

## Pensions for contractors: an overview

Why should you think about pensions? You're young, and fit, and you make a good deal of money. Aren't pensions for old people?

No, you should be aware that pensions can not only save you money right now, because they offer real and substantial tax breaks, but also you can retire at age 55 with a lot more money available to you if you start a pension now. Why pay extra tax now on your savings when you can redirect them to a pension fund?

### Some quick facts about pensions

1. Pensions aren't all about saving money to buy an annuity. 25% of your funds can be drawn tax-free from age 55. And rather than buying a rigid annuity, you can leave funds invested and simply skim an income from the pension pot each year.
2. Your savings can be passed on to your family if you die before age 75 - provided you've not bought an annuity. The money will not be subject to inheritance tax.
3. You no longer pay large portions of your payments in commissions to an IFA - charges are negligible - comparable to buying a tracker fund.
4. Your funds are perfectly safe as pensions funds cannot become insolvent. A private pension fund is carefully protected by law.
5. If you're risk adverse and concerned about funds invested in the stock market you can option for keeping the pot in cash - just like an ISA.

### Pensions save on tax

The principle is simple. Normally you pay tax on your income. When you put part of your income into a pension, you save most of the tax you would normally pay on it. So, if you've not already set up a pension or don't currently make full use of the allowances available, you could be paying substantial amounts of tax unnecessarily. And this is true whether or not you are caught by the [IR35 tax legislation](#).

You can invest money personally from your own funds or direct from your company bank account. If caught by IR35, you save not only the income tax (PAYE) that would ordinarily be payable but you also avoid the employers and employees national insurance contributions.

"The amount of tax relief can be as much as 48% (or 58% for those earning over £150K) meaning that for each £100 invested you pay £52 and the tax man pays the rest," explains Tony Harris, chief executive of the Richmond, Surrey-based [ContractorFinancials](#), an independent financial advisor which specialises in contractor financial advice.

### Calculate your savings in pensions

Take a look at our [pensions calculator](#) to see just how much tax relief pensions can offer you. For example, if you earn £100 of corporate income, you can put £100 into your pension fund. Never mind about any tax on it.

### Tax relief - how it works

Let's say you are a contractor with a [limited company](#), not caught by [IR35](#), and you are a higher rate tax payer. You'll probably be [taking a low salary](#), and drawing the rest of your income in [dividends](#).

For £100 of company gross profit: when you pay dividends, first you pay corporation tax of 21% (£21) leaving a dividend of £79. Then you pay further tax on the dividend of 22.5% (£17.78), leaving you with £61 in your pocket. You've just paid the Revenue £39 for the privilege of having £61 in your hand now.

But if you contribute to your pension: Instead of taking £61 now, the company makes a £100 contribution to your pension. In reality £25 of your contribution represents the part of the pension fund which you can draw tax free when you are retire - it also has the opportunity to grow and be worth considerably more than this initial investment. £36 pounds also go into the pension fund, together with the £39 that would have gone to the tax man (quite a decent return). This £75 can also grow and be used to skim off an income at a later date, or buy an annuity.

This is what it means to say you get 39% tax relief. It's the percentage of tax saving you get - the amount you can channel to your pension, rather than the tax man. And remember, all that money invested starts earning interest straight away. For higher rate contractors caught by IR35, the tax relief is 48% (or 58% for those earning over £150,000 per year who pay at the additional rate of

“ The amount of tax relief can be as much as 58% meaning that for each £100 invested you pay £42 and the tax man pays the rest. ”

Tony Harris -  
ContractorFinancials

50%). It's almost like doubling your investment from the word go!

## Funding your retirement

You can access your pensions savings as early as age 55. You will then have an income-producing instrument that will pay the bills for you every month, assuming you've invested in it wisely.

If you rely on the government to pay your pension for you when you get old, you can expect about £70 per week. Will that be enough for you? Worse still, you might not even get that much if the government makes a mess of the pension plans in its trust, which many observers believe it is likely to do. In a nutshell, if you are planning on not working forever you'll need to live off something - and pensions offer a great way of saving for the future.

## Choosing a provider

One of the key decisions in setting up a pension is choosing a provider. Pick wisely, because you clearly do not want to spend a lot of money in set up costs, because your employment situation could change, and you could stop continuous funding. Thanks to a new breed of low cost pensions, even short-term funding will not be hit with excessive charges, and so more of the investment will be yours to enjoy in retirement.

Any pension also needs to be flexible enough to reflect the fact that as a contractor your employment status is inherently changeable. "You must have complete freedom to increase, decrease, suspend, restart and cease contributions completely-literally on month by month basis," Harris points out.

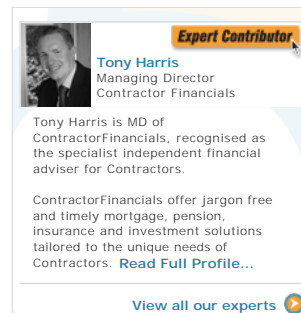
"Any pension must be versatile enough to allow contributions regardless of whether you continue to work through a one-man limited company/umbrella company, are between contracts or a permanent employee," Harris adds.

Further, you want to choose a provider that isn't going to disappear. You want a provider that has the financial strength and backing to remain the steward of your fund for the long term. New entrants to the pensions field come and go, so it is vital that any provider have a good track record and have made the long term commitment required. Continuity is key as fund managers often leave and go to new positions at other firms in the event of takeovers. Many investors wind up languishing in closed funds where providers have not had the financial muscle to remain in the market.

You may wish to seek advice from a professional investment advisor or an IFA before making pension decisions, and as it's a complicated field, that's probably a good idea. But don't neglect the important financial and fiscal advantages that pensions offer you.

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ContractorFinancials offer jargon free and timely mortgage, pension, insurance and investment solutions tailored to the unique needs of Contractors. [Read Full Profile...](#)

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