

**IFA Fact-Files**  
**"Pension A day issues"**  
**6<sup>th</sup> April 2006**

PO Box 87, Crockenhill  
Swanley, Kent BR8 9AP

Tel: 01322 669059

Fax: 01322 666825

Email: martin@maaltld.co.uk

Web: www.maaltld.co.uk

## Series 1 CONTRIBUTIONS

*(Other A day fact-files: Pension benefits & Existing Pensions)*

As from A day, there will be a different set of rules governing the contributions that can be paid into a pension scheme. Importantly of course, all pensions will be governed by the same rules as of 6<sup>th</sup> April 2006, so where it used to be important to have the right type of pension, the choice is now reduced. This paper aims to give you the main issues regarding contributions into pensions from A day.

### Maximum contributions & tax relief

There is no maximum contribution that can be paid into pensions but, tax relief may not always be available on the whole contribution. There is a new annual allowance applicable to pension contributions which has a bearing on the tax relief for the pension.

#### Annual contribution allowance

This is reviewed every 5 years and for the next 5 years will increase by £10,000 per annum as follows. Contributions can be paid in excess of these amounts, but there are likely to be tax consequences:

2006/07 tax year	£215,000
2007/08 tax year	£225,000
2008/09 tax year	£235,000 etc

In the year pension benefits are taken or in the year the individual dies the annual allowance does not apply.

Ordinarily, the maximum contributions that attract full tax relief can be summarised as follows:

#### Personal contributions

- **£3,600** per annum, or
  - **100% of** UK net relevant earnings (usually **salary**) subject to the annual allowance above
- Personal contributions combined with Employer contributions to ensure not more than annual allowance paid in

#### Employer contributions

- Up to **£215,000** in the tax year 2006/07.
- **Unlimited** in the year pension benefits are taken or in the year the individual dies.

The matrix on the reverse side helps to show how this works in practise.

### Carry Back

The last opportunity for most people (except those with old S226 plans) to Carry Back will be the 31<sup>st</sup> January 2006. This allows people to base a contribution on the immediate preceding years' earnings. This was a particularly useful facility for the self-employed.

In future, a contribution made within a tax year must apply to the tax liability in that tax year also. An estimate of profits will therefore have to be made, if one wishes to try to maximise pension contributions against tax liabilities. The effect of this should not be too great as the maximum contributions have been raised significantly. The effect will be on the tax planning, rather than the pension fund.

**Pension contribution & tax relief matrix (assumes 2006/07 tax year)**

Matrix does not apply in year of drawing pensions or death. The areas of most potential gain have been coloured grey. The remaining scenarios are inefficient (sometimes very) for tax purposes:

	Salary of £3,000	Salary of £30,000	Salary of £215,000	Salary of £400,000
<b>Employer contribution of £3,600</b>	Full Corporation Tax relief	Full Corporation Tax relief	Full Corporation Tax relief	Full Corporation Tax relief
<b>Employee contribution of £3,600</b>	Full basic rate tax relief – net cost £2,808	Full basic rate tax relief – net cost £2,808	Full 40% tax relief – net cost £2,160 higher rate tax via Self Assessment	Full 40% tax relief – net cost £2,160 higher rate tax via Self Assessment
<b>Employer contribution of £200,000 *<sup>3</sup></b>	Full Corporation Tax relief * <sup>2</sup>	Full Corporation Tax relief * <sup>2</sup>	Full Corporation Tax relief	Full Corporation Tax relief
<b>Employee contribution of £200,000</b>	Basic tax relief on £3,000 – net cost £2,340. Effective tax relief only 0.33%	Basic tax relief on £30,000 – net cost £23,400. Effective tax relief only 3.3%	Full 40% * <sup>1</sup> tax relief – net cost £120,000 higher rate tax via Self Assessment	Full 40% tax relief – net cost £120,000 higher rate tax via Self Assessment
<b>Employer contribution of £300,000 *<sup>3</sup></b>	Full Corporation Tax relief * <sup>2</sup> . Individual taxed at 40% on £85,000 – tax charge £34,000	Full Corporation Tax relief * <sup>2</sup> . Individual taxed at 40% on £85,000 – tax charge £34,000	Full Corporation Tax relief * <sup>2</sup> . Individual taxed at 40% on £85,000 – tax charge £34,000	Full Corporation Tax relief * <sup>2</sup> . Individual taxed at 40% on £85,000 – tax charge £34,000
<b>Employee contribution of £300,000</b>	Basic tax relief on £3,000 – net cost £2,340. Effective tax relief only 0.22%	Basic tax relief on £30,000 – net cost £23,400. Effective tax relief only 2.2%	40% tax relief up to £215,000 – 40% tax charge on next £85,000 via Self Assessment	40% tax relief up to £215,000 – 40% tax charge on next £85,000 via Self Assessment

\*<sup>1</sup> Marginally less tax relief than 40% due to Basic Rate tax bands.

\*<sup>2</sup> Subject to Local Inspector of Taxes ruling on whether pension contribution is excessive against earnings – speak to your Accountant.

\*<sup>3</sup> Full tax relief only available for Companies with profits in excess of the pension contribution.

**Contribution opportunities**

The following are areas of opportunity under the new regime:

Low salaried Company Directors

Subject to \*<sup>3</sup> above, Directors can continue to pay low salaries whilst using their companies' contribution to offset against company profits and therefore Corporation tax.

Those with minimal pension funds approaching retirement

Without the need for large salaries, large pension contributions can be made in the final years before retirement – particularly efficient for company directors, less efficient for ordinary employees.

Commercial property purchase

Although borrowing potential has reduced, larger contributions can be made to boost funds to sufficient size to make this a worthwhile option.

Employees with other funds

Funds from Inheritances etc could be used to pay into a low pension fund to reduce tax liability on current income and to boost tax efficient pension fund. Investment benefits from immediate 22% up to 40% boost.

*If you have any questions or need an independent review of your pension arrangements, please contact Martin Andrews to discuss your situation further. Martin Andrews & Associates Ltd is an Independent Financial Adviser authorised and regulated by the Financial Services Authority.*

*Information given in this document should not be taken as advice as it is intended for guidance only. If you wish to have an assessment of your own situation, you should contact the office for advice.*