

PENSION ISSUES 2000/01

There are a number of important changes on the horizon relating to pension investment, and these need to be considered carefully at the present time. This briefing sheet aims to provide more detail on the points you need to consider.

Abolition of carry forward/carry back relief from 5 April 2001

This is important if you are either self employed, or employed but not in an employers pension scheme. If you are a company director and your company has set up an Executive Personal Pension scheme for you, then that counts as an employers scheme, so carry forward/carry back would not apply unless you had another source of earned income.

The current rules provide that you can contribute a set percentage of your earned income (simply defined as income from Self Employment or Employment, other than where the employment is covered by an employers scheme) into a Personal Pension Policy. If you do not use all your relief then it can be carried forward for up to six years (known as carry forward relief).

Additionally a premium paid in any one year can be related back and treated as if it was paid in the previous tax year. This election must be made by 31 January of the year of assessment after the contribution is paid, eg to carry a 1999/00 contribution back to 1998/99, notice must be given by 31 January 2001 (known as carry back relief). This is of use if you were, say, a 40% tax payer in the earlier year but only a 22% tax payer in the later year.

Premiums qualify for relief at your marginal tax rate. Base rate tax relief is given at source (22%) for employees – if you are only liable to tax at 10% then the difference is not reclaimed by the Inland Revenue; if you are liable at 40% then extra relief is given via your Self Assessment or tax code.

The new rules still allow you to contribute a set percentage of your earned income, or £3,600 if greater - £3,600 is a minimum contribution level and can be made even if you have no earned income.

The existing rules on carry forward and carry back are abolished. Carry back is still allowed provided the premium is paid by 31 January of a year of assessment and the election is made at that time – eg a premium paid up to 31 January 2003 can be carried back to the 2000/01 tax year, provided an election is made at the time of payment – this is 12 months earlier than under the current rules and is before the final taxable income for 2002/03 (the original year of payment) is known.

In place of carry forward is a provision which allows the income threshold for a year to be based on the best of the last five years (known as the basis year), so for example, and assuming contributions exceed £3,600, the provisions allow for the 2002/03 tax year contributions threshold to be based upon the best year between 1997/98 and 2002/03. The practical effect of

this is that where a contribution is not made in a year of assessment, that year is wasted, save that if income subsequently falls the benefit of the better year lives on for the next five years.

Tax relief is still available for contributions. For both the employed and self employed basic rate tax relief will be given at source, higher rate tax relief will be given via Self Assessment or tax code.

The practical effect of abolishing carry forward relief for a growing business is set out in the example below:

Example assuming 17.5% contributions threshold, profit growth at £10k pa, investment in year 5, old rules:

Year	Profits £	Relief £	Carried forward £
1997/98	10,000	1,750	1,750
1998/99	20,000	3,500	5,250
1999/00	30,000	5,250	10,500
2000/01	40,000	7,000	17,500
2001/02	50,000	8,750	26,250
2002/03	60,000	10,500	36,750

The effect of the rule change can be clearly seen: under the old rules a contribution of £36,750 could have been made in 2002/03 – under the new rules a mere £10,500 could be paid. This means if you are putting off pension provision so that the profits of a growing business can be re-invested, as above, with the intention of "catching up" later, the ability to make a catch up contribution will be severely impaired.

Contributions thresholds are:

Age	% of income
to 35	17½%
36 to 45	20%
46 to 50	25%
51 to 55	30%
56 to 60	35%
60 and over	40%

Action needed you need to consider if you have unused relief available from 1993/94 (based on six years carry forward plus one year related back) or later and then consider making a one off contribution by 5 April 2000 to absorb this.

As a special offer to clients we will prepare a report on your pension capacity for a fee of £60 + vat, refundable if you place pension business through one of our panel IFAs and we receive commission. We recommend you instruct us in respect of this report as early as possible to avoid a rush next spring.

Stakeholder pensions for employers

If you employ more than 5 people, and one earns at least £3,484 pa, then you must ensure that by October 2001 they have access to a Stakeholder pension scheme through your payroll.

If you have an existing Occupational Scheme or Group Personal Pension Plan then you may be exempt from these rules, although in the case of a Group Personal Pension Plan the exemption will only apply if an employer contribution of at least 3% of salary is made.

There is no obligation on the employer to contribute to the stakeholder scheme.

However the employer must:

- Select a suitable scheme
- Inform staff that it is available
- Make deductions from their pay and promptly pass these to the pension provider

There is no requirement for the employee to join the scheme, and employees can mix a stakeholder pension payment with contributions to existing personal pension schemes, AVCs, FSAVCs and company schemes.

Stakeholder pensions for employees

Between April 6th and October 31st 2000 all employers who employ more than 5 staff must make available a Stakeholder Pension to each employee who earns above the Lower Earning Level (currently £76.00 per week). This involves providing an employee with a means of deducting the pension contributions from wages at a frequency that suite the employee (i.e. weekly, bi-weekly and monthly).

There are no maximum income thresholds, anyone can contribute and you don't even have any Net Relevant Earnings (taxable income), but there are restrictions to how much you can pay into a stakeholder pension each tax year.

The Government has started with a maximum contribution of up to £3,600 * each tax year regardless of earnings. If anyone elects to pay more than this certification of earnings will be required for the tax year of contribution. This is known as the "Certified Year". Further contributions above £3,600 can be paid for a period of 5 years based on this certified income level and then another proof of earnings will be required and this becomes the new "Certified Year".

If earnings increase substantially within 5 years, it is possible to re-certify and create a Certified Year. Maximum contributions will be based on the normal personal pension limits that are based on an individuals age at the start of each tax year and the relevant personal percentage for that year (see table under section on personal pensions).

Stakeholder Pensions are very flexible. An individual can stop or vary contributions at any time and restart contributions anytime in the future without penalty. Furthermore, the Stakeholder Pension can be transferred to another Stakeholder Pension provider or another pension product also without penalty.

If an employee ceases employment and has no certified earnings, Stakeholder contributions above the £3,600 can continued to be paid for up to a further 5 years based on the income provided for the "Certified Year".

Otherwise, if £3,600 or less is contributed to the Stakeholder Pension, payments can continue up to 5 years after retirement with no proof of earnings.

* The £3,600 limit may be amended for future tax years by Treasury Order.

IR35: mitigating the cost through pension investment

If you run a Personal Service Company (PSC) and are likely to be caught by IR35, then pension planning is an important way of reducing the tax cost of IR35. The example below shows the likely saving at various income levels and contribution rates.

Example of saving from pension contributions for a PSC, caught by IR35, 2000/01 tax rates:

Income level £	Pension paid £	Tax and NI without pension £	%	Tax and NI with pension £	%	Net cost of pension payment £
100,000	15,000	42,339	42%	35,241	35%	7,902
80,000	10,000	32,875	41%	28,143	35%	5,268
60,000	5,000	23,411	39%	21,045	35%	2,634
40,000	4,000	13,947	35%	12,170	30%	2,223
30,000	2,000	10,184	34%	9,378	31%	1,194
20,000	1,200	6,155	31%	5,671	28%	716

Action: There is a lot of uncertainty surrounding IR35, but you need to give serious consideration now to whether you will be caught; if you are then pension funding offers significant savings, for example on earnings of £60k pa a £5k pension contribution costs a net £2,634, implying tax and NI relief of 47%, or put another way for every £1 you pay into your pension, the government contributes 89p.

Types of pension investment

There are various types of pension investment available, the main ones being:

Personal Pensions Policies

These are available to employees without an occupational scheme and the self employed. They are defined contribution schemes which produce a fund for your retirement. This fund is used to draw a tax free sum and purchase an annuity.

Retirement Annuity Policies

Similar to Personal Pension Policies but withdrawn in 1988 – contributions can be made to existing schemes but new schemes cannot be started.

Stakeholder Pensions	These are being introduced in 2001 as a low cost form of Personal Pension, designed to attract people not currently making private pension provision.
Executive Pension Plans	These are a form of Occupational Scheme for one or two employees, normally directors, of a small company. They are defined contribution schemes.
Small Self Administered Schemes	These are a more complicated form of pension provision for the owners/directors of a small business. Originally they offered considerable benefits by allowing the fund to be invested by the beneficiaries rather than a life office, including investment in the sponsoring business. Unfortunately the self investment rules have now been curtailed, and additionally there are now obligations to have professional pension managers as trustees, making them considerably less attractive.
Occupational Schemes	These are employer sponsored schemes for a number of employees, and may be defined contribution or defined benefit.
Additional Voluntary Contributions	AVCs are additional payments made to an Occupational Scheme to attract more benefit. Freestanding AVCs (FSAVCs) are an extra contribution by an employee, but invested in with a Life Office rather than with the Occupational Scheme.
Defined Benefit Schemes	Pay a preset level of pension, and the contribution levels are set, and subsequently adjusted, to meet this. Typical of occupational schemes.
Defined Contribution Schemes	Take a set level of contribution, invest it, and build up a fund. The final pension depends on the fund build up and investment returns. Typical of Personal Pensions and FSAVCs.

Choosing an advisor

When considering pension matters it is important that you seek advice from a qualified Independent Financial Advisor (IFA), who is PIA authorised.

Many Financial Advisors are tied to one company, including most of the advisors working for Banks and Insurance Companies, and accordingly the range of products they can recommend to you is limited. The limitations of this are obvious, and you should consider very carefully the merit of dealing with a tied advisor.

Garbetts has a panel of IFAs who we regularly work with, and we will happily put you in contact with one of these. We will only recommend IFAs who we have worked with, and where we are happy with their technical skill and ethical standards. Where we receive an introductory fee or commission from the IFA you will be advised of this.

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Garbetts acknowledge and thank Graham Legg from Heritage Financial Services for his assistance in drafting this document