Low Incomes Tax Reform Group.

A voice for the unrepresented.

**Draft legislation Finance Bill 2022/23: pensions relief relating to net pay arrangements**
**Response from the Low Incomes Tax Reform Group (LITRG)**

## 1 Executive Summary

1.1 We welcome the opportunity to comment on the draft legislation to address the 'low earners anomaly' for pensions relief relating to net pay arrangements.

1.2 While we are cautiously optimistic that the new rules will largely bring to an end the longstanding difference in treatment of non-taxpayers who pay into pension schemes operating the two different methods of giving tax relief, the draft legislation does give rise to various concerns.

1.3 Most notable of these concerns is the government's proposal to treat any compensatory payment made by HMRC as employed earnings for income tax purposes. Where net pay pension savers have total income above their personal allowances, but receive a top-up payment based upon HMRC's calculation under the draft legislation using employed earnings alone, it appears from our calculations (Appendix 1) that these people may be better off than their relief at source contributing counterparts. We therefore recommend that the payments are instead deemed to be a tax refund, which we believe (as illustrated at Appendix 2) would avoid this and other potential complexities.

1.4 Subject to our understanding of how the DWP treat pension contributions in practice being correct, we believe that treating the payments as either earnings or tax refunds would have broadly the same outcome in terms of universal credit (UC) interaction. We do, however, recommend that HMRC and DWP together look at our more general concern, described in Appendix 3 to this response, that the wording of the UC Regulations arguably does not match DWP's current practice.

1.5 It is important that information about top-up payments is shared automatically between HMRC and the DWP for universal credit claimants, to ensure that claims are adjusted accordingly, without input required from the claimants themselves.

1.6 Making top-up payments to individuals in the tax year after which the contributions were paid also gives rise to some other potential impacts and practical considerations. For example, those in Self Assessment might need to amend the previous year's tax return on receipt of a top-up payment. To keep things simple, we would therefore recommend that HMRC factor this into the development of their processes, such that a Self Assessment return filed prior to a top-up payment being made is automatically corrected.

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1.7 The legislation states that HM Revenue & Customs must 'so far as reasonably practicable' make the necessary payments to affected individuals. While it is welcome that the onus of making the payments is largely placed on HMRC rather than individuals having to claim, our concern here is that this phrase is perhaps open to interpretation. Pension savers could be left without redress if, for example, they are not easily contactable or perhaps mistakenly ignore HMRC communications due to a suspicion that they are a scam. We therefore recommend that an ability to claim the relief is built into the legislation, together with an explicit right of appeal if HMRC fail to make a payment where the individual believes one to be due.

1.8 Finally, this issue has been known about for a long time and we are disappointed that there is no proposed redress for either individuals' historic financial loss or further losses between now and introduction of top-up payments from April 2024. We therefore repeat in this paper our calls for backdating.

## 2 About Us

2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998, LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low-income workers, pensioners, migrants, students, disabled people and carers.

2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

## 3 Introduction

3.1 Our interest in the 'net pay anomaly' for low-income pension savers stretches back several years. We have worked together with Baroness Ros Altmann and a coalition of organisations across the pensions industry, establishing the Net Pay Action Group ('NPAG'). The members have been united by a collective concern that non-taxpayers saving into net pay pension schemes are losing out financially as compared to those saving into relief at source schemes.

3.2 In October 2020, we responded to HM Treasury's call for evidence on pensions tax relief administration.[1] As part of this submission we pointed out the social injustice of the current system

[1] LITRG response: https://www.litrg.org.uk/sites/default/files/files/201012-LITRG-response-HM-Treasury-Pensions-Tax-Relief-Administration.pdf

that in its very nature affects those on some of the lowest incomes. We also highlighted that there is a very important equality issue, with nearly three quarters of those affected being women.

3.3 Our recommendation at that time, as has been our suggestion all along, was that HMRC should make a compensatory payment to those affected by the net pay anomaly, and for this to be treated as if it were a tax refund. Such a solution[1] would, we believe, be more straightforward and present fewer practical problems than to treat top-up payments as if they were earnings from employment as is the suggestion in the draft legislation. We explain these concerns in detail below.

3.4 This submission is made in our capacity as LITRG and not as part of the NPAG.

**4 The draft proposals**

4.1 We generally welcome the government's attempt to address the long-standing anomaly that non-taxpayers face when saving for retirement under a net pay pension scheme.[2] However, we have examined the draft legislation relating to the proposed payments (which we will refer to as 'top-up payments') and wish to comments on the following areas:

- The treatment of top-up payments as earnings
- Universal credit interactions
- The duty on HMRC to make payments
- The implementation date

4.2 ***The treatment of top-up payments as earnings***

4.2.1 The draft legislation deems the payments to be treated as 'earnings' for the purposes of income tax[3] for the 'relevant tax year' – i.e. the tax year in which the pension contribution is paid, not the one in which it is received.[4]

4.2.2 As we understand the draft legislation, this deemed treatment will not apply for the purposes of determining whether the provision itself applies, nor in calculating the amount of the top-up

[1] Rather than implement a separate process, our proposal was that HMRC should use their existing annual reconciliation of individuals' data – the P800 tax calculation – to make 'tax refund' payments to those in net pay schemes equivalent to what they would have received had they contributed to a relief at source scheme. For more detail of this proposal, see https://www.litrg.org.uk/sites/default/files/190509-LITRG-briefing-Net-Pay-Arrangements-lower-paid-workers-FINAL.pdf

[2] We use the term 'non-taxpayers' broadly in this submission to refer to those with income below their personal allowances, thus missing out altogether on tax relief on their net pay pension contributions as well as those missing out partially on tax relief where their income is just above their personal allowances.

[3] Subsection 5 of the draft legislation.

[4] The relevant tax year being defined in draft s193A(1)(b).

payment. Such exclusion is sensible and is indeed necessary to avoid the otherwise circular situation of HMRC making a top-up payment only for that to take the individual over their allowances which would thus reduce or eliminate entitlement to the payment itself.

4.2.3 We do, however, think there are potential unintended consequences arising from the proposal to treat the top-up payments as earnings rather than as a tax refund as was our suggestion, noted at 3.3 above.

4.2.4 We understand that the draft legislation requires HMRC to calculate the payments based on employment income alone.[1] It could therefore be that some individuals receive a payment where their income exceeds their personal allowances in the relevant tax year and that some adjustment is therefore required to prevent any doubling up of tax relief which would otherwise occur. Treating the payments as if they are earnings will not, however, achieve this.

4.2.5 We attach Appendix 1 to this response illustrating that in fact a net pay contributor could become better off than someone paying in to a relief at source scheme if they have income other than employment income. The example in Appendix 1 uses a scenario of an individual with both employment and self-employment income. To HMRC, using PAYE data alone, the individual will appear to be a non-taxpayer, eligible for a top-up payment. But overall, they are a taxpayer and would therefore – notwithstanding the present draft legislation – already receive tax relief on their net pay pension contributions when their total income is tallied under Self Assessment. Making a top-up payment to them, treated as earnings, will apparently lead to them being better off than an otherwise equivalent saver contributing to a relief at source scheme.

4.2.6 While it may be that the majority of those who HMRC identify as being due a top-up payment based on earnings data do not have other income, it would seem rather odd to implement a solution which leads to the reversal of fortunes described above – i.e. producing a favourable result for some people with higher incomes contributing to net pay schemes. This is particularly so when there is an alternative solution: our previous recommendation to treat the payments as tax refunds. As shown in the calculations at Appendix 2 to this response, treating the payments as tax refunds would allow any subsequent Self Assessment calculation (or other tax assessment) to bring any refund back into account, and ensure there is no doubling up of relief.

4.2.7 Treating the payments as tax refunds rather than earnings would, we believe, also avoid other unintended consequences. For instance, treating the top-up payments as earnings might lead to some odd interactions if the recipient of a top-up payment were on the margins of a higher rate tax liability, or liability to the high income child benefit charge. While it may be a very small minority of top-up payment recipients in this position,[2] someone could have a small amount of employment

[1] Subsections 1(c) and 3 of the draft legislation. We understand that HMRC will use employment income data received from employers under PAYE/real time information.

[2] We do not have any data available to identify how many of those making net pay pension contributions via employment income would appear to HMRC, from totalling employment income alone, to be non-taxpayers but are in fact taxpayers when taking into account their total income from all sources.

income and appear to be a non-taxpayer eligible for a top-up payment while also having a much larger source of self-employment income. Receipt of a top-up payment which is treated as if it were earnings could then mean, for example, that their personal savings allowance entitlement drops from £1,000 (for basic rate taxpayers) to £500 (for higher rate taxpayers). This small amount of extra deemed employment income would also affect the calculation of their adjusted net income[1] which might in turn lead to a liability to the high income child benefit charge (and consequent need to register for Self Assessment).

4.2.8 We therefore recommend that the draft legislation is re-framed to treat the top-up payments as deemed tax refunds relating to the year in which the pension contributions were made, rather than as earnings from an employment.

*National insurance contributions*

4.2.9 Continuing on the subject of the top-up payments being treated as earnings, we assume that since they are only cited as being taxable under the income tax legislation,[2] they would not be subject to National Insurance contributions. Furthermore, they appear to be deemed as earnings from 'an employment' – that is, not the same employment in which the individual was engaged when making the net pay contributions. As such, the total earnings from this deemed or notional employment would be well within the lower earnings limit, so there should be no suggestion of National Insurance contributions being due. However, confirmation of this point would be helpful, given that the employee would not have received a deduction from NICable earnings when making the pension contribution. Note that this would not be a concern if our recommendation at 4.2.8 above (to instead deem top-up payments to be a tax refund) is taken up.

*Interaction with Self Assessment*

4.2.10 The draft legislation provides that HMRC must make top-up payments 'as soon as reasonably practicable after the tax year in which the contribution is paid'.[3]

4.2.11 For those in Self Assessment (or filing End of Period statements/final declarations under Making Tax Digital (MTD) provisions, in future), it will need to be clear where top-up payments are to be returned. If the payments are to be treated as earnings (but see our recommendation at 4.2.8 to treat them instead as deemed tax refunds), will there be a box for them on the form, without the individual having to file separate 'employment' pages? If they were to be treated as deemed tax refunds, we believe that individuals filing Self Assessment returns could include any such payments in box 1 on page TR6 of the SA100 (or its online equivalent).

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[1] ITA 2007, s 58: https://www.legislation.gov.uk/ukpga/2007/3/section/58 (the top-up payment, being deemed to be employed earnings would be factored in to the individual's net income at Step 2 of the income tax calculation in ITA 2007, s 23: https://www.legislation.gov.uk/ukpga/2007/3/section/23).

[2] Chapter 1 of Part 3 of ITEPA 2003.

[3] Subsection 4 of the draft legislation.

4.2.12 In either case, HMRC communications will need to be clear about the interactions with Self Assessment/MTD. For those filing online, we would recommend that HMRC ensure data relating to top-up payments is pre-populated where necessary.

4.2.13 There is also a further question on timing of the payments and a potential practical hurdle for early filers after the tax year end. An individual could, for example, file a Self Assessment return for the 2024/25 tax year in April 2025. If they then receive a top-up payment in June 2025, how will HMRC deal with this? The individual could file an amendment to the return at that point, but it would presumably be preferable and within HMRC's power to issue a correction under s9ZB TMA 1970[1] as there would have been an obvious omission from the return and HMRC would have the information available to them to make the correction. We therefore recommend that HMRC consider this point carefully and build it into their processes from the outset with the aim of keeping it simple for individuals.

4.3 ***Universal credit (UC) interactions***

4.3.1 There will be pension savers benefitting from the proposals set out in the draft legislation who also claim UC. It is therefore important to consider the interaction. Similar considerations will be needed for other means-tested benefits, where the rules may be slightly different. As mentioned above, it is proposed that the payments made to pension savers will be treated as earnings for income tax purposes in the relevant tax year, and by extension we assume would also be considered earnings for the purposes of UC[2], though presumably in the assessment period in which it is received.[3]

4.3.2 In many cases, based upon our understanding of how the DWP deducts pension contributions from income, this should mean that there is broadly equal treatment between universal credit claimants contributing to relief at source schemes and net pay schemes.

4.3.3 In this respect, we understand that the Department for Work and Pensions (DWP) currently deduct pension contributions from universal credit claimants' income as follows:

- Contributions to a relief at source scheme – the net of basic rate tax amount is deducted from UC income
- Contributions to a net pay arrangement scheme – the gross amount is deducted from UC income

4.3.4 While we understand this operational practice fits the policy intent to calculate UC entitlement based upon the claimant's available income, we do not think it matches the UC Regulations as they are currently written. We believe the regulations say that the gross amount is to be deducted in all

[1] Correction of personal or trustee return by Revenue

[2] Under the Universal Credit Regulations 2013, Regulation 55 ('Employed earnings') includes general earnings as defined by s 7(3) of ITEPA 2003 – which in turn states that general earnings are earnings within Chapter 1 of Part 3, as referenced above.

[3] Universal Credit Regulations 2013, Regulation 54

cases. We explain this issue further and our belief that the UC Regulations require clarification in Appendix 3 to this submission.

4.3.5 Based upon what we understand to be DWP practice, the net pay pension contributor will therefore have their gross pension contribution deducted from their UC income at the point of deduction from their wages. The top-up payment will then be taken into account as earned income when it is paid. Overall, this is broadly equal to a relief at source pension contributor having only the net of basic rate tax contribution deducted from their UC income at the point it is paid.

4.3.6 Taking a £200 gross pension contribution across a tax year as an example, from £10,000 annual wages, the net pay contributor would have UC income across the year of £9,800 (ignoring any other potential deductions, such as NIC, for the purposes of this simple example). In the next tax year, they should receive a top-up payment of £40 (net pay pension contribution of £200 x 20% deemed basic rate relief). This £40 will be added to their UC income in the assessment period in which it is received. Overall, they will therefore have had £10,000-£200+£40 = £9,840 of income assessed in their UC calculation. The relief at source contributor would have paid the net amount – £160 – to their pension scheme, so will have had £9,840 taken into account as income for UC purposes across the year.

4.3.7 However, those paying in to net pay schemes will find there is a timing difference as compared to relief at source contributors, since the calculation of their net position will take place at a later date, when their top-up payment is received from HMRC. This means that there could be some anomalies. For example, someone who is not claiming UC at the time they are making net pay contributions would not have received the 'benefit' of pension contributions being taken into account in a UC calculation, but if they are claiming UC at the time the top-up payment is made, they will have that amount taken into account in their UC calculation. They will therefore lose out as a result. Vice versa, someone may get the benefit of gross net pay pension contributions coming off their UC income but by the time the top-up payment is made, they might have stopped claiming UC – thus the top-up payment will not be taken into account for UC and they will have received an extra benefit. That said, the same result would have occurred whether the top-up payment is constructed in the legislation as a tax refund or earnings, and is arguably inevitable, short of finding a workable means to replicate more exactly the giving of immediate relief to net pay contributors as through relief at source schemes.

4.3.8 Turning to our recommendation at 4.2.8 above that top-up payments should be deemed to be tax refunds instead of employed earnings, we believe the net effect for universal credit purposes would be the same as described above. This is because the UC Regulations treat tax refunds as if they are employed earnings unless they are taken into account as self-employed earnings.[1]

4.3.9 Whether deemed to be earnings or a tax refund (which is treated as earnings for UC in any event), since the top-up payment received from HMRC will need to be declared to the DWP for the purposes of universal credit, we would like to seek assurances from government that reporting between the

[1] UC Regulations, Reg 55(4A): https://www.legislation.gov.uk/uksi/2013/376/regulation/55

two organisations will take place automatically and will not require universal credit claimants to make their own reports to DWP. We understand that this is not the current procedure for tax refunds[1] (where UC claimants have to tell the DWP about a tax refund received), but we feel that this is essential to ensure that pension savers under net pay arrangements are placed on a broadly equal footing to those in relief at source schemes. They might otherwise face an extra burden and risk non-compliance across government departments if they fail to report receipt of the top-up payment for universal credit.

4.4 ***Duty on HMRC to make payments (versus the ability of an individual to claim, and the right to appeal where HMRC do not make or refuse to make a payment)***

4.4.1 Clarity about the process of making these payments is essential. Subsection 2 of the draft legislation[2] puts the onus on HMRC to make payments under the new s193A FA 2004, 'so far as reasonably practicable'. This is very welcome in one respect – that is, that HMRC has the primary obligation to seek out those affected and offer them a top-up payment. That said, we are unclear what precisely is meant by 'reasonably practicable' and have concerns that pension savers may still not receive payments if the bar for what is considered 'reasonably practicable' is not set high enough. We recommend that the draft legislation is amended to include a facility for individuals to claim a payment if they discover they have missed out.

4.4.2 At present, it is far from clear what the 'arrangements' referred to in subsection 2 will consist of. Let's say for example that person A receives a letter in October 2025 inviting them to provide bank details to HMRC for a top-up payment to be made. Person A is having a difficult time in their life, forgets about the letter and uncovers it when organising things a year later. What will happen in that instance? Similarly, what if an individual has moved house and HMRC's correspondence relating to a top-up payment being due is never received? It is not clear from the draft legislation whether there will be any time limit for the individual to act on HMRC's invitation. It might be assumed that if the person responded a year later, or even longer, it would remain within the realms of 'reasonable practicability' that HMRC should still make that payment. But from the draft legislation as it stands, we do not know the answer to this question for certain. It appears that the exact process will be left to HMRC guidance, which is not satisfactory. There should be a clear facility for the individual to claim within statutory time limits. We also recommend that a formal right should be included within the legislation for individuals to appeal to a Tribunal if HMRC fail or refuse to make such a payment.

*Other practical considerations*

4.4.3 Communications from HMRC inviting people to provide bank details for these payments to be made need to be well thought-out and secure. In recent times, scammers have attempted to exploit both

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[1] https://questions-statements.parliament.uk/written-questions/detail/2019-03-27/237574

[2] Subsection 2: *"The Commissioners of Her Majesty's Revenue and Customs must make reasonable arrangements to secure that, so far as reasonably practicable, they pay to the individual the appropriate amount in relation to the contribution."*

individuals and the tax system generally, and HMRC have had to review the role of third parties in assisting individuals claiming tax refunds.[1]

4.4.4 Individuals may therefore be nervous at receiving a communication from HMRC telling them they are due a payment and they need to provide bank details to receive it, viewing it as a potential scam.[2] Ways of mitigating this issue might include HMRC providing a dedicated telephone line to deal with queries and to show payments due within individuals' personal tax accounts so that people have a means of checking that it is a genuine HMRC contact.

### 4.5 *Implementation date*

4.5.1 Our final concern relates to the delayed implementation of the new legislation.

4.5.2 This issue has been known about for many years, and it would be remiss of us to comment on the draft legislation without stressing that there are many pension savers who are currently losing out financially as a result of this anomaly. The present government committed to look at resolving the issue in its 2019 manifesto[3] and announced the proposal on which the draft legislation is based at the 2021 autumn Budget.[4] We would have hoped to see the government undertake an exercise of identifying historic loss to such pension savers and compensating them retrospectively, in addition to rectifying the position going forward.

4.5.3 The government has, however, taken an approach to look forwards only, with payments being made in respect of the 2024/25 tax year onwards. While we appreciate that HMRC need time to implement changes to their systems to calculate and make the payments, we would prefer to see some backdating – at least to the 2021/22 tax year during which the proposed solution was announced. Indeed, backdating could help boost take up of initial responses to HMRC communications relating to the top-up payments, as greater amounts would be on offer, thus presenting a greater incentive to claim than for smaller amounts.

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[1] The latest action being this consultation on Raising standards in tax advice: protecting customers claiming tax repayments, 22 June 2022: https://www.gov.uk/government/consultations/raising-standards-in-tax-advice-protecting-customers-claiming-tax-repayments/raising-standards-in-tax-advice-protecting-customers-claiming-tax-repayments

[2] The explanatory note to the draft legislation (background note, point 3) confirms this as the proposed process: "HMRC will notify those who are eligible and invite them to provide the necessary details for the top-up to be paid direct to their bank account."

[3] See https://www.conservatives.com/our-plan which said: "A number of workers, disproportionately women, who earn between £10,000 and £12,500 have been missing out on pension benefits because of a loophole affecting people with net pay pension schemes. We will conduct a comprehensive review to look at how to fix this issue."

[4] See LITRG press release, 27 October 2021: https://www.litrg.org.uk/latest-news/news/211027-press-release-litrg-welcomes-solution-pension-inequality-low-income-workers

4.5.4 We therefore urge the government to reconsider backdating the effective date of the legislation.

LITRG
14 September 2022

## Appendix 1 - 'Top up' payment treated as employment income

| **Assumed scenario:** | |
|---|---|
| | £ |
| Employment income | 10,000 |
| Gross employee pension contribution | 500 |
| Self employed income | 10,070 |

***Net Pay contributor***

| | £ | £ | |
|---|---|---|---|
| Employment income | 10,000 | | |
| Less: Pension | (500) | | |
| | | 9,500 | |
| Self employed income | | 10,070 | |
| 'Top up' payment (note 1) | | 100 | |
| Total income | | 19,670 | **A** |
| Less: personal allowance | | (12,570) | |
| Taxable income | | 7,100 | |
| **Tax Liability @ 20%** | | **1,420** | **B** |

| | |
|---|---|
| Net cash position (A-B) (note 3) | 18,250 |
| Pension position | 500 |

***Relief at Source contributor***

| | £ | £ | |
|---|---|---|---|
| Employment income | 10,000 | | |
| Less: Pension (note 2) | 0 | | |
| | | 10,000 | |
| Self employed income | | 10,070 | |
| 'Top up' payment (not due) | | 0 | |
| Total income | | 20,070 | **A** |
| Less: personal allowance | | (12,570) | |
| Taxable income | | 7,500 | |
| **Tax Liability @ 20%** | | **1,500** | **B** |
| Net pension contribution (note 2) | | 400 | **C** |

| | |
|---|---|
| Net cash position (A-B-C) (note 3) | 18,170 |
| Pension position | 500 |

Note 1 Based on the RTI data, HMRC would identify the taxpayer as entitled to a top up payment. This would equate to 20% of the gross contribution, so £100 in this case. The draft legislation requires that this payment is treated as employment income in the year to which it relates.

Note 2 A taxpayer contributing under a Relief at Source scheme would make a net contribution of 80% - £400 in this case. This would not be deductible from the taxable income, but would still be a cash cost to the taxpayer.

Note 3 The overall difference to the net cash position in the above scenario is £80 (being 80% of the top up payment) in favour of the Net Pay pension saver. This is because the pension saver has other income that takes their income above the personal allowance for the year. In such cases, the pension saver should not (in theory) receive any top up payment. The mechanism of clawing back relief by making the top up payment taxable is insufficient. Assuming they are a basic rate taxpayer, this means that 20% of the top up payment is clawed back as income tax, but the net pay saver will still benefit from 80% of the top up, putting them in an better position than those in Relief at Source schemes.

## Appendix 2 - Tax refund issued

| **Assumed scenario:** | |
|---|---|
| | £ |
| Employment income | 10,000 |
| Gross employee pension contribution | 500 |
| Self employed income | 10,070 |

***Net Pay Contributor***

| | £ | £ | |
|---|---|---|---|
| Employment income | 10,000 | | |
| Less: Pension | (500) | | |
| | | 9,500 | |
| Tax refund generated (note 1) | | 100 | **A** |
| When Self assessment tax return prepared: | | | |
| Net employment income | | 9,500 | |
| Self employed income | | 10,070 | |
| Total income | | 19,570 | **B** |
| Less personal allowance | | (12,570) | |
| Taxable income | | 7,000 | |
| Tax liability | | 1,400 | |
| Plus tax refund already given (note 2) | | 100 | |
| **Adjusted tax Liability** | | **1,500** | **C** |

| | |
|---|---|
| Net cash position (A+B-C) (note 4) | 18,170 |
| Pension position | 500 |

***Relief at Source contributor***

| | £ | £ | |
|---|---|---|---|
| Employment income | 10,000 | | |
| Less: Pension (note 3) | 0 | | |
| | | 10,000 | |
| Tax refund generated - not due | | | |
| When Self assessment tax return prepared: | | | |
| Net employment income | | 10,000 | |
| Self employed income | | 10,070 | |
| Total income | | 20,070 | **B** |
| Less personal allowance | | (12,570) | |
| Taxable income | | 7,500 | |
| **Tax Liability** | | **1,500** | **C** |
| Net pension contribution (note 3) | | 400 | **D** |

| | |
|---|---|
| Net cash position (B-C-D) (note 4) | 18,170 |
| Pension position | 500 |

Note 1 Based on the RTI data, HMRC would issue a tax refund to the pension saver. This would equate to 20% of the gross contribution, so £100 in this case, so would be the same position as if a top up payment were made under the draft legislation.

Note 2 When the pension saver prepares their self assessment tax return, the amount of refund received would be entered on the tax calculation pages (suggest that box 1 of TR6 of the SA100 could be used), which would in turn increase the amount collected under self assessment to cancel out the refund in cases where it is not due, such as in the scenario above.

Note 3 A taxpayer contributing under a Relief at Source scheme would make a net contribution of 80% - £400 in this case. This would not be deductible from the taxable income, but would still be a cash cost to the taxpayer.

Note 4 Under this mechanism, pension savers will each have the same overall net cash position, and the same increase in their pension pot, regardless of the type of scheme used by the employer.

**Appendix 3**

**Universal credit – income calculation and pension contributions**

**Summary**

As we understand it, the Department for Work and Pensions (DWP) currently deduct pension contributions from universal credit claimants' income as follows:

- Contributions to a relief at source scheme – the net of basic rate tax amount is deducted from UC income
- Contributions to a net pay arrangement scheme – the gross amount is deducted from UC income

While we understand this operational practice fits the policy intent to calculate UC entitlement based upon the claimant's available income, we do not think it matches the UC Regulations as they are currently written. We believe the regulations say that the gross amount is to be deducted in all cases.

We believe the DWP should amend the UC Regulations to clarify the policy intent and reflect their current operational practice. To continue with the status quo risks an adverse legal challenge (if contributors to relief at source schemes were to successfully argue that the gross should be deducted).

**Briefing**

We think there is a mismatch between the Universal Credit Regulations and DWP policy/operational practice in respect of deducting pension contributions from claimants' earnings.

The Universal Credit Regulations refer to deducting from earnings (either employed[i] or self-employed[ii] earnings) the amount of 'relievable pension contributions made by the person in that period'. Relievable pension contributions are then defined as being the amount relievable under s188 Finance Act 2004.[iii]

We think it follows that the deduction from earnings allowable under the UC regulations is of the **gross** pension contribution, as that is the 'relievable' contribution made by the person.

However, we believe that the DWP actually uses the **net** figure for contributions paid to relief at source pensions.

For an employee, where contributions are made to a relief at source scheme, the net amount is deducted from pay. It is this net 'paid' amount that the employer reports to HMRC via RTI[iv] and this is the figure which we understand is then passed to the DWP for use in the UC calculation. Similarly, where a self-employed person reports their earnings direct to the DWP via their online UC account, the guidance suggests they must enter the amount of pension contributions 'paid' - i.e. the net figure[v].

To get to the gross deduction from UC income, which we understand to be required by the regulations, the DWP should take the net figures reported them (via RTI or direct from the self-employed claimant) and gross them up by 100/80.

That said, if DWP are deducting the net amount paid to RAS schemes, this seems to be the logical and 'correct' thing to do in policy terms, on the basis that universal credit entitlement is to be calculated by reference to the sum of money in the claimant's pocket in the assessment period.[vi]

This practice follows older benefits regulations, where the law refers to the amount paid, rather than to the relievable pension contribution. For example, the regulations for income support instruct that 'one half of any sum **paid** by the claimant… by way of a contribution to an occupational or personal pension scheme'[vii] is to be deducted from the claimant's employed earnings. Similar wording is used to deduct one half of contributions paid to personal pensions from self-employed earnings.[viii] This wording for income support suggests it is either the net or the gross that is deducted, depending on whether the contribution is paid to a relief at source or net payment arrangement – i.e. the calculation looks at the amount that the person has actually paid out of their own pocket.

By contrast, as explained above, it appears that the UC regulations require DWP to deduct the gross pension contribution. We therefore think that DWP using the net figure for contributions to RAS schemes is technically incorrect as it stands and that the UC regulations need to be amended to clarify that it is the paid amount that is relevant to the calculation.

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[i] Si 2013/576, UC Regs, reg 55(5)(a) - https://www.legislation.gov.uk/uksi/2013/376/regulation/55
[ii] SI 2013/0576 UC Regs, reg 57(2) *Step 4* - https://www.legislation.gov.uk/uksi/2013/376/regulation/57
[iii] SI 2013/0376, UC Regs, reg 53(1) - https://www.legislation.gov.uk/uksi/2013/376/regulation/53
[iv] RTI data items, item 65 – see https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/880137/RTI-Data-Item-Guide-20-21-v1-2.pdf
[v] See GOV.UK guidance, para 2.3, final bullet https://www.gov.uk/government/publications/universal-credit-and-self-employment-quick-guide/how-to-report-your-earnings-from-self-employment#reporting-your-income-and-expenses
[vi] As indicated in reply to written question HL10794: https://questions-statements.parliament.uk/written-questions/detail/2020-11-27/hl10794
[vii] SI 1987/1967 – Income Support (General) Regulations 1987, reg 36(3)(b) - https://www.legislation.gov.uk/uksi/1987/1967/regulation/36
[viii] SI 1987/1967 – Income Support (General) Regulations 1987, reg 38(1)(b)(ii) - https://www.legislation.gov.uk/uksi/1987/1967/regulation/38