The idea behind tax relief is to encourage people to save for retirement. In allowing pension tax relief, the value of your savings for retirement are helped by money that would otherwise have gone to the tax man. Exactly how it works will depend on the way your pension scheme operates its tax relief.

In summary, this means that a £1 contribution only costs you 80p if you’re a basic-rate taxpayer, as little as 60p if you pay higher-rate tax and 55p if you pay additional-rate tax.

IN THIS GUIDE WE COVER:

- How tax relief could work for you
- How much you can pay into your pension
- How you may be able to make higher tax-efficient contributions to your pension in this tax year
How much is tax relief worth to you?

This depends on how much you earn, what rate of Income Tax you pay and the type of pension you belong to.

- With most personal pensions, such as the Fidelity Self-Invested Personal Pension, your pension provider claims back Income Tax at the basic rate of 20% and adds it to your pension ‘pot’. Anyone, including people who don’t pay tax, can claim back basic rate Income Tax in this way. So, if you put £800 from your take-home pay into your pension, the government will top it up to £1,000. This £200 top-up equates to the basic rate of Income Tax at 20%.
- If you pay Income Tax at the higher rate of 40% you could then claim back up to 20% of tax you have paid, over and above the basic rate, so you could receive £200 back. Effectively this could mean it has only cost you £600 to pay £1,000 into your pension plan.
- Finally, you might pay Income Tax at the additional rate of 45%, in which case you may be able to claim back up to 25% rather than 20%. In other words, you could be eligible for a refund of up to £250, potentially bringing the effective cost of your £1,000 pension contribution down to £550.

Tax relief may work differently with a work place pension, as contributions are often taken from your pay before any tax is deducted – in other words, they come out of your ‘gross’ pay. This means that you receive your tax relief immediately, at the highest rate of Income Tax you pay, and you don’t need to claim it from HMRC yourself.

Please note, you can only claim higher or additional rate tax relief against earnings that are taxed at those rates.

Tax relief in everyday life

James stays at home to look after his children, no salary.

James receives an inheritance and pays £800 into his pension. Even though he doesn’t pay Income Tax, James’s pension contribution is topped up to £1,000 with tax relief.

Tim – engineer, salary £50,000.

Tim puts £800 of his overtime pay in a pension. Tim’s contribution is topped up to £1,000 with basic rate tax relief, and because he earns enough to pay higher-rate Income Tax, he could then claim up to a further 20% tax relief. He gets a refund for £200 from HMRC so it has effectively cost him just £600 to put £1,000 in a pension.

Cheryl – clerical worker, salary £20,000.

Cheryl receives a bonus after tax, of £800, which she pays into her pension. The company managing the pension claims back the £200 tax she paid, so £1,000 ends up in her pension.

Simone – barrister, earning around £200,000 a year.

Simone makes a one-off pension payment of £800. Her payment is topped up to £1,000 with basic rate tax relief. Because Simone earns enough to pay additional rate Income Tax, she could claim back up to another 25% of tax relief. When HMRC work out how much tax she owes for the year, they refund her £250. Her pension has an extra £1,000 in it, but overall she has only paid £550.
Other pension tax benefits

The tax on pension contributions comes on top of the other tax benefits available through pensions:

- The investments in your pension are sheltered from Income and Capital Gains Tax, which can make a significant difference to the value of your pension pot over the years.
- From the age of 55 you usually have the option of taking up to 25% (or sometimes more) of your pension as a tax-free lump sum. You are free to spend or invest this as you like, though you cannot reinvest it into another pension scheme.

How do I claim my tax relief?

With the type of personal pension where the government tops your pension up with 20% basic rate tax relief, you will not need to do anything else, if you only pay basic rate Income Tax, or you are not a taxpayer. The company looking after your pension will claim any relief you are entitled to from HMRC and pay it straight into your plan.

If you pay Income Tax at the higher or additional rate, you can claim the extra relief on your contributions through your tax return or simply by writing to HMRC with full details of your pension payments, plus your National Insurance number and taxpayer reference. Your claim can relate to contributions made as long as four years ago.

You may receive your tax relief as a cheque or an electronic payment into your bank account. Alternatively, HMRC could deduct it from your overall tax bill for the year, or adjust your PAYE tax code for next year.

How much can you pay in?

You are currently entitled to tax relief on pension contributions up to the total amount of your relevant earnings in a year, or £3,600 gross (£2,880 net), whichever is higher. However, there is an upper limit known as the Annual Allowance which is £40,000 for the 2017/18 tax year. Exceed this limit and any tax relief given will effectively be reclaimed due to a tax charge being applied.

- So, if you earn £30,000, you could pay £24,000 into your pension and have it topped up by £6,000 to make a total contribution of £30,000, equal to the amount you earn.
- On the other hand, if your salary is £80,000, the most you could personally pay in to pensions in one year for tax relief purposes without making use of carry forward (see below for details) is £32,000. This will have £8,000 of tax relief added, taking you up to the Annual Allowance of £40,000. As a higher-rate taxpayer you could claim a further £8,000 back through your tax return.
- Even if you have no earnings at all, and therefore pay no tax, you can pay £2,880 into a pension plan and have it topped up to make a total contribution £3,600.

You should remember that the annual limit you can receive tax relief on for your pension contributions includes any contributions to a pension made by an employer. If you exceed the annual allowance across all your contributions, you may have to pay what is known as a ‘tax charge’ on the excess. The rate of this annual allowance charge generally will be linked to the highest rate of Income Tax you pay - so it could be as much as 45% for an additional rate tax payer.
Reduced allowance for high earners

For most people the Annual Allowance is usually £40,000 but for some higher earners i.e. those earning over £150,000 or more, this could reduce from £40,000 down to a minimum of £10,000 (for those who have earnings of £210,000 or more). This is known as the tapered annual allowance – please call us for more information or read our ‘tapered annual pension allowance’ factsheet.

Reduced allowance after withdrawals

Once you take any money from a pension, your annual allowance may be reduced. This is known as the money purchase annual allowance (MPAA), and you can find out more about this in our MPAA factsheet. You may also face restrictions on carrying forward unused allowances from previous years.

Lifetime Allowance

There is also a lifetime allowance, designed to restrict the total amount anyone can have in their pension accounts. This is £1 million. Once the total value of all your pension savings (excluding your state pension) goes above this figure – even if it’s because your pension investments have performed well – you may have to pay a tax charge for exceeding the limits. This is a complex area of pension tax law, and you should consult a specialist adviser if it could be an issue for you. See our Lifetime Allowance factsheet for detailed information on this.
Using your annual allowance from past years

Although pension contributions for a single tax year are usually capped at £40,000, the tax rules may allow some high earners to pay an extra £120,000 into their pension if they haven’t used their annual allowance in previous tax years. In theory, this means they could claim tax relief on pension contributions of up to £160,000 in the 2017/2018 tax year.

To take advantage of this ‘carry forward’ scheme, as it is known, you can go back up to three years but you need to have been a member of a registered pension scheme in the tax year you wish to carry forward from and not have taken full advantage of your annual allowance. These were £40,000 for 2014/15, £80,000 for 2015/16 (although only a maximum of £40,000 is available to carry forward) due to special rules and £40,000 for 2016/17 tax year.

You don’t need to have made any contributions to your pension in the years you wish to use carry forward for, and your new contribution does not have to go into the same pension.

As with any tax relief, you can’t receive it on pension payments that total more than your earnings during the year when you make the contribution. For example, you could only pay £160,000 into your pension in 2017/2018 if you earned that much over the course of that year. You have to use your annual allowance from the current tax year first. You can then go back to the earliest of the three past years you are able to. For more information on rules for 2015/16 (pre-budget and post-budget) you may find our carry forward factsheet useful.

How ‘carry forward’ works in practice

Let’s take the example of David, who earns £120,000 a year and has made the following contributions into his SIPP.

<table>
<thead>
<tr>
<th>Year</th>
<th>Annual allowance</th>
<th>Pension contributions</th>
<th>Unused annual allowance</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014/15</td>
<td>£40,000</td>
<td>£20,000</td>
<td>£20,000</td>
</tr>
<tr>
<td>2015/16*</td>
<td>£40,000</td>
<td>£20,000</td>
<td>£20,000</td>
</tr>
<tr>
<td>2016/17</td>
<td>£40,000</td>
<td>£35,000</td>
<td>£5,000</td>
</tr>
<tr>
<td>2017/18</td>
<td>£40,000</td>
<td>£15,000</td>
<td>£25,000</td>
</tr>
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</table>

In total, David has £45,000 of unused annual allowances from the previous three years and £25,000 left from the current year. Therefore, he can make a further gross contribution of up to £70,000 in 2017/18. With the £15,000 he has already saved, his total contributions for the year for which he could receive tax relief on, could be as much as £85,000. This amount is less than he earns and so he is eligible for tax relief on the full amount.

* Special rules apply for carrying annual allowances forward from the 2015/16 tax year as a result of split annual allowances see our carry forward factsheet for details. HMRC has a handy online calculator that will help you work out whether you have any unused annual allowance that you can carry forward. Go to hmrc.gov.uk/tools/pension-allowance

You do not need to make a claim to HMRC to carry forward any unused annual allowance or show it on your tax return. However, you should keep a record of all your pension contributions in case you want to carry any unused allowance forward to a future tax year.

If you are unsure how the annual allowance works and how it relates to you, we suggest that you speak to your financial adviser or a tax specialist.
SECURE YOUR TAX RELIEF THROUGH A FIDELITY SIPP

Call our UK SIPP team on 0800 358 7480 or visit fidelity.co.uk/sipp

Important information: Fidelity Personal Investing does not give personal recommendations. If you are unsure about the suitability of an investment you should speak to an authorised financial adviser. The value of tax benefits from a pension depends on your circumstances, and rules may change in the future. You cannot take money out of a pension until you are 55. Pensions can be a complex area. If you are unsure we strongly recommend that you obtain financial advice to help you decide what action you need to take, if any.

The information in this factsheet is correct as at 6 April 2017.