Berkshire IFA

How higher rate tax relief works in practice

If you’re a higher rate taxpayer, you’re entitled to claim additional tax relief on your pension contributions. We’ve created some handy case studies to show you how higher rate tax relief works in practice and how claiming can help to boost your pension savings.

What’s tax relief?

Each time you save into your pension plan, you’ll receive tax relief from the government.

Basic rate tax relief is added to your pension automatically. This means if you want to contribute £100 into your pension, it will only cost you £80, as tax relief from the government will make up the other £20.

If you’re a higher rate taxpayer, you’re entitled to receive more tax relief from the government. This isn’t added to your pension automatically. Instead, this will reduce your tax bill.

If you’re saving into a personal pension, you can claim any extra tax relief by completing a self-assessment tax return. You’ll receive this from HMRC through your chosen method.

You can decide to pay the tax saving into your pension as an additional contribution, which would also receive tax relief. You must have enough earnings to cover the contribution, or you won’t get tax relief on the excess. You must also have spare annual allowance, or you may be subject to a tax charge. Find out more at **https://www.gov.uk/tax-on-your-private-pension.**

How does higher rate tax relief work?

The government will let you earn a certain amount each year before you pay any tax. This is called your ‘personal allowance’.

For the tax year 2021/22, the standard personal allowance is £12,570. This can be subject to change.

The table below shows the income tax bands for a UK taxpayer with the standard personal allowance.

Tax band	Taxable income	Tax rate
Personal allowance	Up to £12,570	0%
Basic rate	£12,571 to £50,270	20%
Higher rate	£50,271 to £150,000	40%
Additional rate	over £150,000	45%

If you’re a UK taxpayer living in Scotland and you want to find out what income tax rates apply to you, please visit **http://www.gov.uk/scottish-income-tax**

Tax relief is paid on your pension contributions at the highest rate of income tax you pay. This means you can claim up to 20% extra tax relief if you pay tax at the higher rate and up to 25% extra tax relief if you pay tax at the additional rate.

You should speak to your financial adviser about what higher rate tax relief means for you, based on your personal circumstances.

How higher rate tax relief works in practice

Let's take a look at some case studies to bring higher rate tax relief to life.

Case study 1 – Helen

Helen lives in England and earns £52,000 in 2021/22, which makes her a higher rate taxpayer.

She'll pay basic rate tax on £37,700 of her earnings above £12,570 and higher rate tax on the amount above this.

Based on the current tax bands, the amount of tax she pays before making a pension contribution would be as follows:

- **Personal allowance: £12,570**
- **Taxable income: (£52,000 - £12,570) = £39,430**
- **Basic rate tax: (20% of £37,700) = £7,540**
- **Higher rate tax: ((£39,430 - £37,700) at 40%) = £692**
- **Total yearly tax bill: (£7,540 + £692) = £8,232**

If Helen makes a contribution of £5,000 (including tax relief) to her personal pension, she'll receive higher rate tax relief on the part of the contribution that lies in the higher rate tax band.

For this example, she pays higher rate tax on £1,730 (£39,430 - £37,700) of her earnings, therefore she can claim higher rate tax relief on £1,730 of her pension contribution. By completing her self-assessment tax return, she'll receive another 20% of tax relief. So, her yearly tax bill will be reduced by the following:

- **Total yearly tax bill: £8,232**
- **Less £1,730 at 20%: £346**
- **New total yearly tax bill: £7,886**

The total amount of tax relief Helen has received will be £1,346. This will be made up of basic rate tax relief of £1,000 (20% of £5,000) that's been paid into her pension and £346 (20% of £1,730) that's been claimed through a tax rebate into her bank account. This is 26.92% of the gross contribution.

The reason why it isn't 40% is that before the pension contribution, she only pays higher rate tax on £1,730 of her taxable income. If she had been paying higher rate tax on £5,000 or more of her taxable income, the total tax relief she would receive would be 40% of her contribution (including tax relief).

Case study 2 – William

William regularly contributes £400 per month into his Personal Pension (including tax relief). When he set up his plan, he knew that the government would contribute 20% tax relief.

After a few years, William now falls into the higher rate tax bracket, as he now earns £60,000 a year. His adviser tells him that he can now benefit from higher rate tax relief on his pension contributions. Through the self-assessment tax return, he can claim an additional 20% from the government. His adviser recommends he invests the additional tax relief into his pension, to give his pension savings a boost.

When he makes the single contribution, William's pension provider will claim basic rate tax relief of 20% on his contribution. Please note that William could claim higher rate tax relief on this contribution as part of his next self-assessment.

- **Single contribution: £960**
- **Tax relief: £240**
- **Total contribution: £1,200**

He invests this single contribution alongside the rest of his pension savings into the FEI Risk Level 3 Long Term Portfolio. Over the next 15 years the single contribution could grow to around £2,483[1].

Remember, the value of the investment can go down as well as up, so William could get back less than what he's put in.

As long as higher rate tax relief is available, William could claim the additional 20% and use the money to make a single contribution into his plan each year.

These examples are based on each person being taxpayers in England and using the relief at source system to claim their tax relief.

[1]Figures assume investment in the FEI Risk Level 3 Long Term Portfolio, investment growth of 5% a year above inflation (inflation rate of 2.5% used) and no adviser or FEI discretionary fund manager charges applied. These figures are a simple example and don't include the effect of compound interest. The FEI Risk Level 3 Long Term Portfolio has returned on average 16% a year since chartable data began on 01/09/2008. We have quoted a more cautious investment return of 5% above inflation for the purpose of this illustration. Past performance is used as a guide only; it is no guarantee of future performance.

To find out more about higher rate tax relief and how it might affect you, speak to your financial adviser.

Berkshire IFA Limited is authorised and regulated by the Financial Conduct Authority. Berkshire IFA Limited 11248066 is registered in England and Wales at Albany House, 14 Shute End, Wokingham, Berkshire, RG40 1BJ. FCA Number 826120, email: post@berkshireifa.com, telephone: 0118 334 3500.