

Bulletin 1
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Contributions to a registered scheme

There has been considerable discussion concerning the allowable contributions that may be made to a registered scheme under the new regime, and the extent to which such contributions will benefit from tax relief. This note considers the position in relation to both employer and member contributions.

Including:

Employer contributions

Member contributions

Employer contributions

On the face of it there is no direct limit on the maximum contribution that an employer can pay to a registered scheme on behalf of an employee. In practice, however, it is likely that employer contributions will be restricted so that they do not exceed the Annual Allowance, in view of the adverse tax consequences for the member concerned in respect of any contributions in excess of the Annual Allowance.

Although the employer can pay an unlimited contribution, tax relief will be available provided the contribution meets the general rules on allowable deductions (i.e. under Case 1 of Schedule D) other than the rule disallowing capital expenditure. This means that any such contributions must pass the "wholly and exclusively" for the purpose of the business test. As yet there is no definitive statement from the Revenue on how the "wholly and exclusively" test will be applied under the new regime. Notes are to be issued to the Local Inspectors of Tax on how to apply this and the Revenue has promised to make copies of these notes available to other interested parties.

There must, however, be some concerns over inconsistency if the final decision on the relievability of employer contributions is left to the Local Inspector.

From what comments have been made by the Revenue so far it certainly seems likely that tax relief may well be restricted where substantial contributions are paid in respect of a controlling director of a company or for individuals who are members of a family that controls that company. Initial indications from the Revenue are that the employer's contribution will be wholly and exclusively for the trade if it is in line with the contribution that would have been made to fund the pension provision for a third party employee if that employee was in a similar situation to the controlling director concerned. It certainly throws considerable doubt on whether, for example, the Revenue would be prepared to allow tax relief on a contribution of, say, £100,000 in respect of the controlling director of a company where that director was taking perhaps only a nominal salary (i.e. at the threshold for tax and national insurance) with the balance of remuneration taken in the form of dividends.

It is to be hoped that the Revenue will, as soon as possible, clarify the situation concerning tax relief on employer contributions. If tax relief on employer contributions for a controlling director are to be restricted post A-Day, it may be more attractive for the director's benefits to be maximised, where allowable, pre A-Day.

This is because of the certainty of the availability of tax relief in respect of employer contributions paid pre A-Day to an EPP or SSAS where the contributions are in respect of a member's past service and do not result in the member's aggregate benefits exceeding Revenue limits based on his service and salary with the employer concerned.



Employer contributions (cont.)

However, even this aspect has been thrown into confusion by comments made by HMRC in the recently issued Pensions Tax Simplification Newsletter No. 4. HMRC has confirmed that any contributions paid by an employer in an employer accounting period ending on or after 6 April 2006 will fall to be treated for tax relief

purposes as if paid under the new regime (i.e. subject to the uncertainties described above under the interpretation of the 'wholly and exclusively' rules). This will mean that an employer who wishes to pay a sizeable pre A-Day pension contribution to a SSAS or EPP, but pays this in an accounting period ending on or

after 6 April 2006, will have no certainty that that contribution will be relievably, even where the contribution would have been relievably under the current occupational scheme rules. This is a totally unsatisfactory situation and HMRC should, without delay, provide clear guidance on the relievability of employer contributions paid in this situation.

Member contributions

It is well known that the maximum allowable member contribution to a registered scheme is the greater of £3,600 gross or up to 100% of the individual's earnings.

A number of commentators have indicated that tax relief will be restricted when an individual's earnings exceed the Annual Allowance to the amount of the Annual Allowance (i.e. £215,000 for contributions paid in tax year 2006/07). This is not in fact the case. For example, where an individual has earnings of, say, £300,000 in tax year 2006/07 the individual would be capable of

paying a contribution of up to £300,000 with full tax relief available on the contribution. Of course, in most circumstances the individual is unlikely to pay a contribution in respect of the Annual Allowance as any excess is subject to a 40% tax charge on the member.

There is, however, one situation where the payment of a contribution by the member in excess of the Annual Allowance could be particularly attractive. Consider the example of John Phillips, who is a very successful entrepreneur with earnings of £400,000 in tax year 2006/07.

Phillips is aged 53 and has made very little pension provision. Phillips could consider payment of a pension contribution of up to £400,000. All of this contribution would be tax relievably. If Phillips then drew all his benefits from his registered scheme in tax year 2006/07 these would not be subject to the Annual Allowance, and therefore no excess charge would apply over and above the Annual Allowance limit of £215,000 applicable for that tax year.

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