The PENSIONS Advisory Service

Spotlight

Using a redundancy payment to pay into a pension

During your working life you may find that your employer needs to reduce their workforce. As a result you may find your job no longer exists and you may be wondering how this affects your pension. This spotlight gives an example of how part of a redundancy payment may be used to pay into a pension.

The Pensions Advisory Service is unable to give individual specific advice and you should seek regulated financial advice.

Key facts

It may be possible to pay part or all of a redundancy payment into a pension; however the following factors need to be considered:

- How much is your redundancy payment?
- Can you afford to pay into a pension?
- Will your employer pay the redundancy payment into a pension? Your employer does not have to agree to pay any of the redundancy payment into your pension.
- Will the redundancy payment exceed your Annual Allowance if paid into a pension? The Annual Allowance is the amount you can pay into a pension and receive tax relief. Any payments which exceed the Annual Allowance may be subject to an additional tax charge. Further information on the Annual Allowance is covered later on in this spotlight.
- Were you made redundant before or after 6 April 2018?

Redundancy payments prior to 6 April 2018

Prior to 6 April 2018 individuals who were made redundant were generally able to receive up to £30,000 tax free. Any payment made exceeding £30,000 was classed as earnings and subject to income tax. However, if the excess was paid into a pension by the individual they were able to claim tax relief on this contribution.

Where the employer agreed to make an employer contribution into an individual’s pension arrangement, the individual cannot claim tax relief on the contribution.

From 6 April 2018 the way in which redundancy payments are treated for tax and National Insurance changed. The next section explains the change in more detail and will affect those whose employment ended on or after 6 April 2018 and who also received a redundancy payment or benefit on or after this date.

Termination payments on or after 6 April 2018

With effect from 6 April 2018 part of your redundancy payment may be chargeable to income tax and National Insurance Contributions (NICs). The changes mean redundancy payments may be split into two elements:

The first element, known as Post-Employment Notice Pay (PENP) is taxable as general earnings and will be subject to Class 1 NICs. The PENP represents the amount of basic pay the employee would have received had their employment not been terminated without full or proper notice being given.

PENP is calculated by applying a formula set out in the legislation to the total amount of the payment or benefits paid in connection with the termination of an employment.

The second element is the remaining balance of the termination payment, or benefit, which isn't PENP. This is taxable as specific employment income to the extent that it exceeds £30,000 and is treated in the same way as other payments and the benefits are taxable.

PENP calculations should not be applied to statutory redundancy payments. These payments are always taxable as specific employment income and subject to the £30,000 exemption where appropriate.

Changes to the taxation of non-contractual payments in lieu of notice (PILONs) came into effect on 6 April 2018. Therefore all types of PILONs will be subject to income tax and National Insurance from that date.

The phrase payment in lieu of notice (PILON) still exists and is used to describe a range of payments made in a variety of legal situations. In considering the taxation of such payments it is therefore important to establish the precise circumstances in which they are made.

This is why the employer must provide the employee with a detailed breakdown of their termination payments.

You will need to refer to your employer's breakdown of your redundancy payments to work out the taxable element that could be paid into your pension.

If your total earnings exceed £110,000 pa please check to see if you are affected by the Tapered Annual Allowance.

Statutory Redundancy pay

Statutory Redundancy pay is the legal minimum that you may be entitled to. Your contract of employment may have a higher entitlement of redundancy pay.

You will normally be entitled to statutory redundancy pay if you have been working for your current employer for more than 2 years.

What you will get will depends on your age:

- Half a week's pay for each full year you were under 22
- One week's pay for each full year you were 22 or older but under 41
- One and a half week's pay for each full year you were 41 or older
  Note: ***The length of service is capped at 20 years.***

The amount of tax and national insurance you will pay on your redundancy monies will depend on your employer's redundancy rules and the type of payments received.

There will be no national insurance contributions and no income tax on the first £30,000 of the following ‘termination payments’:

- ***Statutory*** and enhanced redundancy payments
- Ex-gratia payments
- Unfair dismissal payments
- Damages (excluding PENP)

You will need to refer to your employer’s breakdown of your redundancy payments to work out the taxable element that could be paid into your pension.

This is a complex area and you may wish to seek advice from a tax specialist and/or regulated financial adviser.

For more information refer to the gov.uk website:
https://www.gov.uk/redundant-your-rights/redundancy-pay

From 6 April 2019, the maximum statutory redundancy pay you can get for the 2019/2020 tax year is £15,750 (£16,410 in Northern Ireland). A statutory redundancy payment is exempt from income tax and counts towards the tax-free threshold of £30,000.

If your employment is terminated on or after 6 April 2018, your employer should provide you with a breakdown of the different elements of your pay that make up your redundancy payment which correctly identifies those that are exempt from income tax and/or National Insurance Contributions and those elements that are subject to income tax and National Insurance Contributions.

The Annual Allowance & Lifetime Allowance

Contributions can be made by or on behalf of an employee with full tax relief if, in total, they do not exceed the relevant Annual Allowance for that tax year. Tax relief is limited to contributions up to the higher of £3,600 per tax year or 100% of earnings. The Annual Allowance for 2019/20 is £40,000 unless the Money Purchase Annual Allowance (for those who have accessed their benefits flexibly) or Tapered Annual Allowance (for high earners) applies.

In addition, subject to certain conditions, an employee may be able to carry forward any unused Annual Allowance from the previous three tax years (provided that he or she was at some point during those tax years a member of a registered pension scheme). Individuals are subject to income tax under self-assessment at their marginal rate on contributions in excess of the Annual Allowance.

The Lifetime Allowance (£1,055,000 for tax year 2019/20) must also be considered. If the value of the individual’s accrued pension rights when he or she takes the benefits exceeds the Lifetime Allowance the individual is subject to an additional tax charge.

For more information on the Annual Allowance please see our Spotlight:
https://www.pensionsadvisoryservice.org.uk/content/spotlights-files/uploads/Annual_Allowance_SPOT004_V1.9.pdf

Future tax years

If you do not go back to work following your redundancy, you will still be able to make tax-relievable contributions of £3,600 gross. If you start work again, you can make higher contributions of up to 100% of your earnings capped at £40,000.

Any further contributions made to the same scheme by 5 April following your redundancy will be included in the test against the Annual Allowance for that tax year.

About Us

The Pensions Advisory Service (TPAS) works to make pensions accessible and understandable for everyone. We provide independent and impartial information and guidance about pensions, free of charge, to members of the public.

We help with all pension matters covering workplace, personal and stakeholder schemes and also the State Pension. We answer general questions, help with specific queries and offer guidance for people with complaints about their private pension scheme.

The Pensions Advisory Service is provided by Money & Pensions Service

Contacting us

Pensions Helpline (Monday-Friday 9am-5pm) **0800 011 3797**

Online enquiry form www.pensionsadvisoryservice.org.uk/online-enquiry

Web chat live (Monday-Friday 9am-6.20pm) www.pensionsadvisoryservice.org.uk

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