

Contractor guide to UK state-backed pension: National Employment Savings Trust (NEST)

Contractors who work for [umbrella companies](#) or through their own [contractor limited company](#) will potentially be affected by the new state-backed top up pension, the [National Employment Savings Trust \(NEST\)](#). This is due to come into being in 2012, when contractors who have not chosen to opt out will automatically be enrolled on the scheme.

[Tony Harris](#) of [ContractorFinancials](#), an independent financial adviser who specialises in contractor finances, says: "Umbrella company contractors not operating an existing salary sacrifice pension will be automatically enrolled in NEST by their umbrella. As for limited company contractors, they may have to create their own NEST scheme, if they choose not to opt out of this new initiative." And, it appears, opting out is not a once-only activity, as all contractors who opt out will have to confirm their opt-out status every three years.

Harris warns that the impact of NEST may come too late for many contractors, and advises them to sort out their pensions now. "NEST is an expensive pension choice because the start-up costs are high," he explains. "So contractors should ideally [start their own private pension](#) as soon as possible and make full use of the tax breaks available, especially for those earning less than £100k."

NEST - how does it work?

The idea behind NEST is that the scheme bridges the funding gap between what retired contractors and others can expect from the state pension in future and what the state will realistically be able to afford. That is why an estimated 6 million UK workers will automatically be enrolled in NEST, unless they choose to opt out and continue to do so every three years.

"Under NEST, workers will build their retirement fund as a result of shared contributions," continues Harris. "Eventually, the employer will contribute 3% and employee 4% of the worker's salary, and the government will contribute 1%. To soften the blow, the contributions in 2012 will start at 1%, increasing over time and initially only the very largest companies will be affected."

If one-person limited company contractor firms decide to implement such a scheme, rather than opting out, they will have to fund the entire pension themselves, as they are both the employer and employee. For Umbrella company contractors, Harris says they can expect to contribute employer and employee contributions. The good news for all contractors is that in almost all cases the pension contributions are tax deductible.

Contractor pensions - don't wait for NEST

Harris urges contractors without a pension to act now. "Early contributions can have a far greater impact on the size of your overall retirement pot and for freelancers pensions are still highly tax-efficient methods of extracting earnings from contracting income. Those earning below £130,000 per year can invest almost all of their annual earnings without the taxman receiving a penny. Due to the new tax rates for higher earners some contractors can benefit from as much as 68% tax relief and, by investing in a pension now, they will be saving towards a prosperous future, too."

Harris also points out that the details on NEST remain "hazy", and important issues, such as how a NEST pension fund can be utilised and when, are still unclear. "For example," he says, "it is not even clear yet whether a contractor's NEST fund could be combined with their existing private pension. But what we do know is that early adopters of the scheme will be penalised with a 2% set-up charge," he says. "That's 2% of the worker's payments going direct to the provider of the scheme which wipes out the benefit of low running costs whereas the new breed of low cost pensions has no set up costs at all."

Harris concludes: "Given the unique nature of a contractors employment status and the realities of freelance working anyone unsure of which option is best when planning for a comfortable retirement should speak to a contractor specialist independent financial adviser, as these choices require expert professional input that ultimately could lead to a much larger 'pot' for the same overall investment."


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Expert Contributor

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Tony Harris is MD of ContractorFinancials, recognised as the specialist independent financial adviser for Contractors.

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