Pensions for contractors with a limited company

If you have your own **limited company**, you can get very significant tax advantages through pensions while at the same time building up a fund which you can start withdrawing from starting at age 55.

Pensions are liberalised and reformed

Everything changed for pensions funding since the so-called 'A Day' in April 2006 when the regime was vastly liberalised. Pensions reforms announced in 2014 introduced further freedoms on how contractors can use their pensions savings.

No limits

“Following pensions reforms, contractors can invest up to £40,000 each year to a lifetime allowance of £1.25m into their pension pot. Although it is important that the amounts must not be larger than your corporate income for the year of the contribution, otherwise there might be questions from HMRC about whether the money was actually sourced from your trading activities,” explains **Angela James** of **Contractor Wealth**, a financial advisor who specialises in contractor financial advice.

'Pre-taxed' income

Your limited company can contribute 'pre-taxed' company income to a pension. If you are a higher rate tax payer, instead of declaring the income as company profit and taking the income as a **dividend**, you can put the sum straight into a pension.

Dividends versus pensions

You can take a look at our **pensions calculator** to get a better idea for your own situation, but here's an example:

You have £100 worth of company income, and you are a higher rate tax payer, not caught by **IR35**. You can either put the £100 into a pension, or you can declare it as profit and take it as a dividend.

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> Angela James, Contractor Wealth

But if you choose the latter option and take a dividend payment, you pay:

£20 in corporate tax on your £100, leaving £80

25% personal income tax on the net dividend, which takes another £20

Your total take home is £60.

Choosing the pensions option means that the whole £100 goes into a pension fund and then has an opportunity to grow in a tax efficient environment.

In reality £25 of your contribution represents the part of the pension fund which you can draw tax free when you retire. £35 of your money also goes into the pension fund, together with the £40 that would have gone to the taxman. This £75 can also grow and withdrawn at a later date, or used to buy an annuity.

For contractors earning over £150,000 per year the tax saving is even more due to the 45% higher rate of tax. And for those earning between £100,000 and £120,000 per year the effective tax rate is 60% due to the reduction in personal allowances introduced. For high earners pensions are now an even more attractive option for tax savings than ever before.

Annuities, skimming and inheritance

There is no longer a requirement to purchase an annuity by the time you reach the age of 75. You can drawdown a certain amount from your pension as income. Most annuities only pay around a 5% return, but remember you've only invested £35 yourself, but with the £40 from the taxman it is paying off as £75. So even with the choice of an annuity your overall return could be much higher because of the initial tax savings.

In the event that you die before you retire, if you've not taken an annuity, the whole of your fund can be passed on as an inheritance completely tax free.

Contractors should not fear that they are 'making a rigid commitment' to pension funding.

“Any **contractor pension** should be flexible: as a contractor your employment status is inherently changeable and you must have complete freedom to increase, decrease, suspend, restart and cease contributions completely - literally on month by month basis,” James points out.


Angela James

Pension Specialist

Contractor Wealth

Angela is a qualified Senior Financial Planner at Contractor Wealth and specialises in pension advice and financial planning for contractors.

Contractor Wealth are a specialist in offering tailored financial solutions for contractors, together with the building of excellent client relationships. **Read Full Profile...**

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So whether you choose a pension with an eye to an annuity, or just to taking some tax-efficient income for yourself as you reach a more advanced age, you should not neglect this possibility for an entirely legal and risk-free tax-saving strategy.

Updated: Saturday, January 31, 2015