WEALTH MANAGEMENT ALERT

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LIGHTHOUSECARRWOOD

All change for pension contributions – again!

Last month the government clarified how it is proposing to restrict tax relief on pension contributions, together with other changes it is planning to make to the pension regime. The changes will take effect from 6 April 2011, possibly even a year later, but will have an immediate effect on pension planning and the actions people should consider taking. Below we look at the key points.

Anti-forestalling will end on 5 April 2011 as expected. Labour's plans for tapering tax relief for high earners via the high income excess relief charge will also be scrapped. However, the government's proposals aim to curtail the ability for people to reduce their income tax by making large pension contributions.

Key decisions

- The annual allowance (AA) for pension contributions will be reduced to £50,000 from April 2011. At some stage this may be subject to indexation increases but not until after 2015/16.
- The lifetime allowance (LTA) will be reduced from £1.8m to £1.5m from April 2012.
- The government is currently considering whether to give individuals the flexibility to pay large AA tax charges from their pension scheme.
- A form of carry-forward of up to three years' previous unused allowances will be permitted. This is intended to ease or smooth out large one-off spikes in accrual that exceed the AA in a single year for people on moderate incomes. The carry-forward limit for 2008/09, 2009/10 and 2010/11 will be £50,000.
- Schemes and employers will be able to manage one-off spikes in pension contributions or accrual through flexible scheme design and other mechanisms, whilst ensuring these do not fall foul of anti-avoidance principles. *
- Final salary benefits will be valued using an increased flat factor of 16. (The current flat factor is 10.)
- The flat AA tax charge on excess contributions (currently 40%) will be replaced with a 'tailored' tax

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Using employer pension contributions to create or increase a loss

It is possible to create or increase a trading loss by making an employer pension contribution. Directors of many companies may feel that making a pension contribution during a trading period when profits are low (or non-existent) is pointless. However, trading losses can be offset against the preceding year's profit or carried forward to set against future profits.

Therefore, as long as the company either paid corporation tax in the previous period or will be paying it in subsequent periods, tax relief will be given for pension contributions providing they are made wholly and exclusively for the purposes of the trade. Pension contributions need to be paid before the end of the accounting period. For instance, ABC Ltd anticipates profits of £10,000 in the trading year ending 31 December 2010. The company made a £400,000 profit in the accounting period ending 31 December 2009. Annual pension contributions for the directors and other employees are £100,000.

Should the payment be made now or delayed?

If the payment is made in the accounting period up to 31 December 2010, the company will have a trading loss of £90,000. This loss can be offset against the previous year's profits, thereby reducing corporation tax for that year by £26,775 (29% of £90,000), and no tax will be due for the year ending 31 December 2010. The total tax saving is £28,875. In this example the pension contribution does not need to be delayed, even though the consequence of the contribution being made is that the company does not make a profit for the period. If the company delayed making the contribution until the next accounting period, corporation tax relief would be delayed, possibly until 1 October 2012.

	31 Dec 09	31 Dec 10
Anticipated profit		£10,000
Pension contribution		(£100,000)
Profit	£400,000	£Nil
Trading loss available for relief	(£90,000)	
Carry back	(£90,000)	
Profit after carry back	£310,000	
Corporation tax rate	29.75%	21%
Corporation tax saved	**£26,775**	**£2,100**

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charge that effectively reclaims tax relief at marginal rates and reduces tax relief to 0% on contributions above the AA.

- Full tax relief at the marginal rate (up to 50%) will be given on pension contributions within the reduced AA.
- Exemptions from the AA test will be introduced for death and ill-health.
- No exemption from the AA test will be available on redundancy.
- The 'final-year, all benefits coming into payment' exemption will be removed from the AA tax charge.
- Pension Input Periods (PIPs) will not be aligned to the tax year. Transitional rules will be effective from 14 October 2010 for people who have already made, or will make, contributions greater than £50,000 in a PIP ending in 2011/12. *
- Some transitional protection will be available for those with pension values already above the reduced LTA or who have made plans based on a LTA of £1.8m. *
- There will be further protection for people relying on existing transitional protection rules. *
- The limit for breaking the LTA link for triviality will remain at £18,000.
- Information that must be provided by both employers and schemes includes requiring schemes to report pension input amounts to members. This would aid correct and timely completion of self-assessment tax returns. *
- Anti-avoidance legislation will be introduced for EFRBS and EBTs to ensure that they do not become more attractive as a means of remunerating or pensioning the highly paid, than any other method. *

The good news is that we have advance warning of these changes, giving people the opportunity to make the most of the current regime if they are able to. Given that anti-forestalling legislation remains in place until next April, action to take before the end of the current tax year will vary according to each individual's earnings, usual level of contributions and the current value of their fund.

We strongly recommend high earners and business owners reassess their contributions for this year in light of the proposed changes.

* May be subject to further consultation.

LighthouseCarrwood advisers are experienced in working with accountants to advise business owners, the self-employed and people on high incomes on tax-efficient ways of building their pension fund. If you feel that your clients would benefit from talking to one of our expert independent financial advisers, please contact us.

LighthouseCarrwood is one of the UK's leading providers of financial planning services to professional practices. We would be delighted to work with you to help your clients reduce their tax liabilities. To discuss how we could work with your firm in a way that suits you and benefits your clients and your business, please contact:
Mark Dallas, Managing Director, on 07899 981607
Mark.Dallas@lighthousegroup.plc.uk.
www.lighthousecarrwood.co.uk

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