FINANCE UPDATES

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PENSION OPTIONS FOR DIRECTORS

Saving for retirement through your limited company.

Being the director of a limited company gives you a degree of independence – from having the freedom to choose how and when you work, to determining the direction of your business as you build it over time.

But it also means there's no one to set up a safety net for you, or to provide the kinds of workplace benefits that you might be legally obliged to provide for any of your employees.

So, even while you're hard at work running your company, it's also important to take some time to plan for your own future, and ensure you'll be in a secure financial position when the time comes to call it a day and retire.

Contributing into a pension can bring significant tax advantages for directors as your contributions can be treated as an allowable business expense and be offset against your limited company's corporation tax bill.

As a company director, you have two main options and each of those come with different tax implications.

You can contribute as an individual – in the same way that an employee might – or you can pay into your pension directly from your limited company, as part of your remuneration package.

Many directors use some combination of the two, but the best option for you will depend on your specific financial circumstances, so be sure to get professional advice before making any changes to your pension.

PERSONAL PENSION CONTRIBUTIONS

Anyone can contribute to a pension scheme on an individual basis and receive tax relief at their marginal rate when doing so.

For example, if you pay income tax at a rate of 20%, you'll get 20% relief on your pension contributions.

This means £100 from you would make up 80% of the contribution and the 20% tax relief would add £25 to it, meaning the total contribution would come to £125.

However, this relief applies up to certain limits, the main one being the pension annual allowance.

In a single tax year, you can receive this relief when you contribute up to 100% of your PAYE earnings, or £40,000 – whichever is lower.

This may be tapered for very high earners, or reduced to the money purchase annual allowance of £4,000 for those who have already crystallised a pension benefit.

Your earnings, for the purposes of this relief, do not include dividends, so this limit could create a drawback for limited company directors who take a small salary and a large dividend.

There are a couple of ways of planning around this. For example, if you haven't made pension contributions in recent tax years, you may be able to make use of any remaining annual allowance with the carry-forward rule.

Carry-forward allows you to make use of any annual allowance that you haven't used over the last three tax years, as long as you were a member of a registered pension scheme.

To take advantage of this rule, you must use up your annual allowance for the current tax year (2020/21) first, then use any unused allowance from 2019/20, 2018/19, and 2017/18.

Otherwise, to contribute higher amounts and still receive tax relief, you could consider raising your salary.

This may have other effects, however, including increasing the amount of national insurance you pay.

PENSION CONTRIBUTIONS FROM PROFITS

Your other option is to make pension contributions directly from your company.

This has a few potential tax advantages, and is often more efficient than paying into a pension from your personal funds.

It means that the money is going straight from your company to your pension, so national insurance is not deducted as it would be if the money was paid as a salary.

It can also qualify as an allowable business expense, so by making a pension contribution you can reduce the amount of profits that are liable to corporation tax at 19%.

However, pension contributions from your company must meet HMRC's rules for allowable deductions, including the condition that they are 'wholly and exclusively' for business purposes.

To assess whether or not this is the case, HMRC may look at whether your pension contribution is "excessive" for the value of the work you undertake, or how it compares to the company's pension contributions for employees.

Problems could also arise if your pension contribution exceeds your company's annual profits, which might suggest it's not being given exclusively for the purposes of business.

In most cases, if you're the sole director of a limited company and the company is making pension contributions within reason, you should be able to claim them as an allowable deduction.

PENSION OPTIONS FOR DIRECTORS

Your company can contribute to either a workplace or personal pension as a corporate expense. These come in a few different types, so we've listed some examples below.

Personal pensions

Stakeholder pensions are a type of pension scheme that must meet specific Government standards, including a limit on charges, charge-free transfers, flexible contributions, low minimum contributions, and a default investment fund.

If you want more choice over your pension investments, a self-invested personal pension plan offers more control over the investments than you would have with a standard personal pension scheme.

There are a range of assets you can invest in, including shares, exchange traded funds, open-ended investment companies and unit trusts, investment trusts, commercial property, gilts, and corporate bonds.

Workplace pensions

If your company has employees, it's likely you'll need to set up a workplace pension scheme.

A small self-administered scheme (SSAS) offers a high level of flexibility in how your assets are invested.

A SSAS can be open to all employees, as well as their family members, but is typically limited to 11 members.

Multi-employer pension schemes work as a type of 'umbrella' scheme, enabling multiple unconnected employers to contribute.

For example, NEST is the multi-employer pension scheme set up by the Government, but there are several others to choose from.

IMPORTANT INFORMATION

The way in which tax charges (or tax relief, as appropriate) are applied depends on individual circumstances and may be subject to future change. Pensions eligibility depends on individual circumstances and pension benefits cannot normally be taken before age 55.

This document is solely for information purposes and nothing in it is intended to constitute advice or a recommendation. You should not make any pension decisions based on its content.

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