# Government pressed to adopt 'pension bonus' plan to end the unfair penalty that hits low paid workers

- **Some 1.5million poorly paid staff lose Government payments into their pensions**
- **This free pension cash is automatically given to better paid workers**
- **The Treasury put forward four potential fixes to tax flaw over the summer**
- **Experts favour solution where HMRC would pay' bonuses' into workers' funds**

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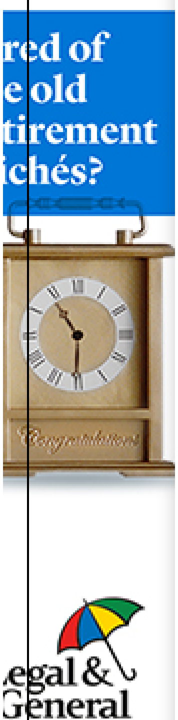
Low earners denied free pension cash given to better paid colleagues should be compensated with a bonus into their pots from the taxman, say experts.

Critics have long demanded action over a tax flaw which means an estimated 1.5million poorly paid staff lose Government payments into their pensions, depending on the type of scheme operated by their employer.

The Treasury **put forward four potential fixes** over the summer, and asked for feedback and other suggestions in a consultation which has just closed.



**Tax penalty: An estimated 1.5million poorly paid staff lose Government payments into pensions which are automatically handed to higher income workers**

A solution where HMRC would use information it already holds on lower earners to pay money into their retirement funds is favoured in responses made public by pension groups and other industry players.

The other options involve either clawing back money from low earners who do get the cash at present - an idea that attracted strong criticism - or two methods forcing employers to change how they currently administer pensions.

**>>>Why are some low earners losing pension top-ups? Find out below**



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'The inequity of the existing system, which disproportionately impacts low earners and women, has gone on for too long and must be fixed if all savers are to get the most out of their retirement savings,' says Nigel Peaple, director of policy and research at the Pensions and Lifetime Savings Association.

The industry group supports the HMRC bonus option - which it suggests won't be as difficult the Treasury makes out in its consultation document - and dismisses the other three ideas as not fair and proportionate.

'In the absence of a solution, the Government would be perpetuating an anomaly that has created social injustices at the heart of the pensions system,' the PLSA says in its response.

For example, women in **net pay schemes** amount to three-quarters of those affected by this anomaly, and other groups who are disproportionately low paid, such as ethnic minorities, are also likely to be significantly affected.

'We believe that this situation is indefensible and must be rectified.'

Victoria Todd of the Low Incomes Tax Reform Group, an offshoot of the Chartered Institute of Taxation, says: 'Action must be taken to ensure all low-income workers get a government

## How much are low earners losing?

The Government previously calculated low earners affected by this anomaly would miss out on £65 in the 2019-2020 tax year.

But this would eventually build into a valuable pot due to the **compound effect of investing over long periods.**

Some workers earning £12,499 a year could retire with a pot worth £51,000, while others whose employer operates contribution to their pension, as was promised under auto-enrolment.

'Currently an estimated 1.5 to 1.75 million people miss out – three quarters of whom are women.

'The numbers affected will only grow as auto-enrolment is extended to 18-year-olds and the lower earnings limit is removed. Failure to act could damage confidence in pensions and auto-enrolment.'

pensions differently would end up with £59,000, according to figures from financial services firm Quilter.

That assumes 4 per cent net investment growth after charges in both cases, and a retirement age of 68,

Todd claims the Treasury consultation 'misrepresents' the proposal for HMRC to reimburse low paid pension savers, saying: 'The additional administrative burdens indicated in that paper are either mistaken or over-stated.

'While we recognise that our proposal adds some complexity, it is important to balance the oftentimes competing objectives for the tax system. In this case, we believe that some complexity is a reasonable price to pay to fix the inequality.'

Kate Smith, head of pensions at Aegon, says: 'All of the solutions put forward come with challenges and increased costs, with no easy solution. But it's essential that all those currently losing out do receive their Government top-up.

'The solution has to be around levelling up, not down, meaning one option of removing tax relief for all low earners is completely unpalatable.

'We strongly believe that the only systematic way to resolve the net pay anomaly is for HMRC to use the data it already collects, expanding this if necessary, to pay low earners saving in net pay schemes a bonus using real time information, without requiring this group to make a claim.

'This is the most workable, least disruptive solution for these low earners and their employers.'

Smith suggests a similar 'real time information' solution could be used to make automatic corrections where devolved nations' income tax rates differ from the rest of the UK, **as they do in Scotland,** and for higher rate tax payers.

The Treasury consultation, promised in the Conservative manifesto at the 2019 election, was a victory for former Pensions Minister Ros Altmann and the Net Pay Action Group, a coalition of campaigners and industry experts calling for low-earning pension savers to be treated fairly.



John Glen, Economic Secretary to the Treasury, had previously said that **fixing the tax flaw was not 'cost effective'.**

Unveiling the consultation, he said: 'The majority of saving into a pension is unaffected by which method of pensions tax relief administration their scheme uses.

'However, low earners saving in a pension may end up in differing financial positions depending on how their scheme is administered.'



He cautioned that any change could create challenges elsewhere for pension schemes, their members or the wider tax regime.

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'Low-paid workers are being failed by a pensions lottery,' TUC boss Paul Nowak told This is Money **here.**

The consultation stressed any solution adopted must be simple, deliverable and proportionate.

## Why are some low earners losing pension top-ups?

Low paid workers can miss out on government pension cash due to an obscure quirk of the tax system.

This is because the Government has frozen the earnings threshold at which people are automatically enrolled into pensions at £10,000. Meanwhile, the personal allowance, the level at which people start to pay tax, is currently £12,500.

Some people who earn between those two sums lose pension tax top-ups - but whether or not you miss out depends on the tax mechanism used by your work pension scheme.

Employers and their pension providers have two options when handling pension tax relief for staff - known in financial jargon as net pay and relief at source.

Most master trusts, which manage centralised funds for lots of employers at once, use **net pay** which is convenient for top-paid staff but penalises lower earners.

Net pay means workers contribute directly into their pension before their tax bill is calculated, so their pension tax relief is already included and there is no need to claim it from HMRC.

Under **relief at source** the pension provider claims the income tax relief directly from HMRC and adds it to each worker's pension.