

Pension tax relief at the end of the tax year (Lecture P1423 – 16.05 minutes)

Towards the end of the tax year, high net worth individuals are bombarded with end of year tax advice. This often includes offers on investments in venture capital trusts, enterprise investment schemes and seed enterprise investment schemes.

I will deal with these in another article, but there are only two reliable methods of reducing one's taxable income towards the end of the tax year, charitable contributions, and pension contributions.

Charitable contributions allow for a carry back of contributions into the prior tax year up to the date when the taxpayer files the tax return or the 31st of January, whichever is earlier.

Pensions do not have the equivalent facility for carrying back contributions and treating them as paid in a prior tax year. Therefore, the only opportunity to make tax efficient pension contributions which reduce one's taxable income in the 2023/24 tax year ends on the 5th of April.

Pension contributions reduce taxable income if made by the individual and therefore are of particular interest to those who are in the £50k to £60k adjusted gross income (AGI) band and are in receipt of child benefit. The marginal tax rate of child benefit for someone with three children is approximately 67%. The other pinch point is where adjusted gross income exceeds £100k, at that point the personal allowances phase down. The taxpayer loses £1 of personal allowance for every £2 of additional taxable income until the personal allowance is exhausted at £125,140. This is an effective marginal rate of 60% and with national insurance effectively becomes a marginal rate of 62%.

Additionally, those with young children who might be looking to access various government child support schemes, existing and starting in April, they should be aware that no child support is given once the adjusted gross income of either parent exceeds £100k. It therefore makes sense to look at whether to reduce AGI by making additional pension contributions. This year, in particular, is of interest as the Government has abolished the lifetime allowance, increased the annual allowance to £60k and increased the threshold at which the annual allowance is phased down, from £240k to £260k.

The income threshold remains at £200k. This means that in the current year, if an individual has not made any pension contributions but has had a pension scheme for the previous three tax years, they could in theory pay as much as £180k in the current tax year by keeping their income below £200,000. This includes £40k of each of the prior three tax years in unused relief and £60k for the current tax year. Furthermore, it is likely that they will be able to put in another £60k in the next tax year.

If one has an Owner Managed Business (OMB) with a large amount of surplus cash sitting in the company, one needs to look at whether it is sensible for the company to make contributions or whether the individual should. The advantage of the company making the contributions is that there is no national insurance on the company contributions, either employer or employee. Whereas if the individual makes the contributions, they will have come out of income that has been subjected to both employer and employee NIC and this is not recoverable.

Furthermore, if the company sits in the marginal band of corporation tax, between £50k and £250k profits, the corporate tax saving by making a pension contribution would be at 26.5% of the marginal rate, rather than at 25% or 19%. So quite often, it makes sense for the company to make the pension contributions rather than the individual.

But there are occasions when the individual has a very high rate of marginal rate of tax, where they should make the contributions.

At this stage, the wealthy and organised taxpayer has a shrewd idea of their income for 2023/24 and should be able to make the appropriate calculations regarding the best way of making the contributions. This obviously does depend on the status of the individual and the company in terms of both their tax and their national insurance contributions.

The abolition of the lifetime allowance and the increase in the threshold, make pensions contributions more interesting. Although the Labour party has pledged to reverse the reforms. The question remains open as to whether they would reinstate the lifetime allowance for everyone or indeed would give protection to those who at the time of the lifetime allowance was reinstated were above the threshold. It is likely to avoid charges of retrospective taxation but would offer the opportunity of a further election to protect the existing pension contributions, although this is not clear at present.

In conclusion, pension contributions remain a tried and tested method of reducing tax liabilities. One should also remember that pensions grow tax free of capital gains tax and income tax and therefore remain the most tax efficient form of long-term saving.

Contributed by Jeremy Mindell