

Planning - £3,600 pension contribution limit (Lecture P1379 – 8.02 minutes)

Annual pension contributions of up to £3,600 can be paid without reference to the level of an individual's earnings by virtue of s.190 FA 2004. This facet of the pension legislation allows the owners of family businesses to make tax-efficient pension provision for, e.g., their grandchildren from birth.

The pension arrangement will initially have to be set up on the youngster's behalf by a parent, but, once this has been done, a grandparent can then make regular payments into the grandchild's pension scheme, using the normal expenditure exemption for lifetime gifts under s.21 IHTA 1984. Provided that the payments are regular (for example, a monthly direct debit), are paid out of income as opposed to capital and do not adversely reduce the grandparent's normal standard of living, the IHT relief will be available ab initio. There is no seven-year rule here.

Making contributions in this way will be a useful means for a wealthy grandparent to take money out of their estate for IHT purposes. Note that there is no restriction on the number of grandchildren who can benefit from this favourable regime.

The grandparent, who will be paying into a 'relief at source' pension scheme, is allowed to invest £240 per month (£2,880 per year) from birth up to the date of the young person's 18th birthday and, because such contributions are deemed to be net of basic rate tax, HMRC add an additional £60 per month (£720 per year) to the youngster's pension pot. As a result, the fund, which grows free of tax, can receive a maximum of £3,600 annually.

Typically, such a fund, if started from birth, could be worth in excess of £100,000 in today's money by the time of the grandchild's 18th birthday. If left to accumulate until the grandchild reaches pensionable age, one is likely to be looking at a value of well over £500,000 to which the individual has never had to make a single contribution!

Although the pension beneficiary cannot start to draw their pension until they attain the age of 55 (57 from 6 April 2028), this fact is unlikely to matter. The substantial sum invested on the grandchild's behalf will undoubtedly free up their own savings to be invested in other more flexible ways.

Contributed by Robert Jamieson