

## **Pension tax relief for net pay arrangements (Lecture P1337 – 9.21 minutes)**

For most people, there are two main methods of giving tax relief for pension contributions:

1. net pay arrangements where pension contributions are taken out of an employee's gross pay before tax, thereby automatically reducing the individual's taxable pay; and
2. relief at source schemes which apply to the self-employed and to some employees who pay pension contributions out of their taxed pay (in these cases, the individual obtains tax relief when the pension fund reclaims basic rate tax from HMRC to add to the pension contributions).

While these two procedures provide identical outcomes for many taxpayers, low earners with taxable incomes below the personal allowance can have different levels of take-home pay, depending on how their pension scheme is administered. Those in schemes using relief at source receive a 20% top-up on their pension saving, even if they pay no income tax. However, those in schemes using net pay arrangements receive relief at their marginal rate which, if they are not liable to pay income tax, is effectively 0%. The effect is that low earners in schemes using net pay have less after-tax income than they would if they were saving into a relief at source scheme. This is unfortunate.

The legislation for net pay arrangements is set out in S193 FA 2004. However, the Government are proposing an amendment to these rules by virtue of a new S193A FA 2004. Where an individual is entitled to be given tax relief in accordance with S193 FA 2004 and that person is not liable to pay income tax for the tax year in which the pension contribution is made, there will be a duty on HMRC – with effect from 6 April 2024 – to make arrangements, so far as reasonably practicable, to pay such individuals an 'appropriate amount' in relation to their pension contribution. This will be an amount equal to the income tax relief not already received on the pension contribution. HMRC must pay this top-up as soon as possible after the end of the relevant tax year into the individual's bank or building society account. In order to be able to do this, HMRC will invite eligible employees to provide the necessary details to enable these top-up payments to be made.

Two years ago, the Government launched a Call for Evidence in this regard which ran between July and October 2020. The Call for Evidence set out three reform principles which had to underpin any changes:

1. simplicity;
2. deliverability; and
3. proportionality.

The response which followed committed the Government to introducing a top-up payment for low earners using net pay arrangements, seeking broadly to equalise their take-home pay with comparable low earners using relief at source schemes.

*Contributed by Robert Jamieson*