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Why maximising your pension contributions is like getting a pay rise

It sounds counterintuitive. Of course it does. Paying more money to get a pay rise? Well, when it comes to pensions, it's not as ridiculous as it sounds.

One of the simplest reasons, which you'll see the effects of immediately, is that in a workplace pension your employer pays in as well as you. It's extra monthly money on top of your salary that goes straight towards your retirement.

In a defined contribution pension (which most workplace pensions are), 'auto-enrolment' rules mean your employer must contribute an equivalent of 3% of your salary, and you have to put in 5%. So, in other words, the equivalent of at least 8% of your salary goes into your pension every month, but you only pay for 5% of it.

It's a match!

Some would argue that's a bit of 21st century slang, but matching pension contributions can lead to swiping right on maximising your pension for a pay rise.

That's because some employers will match your contributions, encouraging you to put in more money. Effectively, the more you contribute, the more they do – up to a certain limit.

So, the lesson is to get more from a match. If you contribute 6% of your salary, your employer could match it with 6% of their own money. You end up with a 12% contribution total, but only pay for half of it. Now doesn't that sound like a good deal?

To make the most of your workplace pension, ask your HR department how much your employer is prepared to put in your pot.

What a relief!

Regardless of your employer's contribution level, it's worth adding that bit extra into your pension savings. That's because of the little cherry-on-the-top, the tax relief. Every time you contribute, the government boosts the value of your contribution with tax relief.

There's two ways you can get tax relief on your pension contributions - these are called relief at source and net pay. Your employer will decide what method is used.

In a net pay arrangement, effectively, if you pay the basic rate of 20% income tax, and then stick £80 into your pension, the Government will top that up by £20.

You've turned £80 into £100 without even thinking about it. Talk about patting your future self on the back.

And, if you're a higher rate taxpayer and pay income tax at 40%, you could claim an extra £20 tax relief. This makes the cost of a £100 contribution into your pension £60 to you – £20 claimed by your pension provider and £20 reclaimed by you.

If you're a higher rate tax payer, this additional tax relief can usually be claimed through your self-assessment tax return.

With **relief at source**, your employer deducts the agreed pension contribution from your 'take home' pay and sends this to your pension provider.

Your pension provider then claims 20% in tax relief direct from the government, which they add to your pension pot.

Through this method, if you pay a higher rate of tax than 20%, you will have to claim the extra tax relief through a tax return.

Income tax bands are different [if you live in Scotland].

A worthy sacrifice

You may be able to even boost the total paid into your pension further or increase your take-home pay if your workplace pension scheme offers salary sacrifice.

If you "sacrifice" part of your salary, your employer then pays your pension contribution themselves. Including their own contribution. You've elected to decrease your overall pay because a part of it has been earmarked for your pension.

Providing you pay Income Tax and National Insurance, you'll pay lower Income Tax and NI than you would have done, because your taxable salary is less than it was 'on paper'.

And because of that, you can choose to use this saving to either increase the total paid into your pension, or to increase your take-home pay.

Employers save on National Insurance too, and some may even add their National Insurance savings into your workplace pension as well - giving your pot a helpful boost.

Salary sacrifice may not be right for everyone, so it's always a good idea to speak to your employer first.

If you're on the road to maximising your pension contributions, it's always a good start to get to know your pension like the back of your hand. Do you have the option of salary sacrifice? Does your employer match your contribution level, or pay a set amount? Get to grips with the nitty gritty, work out what works for you, and get buckled up for a retirement journey where your pension works as hard as it can for you.

This information is based on our understanding of current taxation law and HMRC practice, which may change.