

The last piece in the contractor pension puzzle

In a recent announcement, HM Revenue have issued guidance that clears up a particularly thorny area in [contractor pensions](#).

Pension Freedom

The issue relates to pension contributions made from a limited company by controlling directors, their spouses, or related employees. Until now, it wasn't clear by any means whether substantial pension contributions would be acceptable with HMRC and therefore qualify as tax relief as a legitimate business expense.

"This is a significant announcement that clears up most of the questions that had troubled pension contributions in the past 14 months," says Tony Harris, principal with the Richmond, Surrey-based firm ContractorFinancials.

Revenue Will Not Challenge Contributions

Controlling directors may, for the first time, expect that the Revenue will rarely challenge the pension contribution. Controlling directors are responsible for a firm's success or failure, and if the firm succeeds, they have the right to rewards. The Revenue does caution that the contributions must only be commensurate with the level of income of the firm.

These principles will apply whatever the level of remuneration and irrespective of the split between pensions and salary. If a company makes X amount per year, then any percentage of X may be used in pensions. Obviously if the pension contribution amount becomes significantly greater than X, the Revenue may raise questions.

So How Much Can You Put In?

So, if you are a contractor, and you run your own company, how much are you allowed to put in tax-free pension funds? How much can you allocate for your spouse, or other relatives?

This question, which had been fairly straightforward until last April, became terribly complex when HM Revenue issued new guidance as part of their inappropriately named "pensions simplification regime" at that time. Contractor pension contributions made via the limited company, were supposed to be "wholly and exclusively," that was the key word, for the purpose of trade?

Who was going to decide whether your pension was fair or not? The local tax inspector was asked to make the decision, and to do it without a lot of guidance from the head office.

"We called this period the 'pension planning blight' while it lasted, says Harris, principal at the Richmond, Surrey-based firm ContractorFinancials, because nobody could realistically be expected to invest for their future without the absolute certainty that they would receive tax relief on their contribution. To further complicate matters, prior approval of pension investments by the local tax office was not possible and it was only after funds had been sent across to the pension fund that the taxman would pronounce as to whether relief was actually allowable.

New Guidance

Fortunately, in February, the Revenue issued new guidance that cleared up most of the 'blight.' Under the new terms, it became clear that the new guidance ([BIM46001](#)) confirmed that payment of a pension contribution is part of the normal costs of employing staff. "As a result the 'wholly and exclusively' rules will generally only be considered in limited circumstances. "This removed much of the uncertainty for contractors working via Umbrella companies and we were immediately able to invest substantial sums via salary sacrifice arrangements to save them considerable amounts of tax and NI" says Harris but there still remained a question mark over the treatment of Controlling Directors and their Spouses who were still deemed to be at risk of refusal for tax relief if they made substantial pensions investments.," says Harris.

The guidance states "[The contribution] will only be disallowable where there is an identifiable non-business purpose for the employer's decision to make the contribution to a registered scheme, or for the size of the contribution." Size is particularly important; it should be clear to the Revenue that you are not channeling funds from many other sources into the pension fund in the hope of obtaining additional relief.

“ This is a significant announcement that clears up most of the questions hanging over pension contributions ”



Tony Harris-
ContractorFinancials

“ The new guidance freed contractors to begin investing in pension funds again ”

Now the same principles apply both to the controlling director, and to spouses, friends, relatives, children--in fact, to anyone who does a job of work at the firm. The Revenue has made it clear that a proportionate contribution should always be allowable and so considerable scope now exists for Contractors to dramatically reduce their tax bills.

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