TaxZone Newthwire

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Editorial Note

The subject of pension schemes is probably perceived as a disaster area by most accountants and their clients. I concur with this viewpoint, as my AVC was with Equitable Life and my wife's scheme is with Standard Life! Our daughter is about to move flats, and her investment in property over the past 12 years has proved to be a much better option than any pension scheme.

This is the enigma facing both employees and self-employed workers. What is the best method of saving for the future and for retirement? Some favour ISAs. Others may change their principal private residence regularly, thereby making a tax- free capital gain. However, constant moves are not to everyone's taste, and there is no certainty that property prices will continue to rise in the future.

The great advantage of investing in a pension scheme, assuming that the government does not interfere further in this area by additional restrictions of tax relief, is that tax relief at the taxpayer's highest rate is available against a qualifying premium. For some taxpayers this means tax relief of 40% on the annual premium(s). In addition, pension premiums are a deduction for Tax Credit purposes, and in some instances where basic rate taxpayers are concerned will attract both income tax relief of 22% and Tax Credit relief of 37%. This medium of investment is therefore still probably worth considering by many.

It should be remembered that major changes to the pension scheme rules are proposed from 6 April 2005. One of the pending provisions will make it possible to treat a second home as part of a taxpayer's pension fund.

Regards

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Disclaimer

Pension Schemes

Statute law

There is a wealth of statute law regarding pensions funds in the Taxes Acts. The principal references dealing with this subject are:

Pension funds - insurance companies:

- Sections 431B, 436 and 438, Taxes Act 1988

Payments to unapproved pension schemes:

- Sections 596A, 596B and 596C, Taxes Act 1988
- Sections 386-392, ITEPA 2003.

Benefits from non-approved funds:

- Sections 393-400 ITEPA 2003.

Occupational pension schemes and personal pension schemes:

- Part XIV, chapter 1, TA 1988 (sections 590-658)
- Part 9, Chapters 1-16, ITEPA 2003 (sections 565-637)

Case law

Similarly case law regarding pensions is well represented in 'Tolley's Tax Cases'. The main references are:

- 57.46 Spreading of pension payment made by company over a number of years (Kelsall v Investment Chartwork Ltd [1994] STC 33).
- 60.002-60.118 Pension and benevolent provisions for employees.
- 65.67-65.72 Pensions generally.

Inland Revenue material

There are numerous Inland Revenue statutory instruments, press releases and extra-statutory concessions that are beyond the scope of this wire, and can be accessed through the Yellow Tax Books.

However, the Inland Revenue Pensions Schemes Manual may be accessed through the Revenue website, and comprises 26 parts.

Other resources

Lexis Nexis has a whole library of books on pensions schemes published under its Tolley imprint. Probably the most relevant are:

- 'Tolley's Basic Guide to Pensions'
- 'Tolley's Taxation of Pension Benefits'
- 'Tolley's' Taxation of Stakeholder Pensions'
- 'Tolley's Personal Financial Planning Manual' (section on pensions)

Other professional publishers no doubt have relevant titles.

Types of pension

Pensions are a vast subject, and this wire can only touch the essentials in a superficial way. The wire will not discuss what are and are not 'relevant earnings' for pension purposes. Readers are recommended to apply to a reputable independent financial adviser for advice regarding the various products.

However, the types of pension likely to be encountered include:

- Occupational pensions, in the form of final salary schemes and money purchase schemes. As is well known the final salary scheme is being phased out by many organisations
- Additional voluntary contributions schemes (AVCs). These may be entered into via the employer or not, and may comprise what is known as a free-standing additional voluntary contribution Scheme (FSAVC)
- Executive pension schemes taken out by businesses for the benefit of directors, management and senior employees
- Personal pension schemes. These are available to workers who have no other pension entitlement. In some instances they may comprise what is known as self-invested personal pensions (SIPPs)
- Stakeholder pension schemes, which are a fairly recent innovation, and will be discussed later. They are, in fact, a form of personal pension, but with specific advantages and a fairly low premium limit
- Small self administered schemes (SSAS). These are popular with the small business community
- Non-exempt approved schemes
- Unapproved and alternative schemes
- Sections 590 and 608 schemes
- Death benefit schemes.

In fact many executive and occupational schemes will include a death benefit, often expressed in a multiple of average salary for the past x years. Other schemes will promise a return of premium with interest on the death of the policyholder before pension date. Most schemes promise an optional tax-free capital sum as part of the benefits on retirement date, with the remainder being taken as pension.

I have not referred to retirement annuity contracts, as these can no longer be entered into, but I shall refer to these contracts when discussing tax relief.

Premium tax relief

The abolition of advance corporation tax and the accompanying tax credit in 1999 hit the investment industry very hard, and this included pension funds. It is one of several reasons why the industry is in a somewhat parlous state now.

However, tax relief on premiums paid remains at present, and is available at the highest rate of tax applicable to the individual. This means that a higher-rate taxpayer may receive tax relief of 40% on his or her premiums. Often this is administered by relief at basic rate when the premium is paid, followed by a further 18% after the self-assessment tax return is filed.

Occupational schemes

The employer will obtain tax relief on its share of the premiums paid for each employee. Some schemes are non-contributory, with the employee being required to pay nothing. Others require the employee to pay a percentage, which might vary but seldom exceeds 6%.

The employee receives tax relief automatically on his or her contribution, and the form P60 will show gross salary after deduction of the pension contributions paid.

In the case of small, owner-controlled companies, the practice of withdrawing profits by dividend rather than remuneration will also affect the position.

Additional voluntary contributions

An employee may supplement his or her pension fund by taking out an AVC scheme. This may be taken out via the employer or arranged personally.

Subject to maximum amounts of premium, which will be discussed later, the employee may increase the % payment up to a maximum of 15% of gross salary in any tax year. Therefore, if 6% has been paid in connection with the occupational scheme, a further 9% may be paid into an AVC. Tax relief at the basic rate is allowed on an FSAVC, with any additional relief being given when the tax return is filed.

Personal pensions

Self-employed taxpayers and employees without an occupational scheme have the opportunity to pay into a personal pension scheme. Contributions are paid net of basic rate tax relief, and tax relief at the higher rate is given by extending the basic rate band by the amount of the contribution paid in the year of assessment.

From 2001/2002 relief for contributions is given up to a maximum that is the greater of:

- The earnings threshold; and
- The maximum percentage of net relevant earnings for the year.

The earnings threshold form 6 April 2001 is 3,600 pounds, but there is also an 'earnings cap' which normally increases year by year, and which amounts to 99,000 pounds in year 2003/2004.

There is also a maximum amount that may be invested in a personal pension scheme by an individual taxpayer, expressed as a percentage of gross qualifying earnings. The current percentages are:

Age in years at beginning Of year of assessment	Maximum percentage
35 and below	17.5
36 to 45	20
46 to 50	25
51 to 55	30
56 to 60	35
61 or more	40

For the purpose of supporting contributions in excess of the earnings threshold of 3,600 pounds, a tax year for which evidence of relevant earnings can be provided may be nominated as the basis year and contributions based on the amount of those earnings may be paid in each of the next five years. The provisions enable an individual to make pension contributions for up to five years after the relevant earnings ceased, by reference to the net relevant earnings of a basis year which may be any one of the six tax years preceding the first year for which there are no relevant earnings.

Stakeholder pensions

Contributions of up to 3,600 pounds a year (the earnings threshold) may be paid into a stakeholder pension scheme by anyone who is not a member of an occupational scheme, from 6 April 2001.

Premiums are paid net, so that the maximum amount payable is 2,808 pounds. The interesting thing about this type of scheme is that anyone may enter into one, whether they have earnings or not, including those who are unemployed, students and those who have reached retirement age. There is no 'clawback' of the tax of 792 pounds deemed to have been deducted, if the individual concerned has not paid an equivalent amount of tax. However, higher-rate tax relief is available at 18% where relevant.

Qualification to pay into a stakeholder scheme is extended to an individual who is a member of an occupational pension scheme but who is not a controlling director and whose total annual remuneration doe not exceed 30,000 pounds. In such circumstance the individual may pay into an occupational scheme and take out a stakeholder pension with premiums of up to 3,600 pounds (gross).

A stakeholder pension is a form of personal pension, and is designed principally for those with low or 'nil' earnings. However, individuals with higher earnings may wish to take out a personal pension based on the criteria outlined above.

Retirement annuities

Retirement annuity schemes are no longer available for individuals after 1 July 1988, but many taxpayers hold such schemes, and many have a combination of personal pension and retirement annuity schemes (RARs). This produces complications regarding the amount of qualifying premiums in any one tax year. Premiums on RARs continue to be paid gross, with tax relief given in the coding notice or following submission of the tax return.

Where a retirement annuity scheme is held, the maximum percentage of gross earnings that can be paid by way of premium in any one tax year is:

Age in years at beginning of year of assessment	Maximum percentage
50 and below	17.5
51 to 55	20
56 to 60	22.5
61 or more	27.5

A complicated scenario exists where there is an interaction between retirement annuity premiums paid on pre-1988 policies and current personal pension scheme premiums. A detailed examination of this is beyond the scope of this wire, but there is a useful example in 'Tolley's Income Tax 2003/04' at 65.9.

Two principles can be mentioned. The maximum relief for personal pension premiums (PPPs) for any year is reduced by any retirement annuity premiums (RAPs) relieved in that year. One effect of this is that if a combination of RAPs and PPPs is to be relieved in any year, the maximum relief available for that year (excluding unused relief brought forward) is restricted by reference to the earnings cap. Also, in computing unused retirement annuity relief for any year, any PPPs relieved in that year must be deducted.

Carry forwards and carry backs

Contributions related back

In connection with personal pension premiums there was a provision, for amounts paid before 6 April 2001, for premiums paid in any tax year to be related back to the previous year, or if there were no relevant earnings in that year, to the preceding tax year.

For contributions paid after 5 April 2001 a person who pays a premium before 31 January in any year of assessment may irrevocably elect for the contribution (or a part of it) to be treated as having been paid in the preceding year of assessment. This does not apply to employer contributions.

Similar provisions to the pre-2001 provisions for personal pension contributions (PPCs) apply to retirement annuity premiums.

Unused relief carried forward

In relation to PPCs there was a provision whereby unused relief could be carried forward and used in any of the six succeeding years. That facility ended in year 2000/2001.

However the facility still exists for retirement annuity premiums. Relief available for a year of assessment which is not used in that year may be carried forward and used to cover that part of a qualifying premium paid in any one of the next six years which exceeds the relief limit for that year.

Tax credits

Although this fact was not apparent for some time, it is clear that pension premiums paid by an individual are a deduction for Tax Credit purposes. This is a very valuable facility for a basic rate taxpayer. Not only will he or she obtain income tax relief of 22%, but also 'Tax Credit relief' of 37% in appropriate cases.

The reliefs are a little less for higher rate taxpayers, but are still valuable in terms of 40% income tax relief and 6.67% 'Tax Credit relief'. This aspect is discussed in more detail in the wire on Tax Credits (see Newthwire No. 21).

Family opportunities

The inception of the stakeholder pension has opened up opportunities for families. The husband, wife or partner on a modest income may contribute, irrespective of earnings. Similarly there is no bar on the older generation or young people and students not yet working, preventing them from paying up to 2,808 pounds a tax year and investing 3,600 pounds in a pension payment.

There are also opportunities for the small business to provide for its key personnel. A small company may take out an executive shame for its directors. The owner of an unincorporated business may take out his or her own personal pension, but also take out an executive or employee scheme for husband, wife or partner.

In this connection it should be remembered that the tax position of the employee partner is of no account. If the partner is not paying tax or national insurance, that is no bar to the taking out of a pension scheme. Premiums can be arranged based on earnings for the past x years, and the annual pension payment is fully deductible by the business.

Any Answers

There have been a number of queries about pensions on 'Any Answers' over the past few years.

Have I messed up my carry forward/carry back contributions?

This was the question asked by David on 24 March 2001, just before the new rules came into effect on 6 April 2001. He had been advised to pay a substantial premium, and to elect for a carry back to year 1999/2000.

Without going into the arithmetic, both Frank Ahearn and Stephen Tobin confirmed that, due to a quirk in the rules, David had until 31 January 2002 to make a pension payment and elect for carry back. However, the election for carry back had to be made on or before the date the premium was paid and was irrevocable.
http://www.accountingweb.co.uk/item/42091/786/784/785

Net pension contributions from 6 April 2001

David Lochhead referred to some confusion about whether premiums on all personal pensions were to be paid net of basic rate tax after 5 April 2001, in his query of 23 March 2001. Martin Sans confirmed that this was correct, and also includes Stakeholder pension premiums. In both instances 3,600 pounds can be paid without evidence of earnings. Retirement annuity premiums continue to be paid gross.
http://www.accountingweb.co.uk/item/42025/786/784/785

Refund of pension contributions - further tax liabilities?

Andrew, in a query dated 19 September 2001, enquired about tax on a refund of pension scheme contributions. A higher rate taxpayer made pension contributions to the employer's scheme. When he left, after less than two years' employment, he received a refund of contributions after a tax deduction of 20%. Is any further tax due?

Andrew Scott confirmed that the tax liability was strictly imposed on the employer and not the employee, but assuming the scheme rules allowed this, the liability could be passed on the employee. As such it is not the employee's income for tax purposes. Section 598, TA 1988 and Simons at E4.802 confirms this approach.
http://www.accountingweb.co.uk/item/48306/786/784/785

Pension contributions

Two clients of Neil Brookes neglected to inform their pension companies when they formed a limited company in 1999. In his query of 2 October 2001 he enquired 'How is the tax relief on the Contributions now claimed?' What entries need to be made on the tax return? Should premium refunds be claimed?

We are not told whether or not the existing policies were personal pension schemes, but one assumes that they were not. If they had been, I would concur with the advice of Peter Wolstenholme, who suggested that the existing pension plans were perfectly acceptable provided that no company scheme had been taken out, and the 'employment' was non-pensionable. He had taken out retirement annuity policies before PPCs were available, and recollected no problems when he became employed.

This advice was tempered by Adam Bell who explained that he had managed to get an insurance company to re-write a policy under similar circumstances. However, it might be easier to write to the tax office, enclosing the form SEPC and requesting the Revenue to make an adjustment.
http://www.accountingweb.co.uk/item/59357/786/784/785

Pension contributions

ADS queried the case of a company that had made pension contributions direct to the directors' personal pension schemes in 1999/2000. The Inland Revenue had contended that the schemes Were 'unapproved retirement benefit schemes'. Consequently the premiums would be tax-deductible by the company but assessed as benefits-in-kind on the directors. ADS asked for help generally in a query dated 9 January 2002.

A risman suggested that if the policies were old section 226 pensions then the Revenue was right and the directors would be liable to tax and Class 1A NIC on benefits-in-kind. If the policies were personal pension schemes, there should be no problem. Jay Tanna confirmed the point about PPCs, referring to section 643, TA 1988. Both Jim Greenwood and Phil Rees stressed that the issue was whether the pension schemes were 'approved' or not. Any reputable insurance company should have picked up this problem before it reached this stage. There could be a case for a compensation claim against the IFA.
http://www.accountingweb.co.uk/item/68535/786/784/785

Executive Pension contributions

Steve queried the case of a close company client that had made a significant contribution into an executive pension fund on behalf of its shareholder/director on 9 January 2002. The contribution was 60% of the salary of the director, smaller annual contributions having been made previously. What were the restrictions on tax relief for such payments by a company?

Jim Greenwood explained that the answer depended on the type of scheme and funding requirements, including ages of the directors and actuarial assumptions. If it is an approved scheme the pension provider should not accept contributions unless they have checked the funding requirement. Tax relief will be allowed except for the spreading of extremely large contributions, which are not relevant in this case and which Jay Tanna referred to in conjunction with section 592(6), TA 1988. If the scheme is not approved there is no limit on the amounts but there will be a benefit in kind on the payment into the FURBS.
http://www.accountingweb.co.uk/item/68605/786/784/785

Carry-back of pension contributions

Nicki explained her difficulties in a query dated 2 December 2002. She had paid a lump sum pension contribution in November 2001 that she wanted carried back against 2000/2001 income. A form PP43 was completed by the IFA and submitted to the Revenue in either November or December 2001.

Unfortunately the tax return was submitted late, and due to her administrative mix-ups Nicki was charged two penalties and two surcharges, plus interest, and all ignoring the pension Contributions payment. Was this correct?

Peter Blatch stressed that the carry back claim was a claim outside the tax return - it has to be made at the time the payment is made. It is therefore within the provisions of Schedule 1A to the Taxes Management Act 1970. According to paragraph 4 of the Schedule the inspector should give effect to the claim as soon as possible after it has been made. Nicki should therefore be credited with the tax credit arising in the previous year on the day the Revenue received the claim. This assumes that the form PP43 was submitted timeously.
http://www.accountingweb.co.uk/item/98046/786/784/785

Small company pension contributions

David Evans, in his query dates 16 April 2003, queried the position of a small company where salaries were low and dividends used to withdraw profits from the company. In such circumstances what is the best option for pension payments - employers' or employees' contributions? A basic rate taxpayer will only receive 22% relief, and tax relief for a company will be 'nil' if within the 10,000-pound band and 23.75% in the marginal band. A higher rate taxpayer would obtain 40% tax relief on a personal contribution.

Roger Jones stated that there was no easy answer. It depended on the company's tax rate, individual's tax rate, balance of dividend against salary and use of PPP basis year provisions. I would add that each director could pay personally into a stakeholder pension scheme, irrespective of the amount of earned income.
http://www.accountingweb.co.uk/item/108122/786/784/785

Tax relief - IR ignoring the contributions!

On 12 June 2003 Nikky queried the position where the Revenue had ignored a stakeholder pension scheme premium on the tax return and had failed to give higher rate tax relief.

Dan foster suggested that the contribution might have been declared in the wrong box in the tax return. But there could also have been a Revenue error. Barry Hallam reminded us that higher rate relief is given by extending the basic rate band, so it was worth checking the SA calculation again. However, as these respondents and I agreed, the additional 18% tax relief should be given one way or another.
http://www.accountingweb.co.uk/item/112210/786/784/785

Ask a question

Readers with a current case should post their query in Any Answers.

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