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IS IT TIME TO REVIEW YOUR PENSION CONTRIBUTIONS?

The tax benefits of making pension contributions can be significant and with the announcements in the Budget earlier this year which increased the annual allowance and abolished the lifetime allowance, it is more important than ever to make sure you are making as much use of your allowances as possible. We have highlighted below a few key points to consider.

Personal Pension Contributions

As a reminder, Personal Pension Contributions made by individuals are paid 'net' of basic rate income tax (20%) since HM Revenue & Customs (HMRC) pay the 20% tax into the pension scheme. For example, if you pay £8,000 into your pension scheme during the year, HMRC will add £2,000 to that, giving a total ('gross') contribution to your pension scheme of £10,000.

For basic rate taxpayers therefore (those with total income of up to £50,270 for the current tax year ending 5 April 2024), there is no additional tax saving by making pension contributions, since tax relief is given at source.

Higher rate taxpayers however can claim an extra 20% of the gross contribution from HMRC. Using the example above, a higher rate taxpayer can claim an additional £2,000 from HMRC on the £8,000 contribution paid. For additional rate taxpayers (those with taxable income above £125,140 for the year), the extra relief would be £2,500. Higher and additional rate taxpayers can therefore benefit from potentially significant tax savings by making pension contributions.

Is there a limit to the amount of pension contributions I can make?

The current annual allowance (the maximum gross contributions which can be made to a pension scheme in the tax year) is £60,000, meaning that any contributions which exceed £60,000 (gross) will suffer a tax charge on the excess at the individual's marginal rate. This annual allowance is reduced for high earners, tapered by £1 for every £2 that an individual's income exceeds £260,000 (subject to a minimum allowance of £10,000). Where an individual is a member of a scheme but, during a tax year the amount they contribute to their pension is less than the annual allowance limit for that year, the unused balance for those years may be carried forward up to three years and used on a 'first in, first out' basis.

As well as the annual allowance, there is potentially a lower limit on the amount on which an individual can claim tax relief on personal contributions made to their pension scheme. This limit is the greater of:

(a) the individual's UK 'relevant earnings' for the tax year (broadly, the level of their salary and/or self-employment/partnership income); and

(b) £3,600 (gross).

Prior to 6 April 2023, there was also a 'lifetime allowance' (set at £1,073,100) which limited the amount of pension contributions which could be made (or benefits accrued) during an individual's lifetime, but this was abolished in the March 2023 Budget.

There are also restrictions on the level of pension contributions that can be made when an individual is already in drawdown on a pension.

What about contributions from my own limited company?

It is relatively common tax planning for those operating their businesses through limited companies to receive a modest salary from their company and 'top up' their income by other means e.g. by way of dividends. By doing this, it does limit the level of personal pension contributions on which tax relief can be claimed.

In this situation, consideration can be given to the company making an employer pension contribution to a pension scheme for the director(s). This is also tax efficient since such contributions will usually qualify for Corporation Tax relief. The annual allowance of £60,000 mentioned above applies to contributions made by individuals and employers, so this would still need to be considered when thinking about the level of contribution to make.

Are there any other tax benefits?

Income and capital growth generated within registered pension schemes is exempt from income tax and capital gains tax.

It will also be appreciated from the above that one of the main benefits for higher and additional rate taxpayers in making pension contributions is to receive tax relief during their working lives which may be at a higher rate (hopefully) than the resulting pension income will be subject to in retirement.

It is also generally much easier these days to transfer pension pots on death to other family members without triggering significant tax charges in doing so. Pension funds can also be free of Inheritance Tax (IHT) if they are suitably written in trust, so that they remain outside one's estate on death. Pensions should therefore form an important part of any IHT and estate planning.

Specific advice in relation to pension schemes should be obtained from your pension advisor or an independent financial advisor. The above is for general guidance only and no action should be taken without obtaining specific advice.

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