you take money out of a pension pot but you'll pay tax on contributions over £4,000 a year. This is because your annual allowance for all defined contribution schemes you're in drops to £4,000 when you get:

- Cash (other than tax-free cash) or a short-term annuity from a flexi-access drawdown fund
- Cash from a pension pot (uncrystallised funds pension lump sums)
- More than the limit from a capped drawdown fund

There are other scenarios when the annual allowance drops to £4,000 - your pension provider will send you a 'flexible access statement' to tell you when this happens.

If your allowance drops to £4,000 for one of your pension pots, you must tell other pension schemes you're in within 13 weeks.

Check how much annual allowance you've used

You'll need your pension statements to work this out, ask your pension provider for them if you don't get them automatically. Your statements will show you which 'Pension Input Periods' (PIP) ended in that particular tax year. PIPs don't always match a tax year and more than one may be relevant. Work out how much annual allowance you used in those PIPs. What counts towards your allowance depends on what type of pension scheme you're in:

Defined contribution pension schemes - Total amount of contributions paid in by you or anyone else (including your employer and the government).

Defined benefit pension schemes - Any increase in the amount your pension provider promises to give you when you retire.

Hybrid pension schemes - The highest amount out of the total contributions and any increase in the amount your pension provider promises to give you when you retire.

If you go above the annual allowance

If this happens you'll get a statement from the pension provider. You should then get statements from all your pension providers so you can work out how much you've gone over the annual allowance. Check first if the overpayment can be absorbed using carry forward (ask an adviser). If it can't, use the information from these statements to fill in a Self Assessment Tax Return (in the 'Pension savings tax charges' section - form SA101 if you're using paper forms).

The amount you went above the annual allowance is added to your taxable income. You'll pay Income Tax on taxable income at the rate that applies to you.

Lifetime allowance

You usually pay tax once you have used up more than the lifetime allowance (£1,073,100) or a higher amount, if you are eligible for lifetime allowance protection. You use up a portion when certain events happen. You can ask your pension provider how much of your lifetime allowance you've used. If you're in more than one pension scheme you must add up what you've used in all schemes. What counts towards your lifetime allowance depends on the type of pension pot, you have:

Defined contribution (personal, stakeholder and most workplace schemes) - The value of pension pots that go towards paying you, however you decide to take the money.

Defined benefit (some workplace schemes) - Usually 20 times the pension you get plus your lump sum (check with your pension provider) Your pension provider may ask you for information about other pension schemes you're in so they can check how much lifetime allowance you have when you:

- Decide to take money from a pension pot
- Turn 75
- Transfer your pension overseas

The order in which you access your pensions may affect how much you can take out before tax is payable, so taking advice on this can be beneficial.

What happens if you exceed the lifetime allowance?

You'll get a statement from your pension provider telling you how much tax you owe. Your pension provider will deduct the tax before you start getting your pension.

You still need to report the tax deducted by filling in a Self Assessment Tax Return.

The rate of tax you pay on savings above your lifetime allowance depends on how the money is paid to you. The rate is:

- 55% if you take it as a lump sum
- 25% if you take it any other way (e.g. pension payments or cash withdrawals)

Lifetime allowance protection

This protects your lifetime allowance at a previous higher level. Your protection certificate will tell you:

- How much lifetime allowance you have
- The type of protection you have (e.g. 'primary', 'enhanced' or 'fixed')
- Your protection certificate number

You'll need to tell your pension provider the type of protection and the certificate number when you decide to take money from your pension pot.

The Financial Conduct Authority does not regulate tax advice. All information is correct to the best of our knowledge at the time of writing. Tax allowances, rates and thresholds are subject to change.