

Contractor pensions - contributions cap blow to higher earners

New tax laws will seriously limit the ability of high-earning UK contractors to make adequate financial provision for their retirement, according to Tony Harris, of Independent Financial Advisers (IFAs) [Contractor Financials](#).

Successful contractors earning at the higher end of the scale have had their tax planning and future retirement income seriously disrupted following new pension rules introduced by the Chancellor in [April's Budget](#).

Previously, contractors have been able to invest significantly into pension funds, in line with government recommendations, but from April 2011, contractors earning over £150,000 per year will lose tax relief on their pension contributions.

"Until now, contractors have legitimately used pension contributions to invest tax efficiently and to plan for their retirement – a strategy strongly encouraged by a government keen to get people to save for their futures," explains Harris. "Removing and reducing tax relief sends some very mixed messages. This is especially concerning as there's a element of retrospective taxation which is against long-established principles of taxation policy."

Changes to tax relief

Since pension simplification rules were introduced in 2006, contractors have been able to [reduce significantly their tax liabilities](#) by contributing a substantial proportion of their income into a pension scheme.

In fact, for many contractors the amount they could invest to provide an income in their retirement was virtually limitless – up to £245,000 per year with a lifetime allowance of £1.75m, based on 2009/10 allowances.

But, as Harris explains, this has all changed: "The Budget revealed that from April 2011, contractors earning over £180,000 per year will have their tax relief capped at the basic rate of 20%, with contractors earning between £150,000 and £180,000 per year receiving relief on a sliding scale of between 20% and 40%."

Anti-forestalling rules = retrospective taxation

And, warns Harris, for those fleet of foot contractors who might pile in the cash while they can, the Chancellor was ahead of the game: "Anti-forestalling rules have been put into place to prevent high earners from maximising contributions over the next two years."

Contractors who have earned £150,000 or more in the last two years will only receive 20% tax relief on their pension contributions above a 'special annual allowance' of only £20,000, which includes contributions from the contractor's net earnings and their [limited company](#).

"Contractors who earn up to £149,999 could technically invest the lot in a pension scheme with no tax liabilities," says Harris. "But if they earn £1 over the limit – easy to do as earnings include income from all sources including rental income from property, [dividends](#) from investments and bank interest – then the special annual allowance applies."

Contractors who pay in over the limit will have to make a repayment of the balance between the basic and higher rate tax relief via their self-assessment tax return.

Regular contributors still benefit

"Those contractors exceeding the £20,000 limit who have historically made regular pension contributions on a monthly or quarterly basis prior to 22 April 2009 can continue to benefit from their current tax relief allowances, as long as they maintain the regular contributions," explains Harris.

Contractors who made regular pension contributions will be able to continue with the contributions as 'protected input amounts'. For example, a contractor who has regularly contributed £3,000 per month can continue to enjoy 40% tax relief.

Unfortunately, contractors who have made irregular contributions and those investing a lump sum each year won't qualify for this benefit, and contractors tempted to switch pension providers will lose their 'protected input amount' benefits altogether.

Key contractor pension opportunities

For contractors earning under but near £150,000 per year, now is the time to invest, advises Harris: "Contractors earning under the

“ Removing and reducing tax relief sends some very mixed messages. This is especially concerning as there's a element of retrospective taxation which is against long-established principles of taxation policy ”

Tony Harris, Contractor Financials

limits still attract full tax relief, and as we've just seen, those who had previously invested on a regular basis seem to have dodged the bullet with regard to the new rules. It could very well be the case that any future tightening of the rules may not apply to prior arrangements either."



For those earning £150,000 to £170,000 Harris has identified a quirk of the anti-forestalling rules. Contractors could first use up the £20,000 pension limit via salary or dividend sacrifice which would reduce their income below the earnings cap, thus enabling them to invest further without the restrictions.

Finally for those earning over £150,000, Harris believes a pension is still a highly tax efficient investment vehicle, as those contractors investing the full £20,000 are effectively receiving a subsidy of £8,000 from the taxman, which is a very good initial 'return' when compared to other investment opportunities.

With increasing pressure on sustaining retirement incomes from the state, Harris feels it is unlikely that higher rate tax relief will be abolished completely. He concludes: "Contractors have an even greater incentive to [invest in a pension](#) that provides for their retirement, particularly with the increases in taxation for higher earners announced in the budget."

Published: Monday, June 08, 2009

[Tweet](#)



Tony Harris
Managing Director
Contractor Financials

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

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

[View all our experts](#)

© 2011 All rights reserved. Reproduction in whole or in part without permission is prohibited. Please see our [copyright notice](#). If you want to use any content you have seen on this site then please [request our media pack](#) and ask for details of our Content Licencing Service.

Readers Comments...

 Be the first to comment on this article

Also of interest...

Related Guides:

- [Pensions for contractors: an overview](#)
- [Reducing the IR35 pain with a contractor pension](#)
- [How pensions work for contractors](#)

Related Calculators:

- [Contractor Pension Calculator](#)

Related Internet Links:

- [ContractorFinancials](#)



ABCe verified website - last audit confirmed **130,682** monthly unique visitors

© Copyright 2011 Byte-Vision Limited UK. All rights reserved [Copyright notice](#)