Pensions for contractors with an umbrella company

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If you are using a contractor umbrella company to manage your contracting income, 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 £1m into their pension pot. If contractors have the scope to cover bills and outgoings by other means, they could avoid paying income tax and National Insurance Contributions (NICs) on a hefty percentage of their contract income," explains Angela James of Contractor Wealth, a financial advisor who specialises in contractor financial advice.

'Pre-taxed' income

Provided your umbrella company has a pension scheme in place you can use 'salary sacrifice' to contribute 'pre-taxed' income to a pension. Most do have a scheme in place, and if they don't they can get one set up fairly quickly. So, instead of paying employers NICs, employees NICs and income tax you can put the whole sum straight into your pension.

> **"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-savings strategy"**
>
> Angela James, Contractor Wealth

Salary versus pensions

Here's an example:

You have £100 worth of income and you are a higher rate taxpayer paying the higher rate of tax at 40%. You can either put the £100 into a pension, or you can take it as salary via your umbrella company.

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

£14 employers and employees NI, leaving £86.

A further £35 is paid as higher rate PAYE tax (Income Tax).

Your total take home is £51.

Choosing the pensions option means that the whole £100 goes into a pension fund and then has the opportunity to grow in a tax efficient environment. In reality £25 of your contribution represents the part of the pension fund which you can then draw out tax free when you are retire. £24 of your own money also goes into the pension fund, together with the £51 that would have gone to the taxman (quite a decent initial 'return' on your £24).

This £75 can also grow and be used to withdraw lump sums at a later date, or to buy an annuity.

Annuities, skimming, inheritance

There is no longer a requirement to buy an annuity when 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 is 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-savings strategy.

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