Pensions: net payment arrangements v relief at source payroll mistakes: how common are they?

Employment Tax | Personal tax

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The Low Incomes Tax Reform Group understands that it may not be uncommon for employers to make errors with tax relief on workplace pensions. Can you help us to gather evidence of the need for clear guidance on how to rectify the position when such mistakes are uncovered?

There is huge potential for confusion about the methods for giving tax relief via the payroll on employee pension contributions to workplace pension schemes.

There are two ways that an employee's pension contributions can be taken from their pay, depending on the type of pension scheme chosen by their employer:

- Under 'net pay arrangements' (NPA): where 100% of the pension contribution due is deducted before tax is calculated on wages (meaning that employees who earn more than the personal allowance should receive tax relief then and there); and
- Under 'relief at source' (RAS) arrangements: where 80% of on wages and the pension scheme reclaims basic rate tax relief from HMRC.

Due to the counterintuitive naming, there will be employers who misunderstand what the two tax relief mechanisms mean and get them back to front.

This can lead to the following situations:

- A contribution is taken from an employee's pay as if it were under RAS but where the pension scheme is set up as NPA. In this situation, tax will have been overpaid and insufficient employee pension contributions will have been paid

into the employee's pension pot.
- A contribution is taken from an employee's pay as if it were under NPA but where the pension scheme is set up as RAS. In this situation, there is double payment of tax relief – once through the payroll and then once when the pension scheme adds the 20%.

If an incorrect method of tax relief is being applied via the payroll, it is crucial that employers identify this at the earliest opportunity, change the method of tax relief being applied, and consider how to deal with what happened in the past. Of course, such mistakes will often only come to light when there is a fresh pair of eyes, such as a tax adviser getting involved.

Interestingly, in terms of rectifying past mistakes, there seems to be no specific guidance available to help employers understand what to do. This is despite the fact that liabilities (either to HMRC or the employee/pension provider) can be significant, especially where the error has happened over many years.

To help us gather evidence of the need for guidance, we would be interested in hearing about any members' experiences of such situations.

If you have clients where this has been an issue, please email litrg@ciot.org.uk with the subject line 'Pension errors' letting us know:

- How many and what type of client they were (for example, sole trader, small business, etc.)?
- What was the size of the error?
- Have you ever been asked for advice about correcting this problem?
- What have you advised?

Any evidence, examples or further information that you could provide us with will be very helpful. Thank you.