

PAYSLP METHODOLOGY SERIES

Chapter 5 — Literature Review

Pension Contributions — Three Scheme Types

*A thematic synthesis of statutory, regulatory
and policy literature*

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ABSTRACT

This literature review examines the regulatory, statutory and policy literature governing workplace and personal pension contributions in the United Kingdom for the 2026/27 tax year. Drawing on the Finance Act 2004 Part 4 as the principal source of statutory authority on registered pension schemes, on HMRC's technical guidance on pension contribution tax relief, and on the Pensions Regulator's detailed guidance on automatic enrolment, the review distinguishes between the three mechanisms by which contributions are extended to individual contributors—net pay, relief at source, and salary sacrifice—and analyses their materially different effects on take-home pay, employer National Insurance liability, and effective after-tax cost. The review identifies four themes: the architecture of tax relief; the role of automatic enrolment in expanding participation; the Annual Allowance and tapered Annual Allowance as instruments of high-earner restriction; and the asymmetric incentive structures produced by these mechanisms. The chapter concludes that the choice of relief mechanism is a material determinant of effective contribution cost and must therefore be explicit in any calculator implementation.

Keywords: pension contributions, net pay, relief at source, salary sacrifice, auto-enrolment, Annual Allowance, 2026/27

1. Introduction

Pension contributions occupy a structurally distinctive position in the United Kingdom's system of personal taxation. Whilst income tax and National Insurance operate as straightforward deductions from gross income, pension contributions interact with the tax system through one of three mechanisms—net pay, relief at source, or salary sacrifice—each of which alters the relationship between gross income, taxable income and net pay in materially different ways. For an employee earning £40,000 and contributing 5 percent of salary into a workplace pension, the take-home consequences of these three mechanisms differ by approximately £200 per year, notwithstanding the identical nominal gross contribution.

This chapter undertakes a thematic literature review of the principal sources informing the calculation of pension contribution treatment for 2026/27 as implemented in the Payslp methodology. Three primary sources are drawn upon. HMRC's technical guidance on private pension contributions (HMRC, 2026) provides the operative position on tax relief mechanics. The Pensions Regulator's detailed guidance on automatic enrolment (TPR, 2026) sets out the framework within which most contributions are now made. Finance Act 2004, c. 12, Part 4, provides the underlying statutory architecture of the 'registered pension scheme' regime that has governed UK pensions since A-Day in April 2006.

The review is structured to address (i) the architecture of tax relief and the three mechanisms by which it is extended; (ii) automatic enrolment and its role in expanding participation; (iii) the Annual Allowance and its tapered form for high earners; and (iv) the asymmetric incentive structures the system produces.

2. Scope and Methodological Approach

The review is restricted to pension contributions made into 'registered pension schemes' within the meaning of Finance Act 2004, Part 4. This category encompasses occupational pension schemes (including defined benefit, defined contribution, and the 'CARE' hybrid schemes of the major public

services), personal pensions (including Self-Invested Personal Pensions or SIPPs), and stakeholder pensions. The review does not extend to non-registered schemes, Qualifying Recognised Overseas Pension Schemes (QROPS), or the state pension, which is treated separately in Chapter 21.

The methodological approach is doctrinal and operational rather than welfare-analytical: the review establishes how each relief mechanism produces its particular effect on take-home pay, rather than evaluating whether the resulting incentive structure is socially optimal. Where the literature makes evaluative claims (for example, on the distributional fairness of the tapered Annual Allowance), the review notes them but does not adjudicate. The three principal sources are taken as definitive on the operative position; the review's contribution is to synthesise the materially different mechanisms into a coherent implementation specification.

3. Literature Review

3.1 Tax relief and the three mechanisms

Finance Act 2004 establishes that contributions to registered pension schemes are eligible for tax relief, but the route by which that relief is delivered is determined by the scheme's administrative arrangements rather than the contributor's election. Three mechanisms operate concurrently in 2026/27. *Net pay* arrangements, used by the majority of occupational schemes including the major public-service schemes, deduct the contribution from gross pay before income tax is computed; the employee's taxable pay is reduced by the gross contribution and the relief flows automatically at the employee's marginal rate, irrespective of whether that is 20 percent, 40 percent, 45 percent, or any of the Scottish rates. *Relief at source* (RAS), used by personal pensions and SIPPs and by some employer schemes, operates differently: the employee contributes from net pay, the scheme reclaims basic-rate relief from HMRC and adds it to the pension pot, and higher- or additional-rate taxpayers must reclaim the additional relief through Self Assessment.

Salary sacrifice is conceptually distinct from the first two: it is not a tax-relief mechanism in the strict sense but a contractual reduction in gross pay in exchange for an equivalent increase in employer contribution. The effect is that no contribution is made by the employee at all; instead, the employer makes a larger contribution and the employee's taxable salary is reduced. Because National Insurance is computed on gross salary, salary sacrifice produces savings on both income tax *and* National Insurance, a distinguishing feature it shares with no other mechanism. HMRC (2026) emphasises that salary sacrifice arrangements must be genuine variations of contractual terms, not merely administrative reclassifications.

3.2 Automatic enrolment and the expansion of participation

The Pensions Act 2008 introduced the framework of automatic enrolment, fully operational since 2018, under which all employers must enrol eligible jobholders into a qualifying scheme. The Pensions Regulator (2026) confirms that 'qualifying earnings'—the band of pay on which the statutory minimum contribution must be paid—remains, for 2026/27, between the Lower Earnings Limit of £6,240 and the Upper Earnings Limit of £50,270. Minimum total contributions are 8 percent of qualifying earnings, of which at least 3 percent must come from the employer.

Automatic enrolment has had profound effects on the composition of pension contributors. The Pensions Regulator (2026) notes that opt-out rates have remained at single-digit percentages despite repeated phasing-in of higher minimum contributions, a result frequently cited in the academic literature as a striking validation of choice-architecture policy interventions. For calculator design, the implication is that the typical user is now contributing under a net-pay arrangement at a default 5 percent personal / 3

percent employer split.

3.3 The Annual Allowance and its tapered form

The Annual Allowance is the maximum aggregate amount on which an individual may receive tax relief on pension contributions in a tax year. For 2026/27 it stands at £60,000 (HMRC, 2026), with carry-forward of unused allowance from the preceding three tax years permitted. For high earners, the tapered Annual Allowance applies: from a threshold income of £200,000 and adjusted income of £260,000 the allowance reduces by £1 for every £2 of adjusted income above the threshold, to a floor of £10,000 at adjusted income of £360,000.

Finance Act 2004 sets out the basic Annual Allowance architecture; the tapered version was introduced in 2016 and amended in 2020 and 2023. HMRC (2026) provides the operative thresholds in accessible terms. The tapered allowance has drawn material attention in the medical literature in particular, where its interaction with NHS Pension Scheme annual pensionable inputs has been identified as a driver of early retirement among senior clinicians. For calculator design, the tapered allowance is a complex but tractable constraint that must be checked before any contribution above £60,000 is treated as relievable.

3.4 Asymmetric incentive structures

The three relief mechanisms produce materially different after-tax positions. For an employee earning £40,000 contributing £2,000 gross: net pay produces a net cost of £1,600 (relief at 20 percent applied automatically); relief at source produces a net cost of £1,600 by the same arithmetic but achieved differently (employee contributes £1,600 net, scheme grosses up by £400); salary sacrifice produces a net cost of approximately £1,440 due to the additional NI saving of £160 (8 percent of the sacrificed amount).

For a higher-rate taxpayer the differences are more pronounced. An employee earning £70,000 contributing £5,000 gross: net pay produces a net cost of £3,000 (40 percent relief); relief at source produces a headline net cost of £4,000 with an additional £1,000 of relief reclaimable through Self Assessment, for the same effective £3,000; salary sacrifice produces a net cost of approximately £2,900 by virtue of the additional NI saving of £100 (2 percent of the sacrificed amount, since the sacrifice operates above the Upper Earnings Limit where the 2 percent rate applies). These differences are not marginal: they are central to the proposition that pension contributions are not adequately characterised by a single ‘tax relief rate’.

4. Synthesis and Implications for Calculator Implementation

The reviewed literature establishes that pension contribution treatment cannot be reduced to a single formula. Three implementation requirements follow. First, the calculator must accept the user’s indication of which relief mechanism applies and adjust the taxable-pay and NI-base calculations accordingly: net pay reduces both; relief at source reduces neither for the current period (the relief flows separately); salary sacrifice reduces both. Second, the calculator should expose the effective after-tax cost rather than reporting only the gross contribution, since the after-tax cost is what actually constrains household budgets. Third, where adjusted income exceeds £200,000, the calculator should warn the user of potential Annual Allowance taper exposure, which cannot be reliably reduced to a single deterministic figure without information on all pension inputs across multiple schemes.

The literature also indicates a practical limitation. The tapered Annual Allowance is calculated on ‘adjusted income’, a concept that includes pension inputs and so creates an inherent circularity in defined-benefit schemes. The Payslp calculator does not attempt to resolve this circularity in real time,

instead flagging the issue and directing users to professional advice where it is potentially relevant. This is a defensible pragmatic choice but should be made transparently.

5. Conclusion

Pension contribution treatment for 2026/27 is governed by a stable statutory framework in Finance Act 2004, operationally expressed through three relief mechanisms (net pay, relief at source, salary sacrifice) whose after-tax consequences differ materially for any given gross contribution. Automatic enrolment has expanded the contributing population to near-universal coverage among eligible jobholders, with default contribution levels of 8 percent of qualifying earnings on a 3-percent-employer / 5-percent-employee split. The tapered Annual Allowance creates a complex constraint for high earners that calculator design must signpost without attempting to resolve in full. The Payslp implementation addresses each mechanism explicitly and exposes the after-tax cost as the primary user-facing metric.

References

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