

Contractor pensions: some light, some darkness

How much can contractors contribute to their [pensions](#)? We still aren't sure.

Although guidance was issued last week by HM Revenue for employer pension contributions policy, there is still some uncertainty about what the terms of that guidance will mean.

The Guidance Does Help

The updated guidance governing deductions for an employer's contributions to a registered pension scheme is at FA04/S196 to S200, with specific reference to [BIM 416001 Specific Deductions: Registered Pension Schemes](#), which assures us that paying a pension contribution is part of the normal costs of employing staff. All contributions are treated as revenue expenditure, not capital expenditure. So the tax deduction on the payment is allowable, except in very specific circumstances.

Previously we had been told that only pension payments of a certain size would be allowed, and that what wasn't allowed would be determined on a case-by-case basis. Not easy to decide, on that paradigm, how much to salt away for your old age.

Wholly and Exclusively For Business

Certainly this guidance is a step forward. Says Rachel Vahey, chief of pensions development at [Aegon Scottish Equitable](#) says: "This guidance allows employers and advisers to plan pension contributions with more confidence, as it is clear the vast majority of pension contributions will receive full tax relief."

The critical change in the process is the relaxing of the "wholly and exclusively for business purposes" criterion, which no one, neither tax inspectors nor pension advisors, knew what to make of. Now that rule will only be applied under certain conditions, and that does make things easier for the industry.

“ Employers and advisers can plan pension contributions with more confidence ”

Rachel Vahey - Aegon Scottish Equitable

But It Doesn't Explain Everything

But the guidance doesn't explain everything, because one would not like to find oneself outside that "vast majority" in the "small minority" that will not receive full tax relief.

Then, the Guidance tells us, the pension contribution should have a recognizable business purpose. This, the Guidance tells us, is a question of "fact." As several experts have pointed out, deciding the purpose of a payment in a business context is not a matter of 2+2=4.

But the local tax inspector is told to compare the pensions received by other employees and to compare them. Rather a difficult criterion to apply in small limited companies, as the experts note.

“ Contributions must have a recognizable business purpose ”

Continues Vahey: "This is an area of some concern for advisers and clients and we very much welcome the Revenue's intentions to give us clarity."

Guidance - Inland Revenue

So, for contractors who own their own [limited companies](#), here is what it all adds up to. As Vahey explains, pensions should reflect company profits. It should be acceptable for owners of companies to take a remuneration package up to the level of profits made by the company, as the profit usually reflects the value added by that individual.

One place where contractors should exercise caution: if pension payments are made to a scheme belonging to a spouse, or to a relative, the Revenue will eye it carefully. That person has to add value to the business in some clear way, and the pension contribution shouldn't be out of step with that value contribution. If your spouse has a small place in the company, but a huge pension, the Revenue will take heed.

Contractors who were trying to fund their old age have had to endure nearly a year's worth of confusion, one that has, by all accounts, caused the pension industry in the UK great harm. No one, least of all the Revenue itself, knew how to assess pension contributions.

So for contractors, and their pension advisors, a sigh of relief is permitted, albeit a small one. But there are still a lot of question marks to be addressed, and a lot of vague shapes that need better definition.

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