



Sapphire

CONTRACTING

Making Pension Contributions to Reclaim the Personal Allowance

Effective tax relief of 60% or more can be obtained on pension contributions if you are able to reclaim your personal allowance...

The threshold for the loss of the personal allowance has remained fixed at £100,000 since its introduction in 2010. Meanwhile, the personal allowance has almost doubled from £6,475 in 2010/11 to £12,570 in tax year 2021/22. This means that both the number of people impacted, and the band at which you can pay an effective rate of 60% has grown substantially. It is a strange quirk of the tax system to have marginal income tax rates of 20%, 40%, then 60%, then falling back to 40% before finally rising to 45% again once income reaches £150,000.



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The 60% effective rate is due to the fact that income in this band is not only taxed at 40%, it also reduces the personal allowance on a 2 for 1 basis. That is for each £2 of additional income above £100,000 the personal allowance reduces by £1. At income levels above £125,140 the personal allowance is zero.

The personal allowance income limit is based on an individual's adjusted net income. For those familiar with tapered annual allowance calculations, note that this is quite different from the adjusted income figure used there. However, adjusted net income involves the same first step, which is to calculate the your total taxable income or 'net income'. This includes income such as earnings, profits from self-employment, rental income and dividends and is after deductions for pension contributions made gross, such as occupational pension contributions deducted from salary before tax is calculated, or an AVC paid gross to an occupational scheme.

From the 'net income' figure two important deductions are made to arrive at 'adjusted net income'. These are the grossed up value of any relief at source pension contributions and any charitable donations made by Gift Aid.

Personal contributions to both occupational schemes and personal pensions schemes will therefore reduce the adjusted net income figure and so can restore some or all of the personal allowance.

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Making personal pension contributions, example:

Keith has income of £125,140 in 2021/22. He makes a net (relief at source) pension contribution of £20,112 and receives £5,028 tax relief at source. His net income falls by £10,056 in return for a pension contribution of £25,140 - an effective rate of tax relief of 60%.

	No Pension	Personal Pension Contribution
Income	£125,140	£125,140
Personal allowance	£0	£12,570
National Insurance	£6,382	£6,382
Tax	£42,516	£32,460
Net personal pension contribution	£0	£20,112
Net income	£76,242	£66,186
Effective tax relief		60%



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Salary sacrifice

Where salary sacrifice is available you can receive even greater benefits. As well as reducing taxable income, a reduction in salary will also lower both the employee and employer National Insurance contributions. Where the employer is willing to re-invest their National Insurance savings the effective rates of tax can be almost 67%.

If Keith instead was able to make his pension contribution via salary sacrifice, for a net cost of just £9,553 an employer contribution could be made of £28,609.

	No Pension	Personal Pension Contribution
Income	£125,140	£100,000
Personal allowance	£0	£12,570
National Insurance	£6,382	£5,879
Tax	£42,516	£27,432
Net income	£76,242	£66,689
Employer contribution		£28,609
Effective tax relief		66.61%

Get in touch

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