



## STIRLING HOUSE A-DAY PREPARATION

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**From 6<sup>th</sup> April 2006 there will be no limit on the amount that can be paid into your pension but there will be a limit on the amount of tax relief you can receive.**

### Contributions: Key Facts

- Contributions to your pension can be made by you, by your current or any former employer or by a third party individual on your behalf. A third party can include a spouse, partner, friend, parent or grandparent. Where a contribution is paid by a third party, it is treated as if it were paid by you.
- The maximum amount that you can contribute to a registered pension scheme in each tax year and receive tax relief on is the higher of
  - £3,600 gross, or:
  - 100% of your “relevant UK earnings”
- Relevant UK earnings will normally be any earnings derived from a UK employment or taxable income from a self-employment.
- While there is a limit on the tax relief you can receive, there is no such limit for employers.
- However, an Annual Allowance will apply to the total pensions contributions from all sources in each year, as well as the amount of any increase in the value of pension benefits held for you under a salary-related pension scheme during that period. If the Annual Allowance is exceeded in any year, a 40% tax charge will be made on the excess. The tax charge would be payable by you, regardless of the source of the excess. (See Annual Allowance Section).
- The Annual Allowance does not apply in any year in which all benefits are taken.
- Personal Pension and Stakeholder Pension schemes accept contributions using the ‘relief at source’ method. This means that contributions are accepted net of basic rate tax relief, and then ‘grossed up’. For example, if you contribute £78.00 per month to a personal pension, the scheme administrator will increase this by £22.00 (the current rate of basic rate tax) so that the gross contributions will be £100.00. The scheme administrator will then reclaim the tax relief from the Revenue. If you are a member of an occupational scheme that operates a ‘net pay arrangement’, or if you contribute to a Retirement Annuity Contract (S.226), then contributions may continue to be paid on a gross basis. If you are a higher rate tax payer then you are able to claim any marginal rate tax relief due via self-assessment.
- Any contracted-out rebates paid by the Government to your pension will not count towards the limit for tax-relievable contributions or the Annual Allowance.



## Contributions: Questions & Answers

**Q: I am currently a member of a non-contributory Occupational Pension Scheme earning £40,000 p.a. and am paying 15% of my salary into an AVC. I've been told this is the maximum amount I can pay into pensions. Do these new rules mean I can pay more?**

**A:** Yes. Under existing rules, because you earn more than £30,000 p.a. you are ineligible to pay a concurrent contribution into a Personal Pension or Stakeholder Plan. The new rules remove this restriction, so you will be able to pay up to 100% of your relevant UK earnings into pensions, and receive tax relief, if you want.

**Q: I am 25 and currently contribute 17.5% of my 2002/03 tax earnings to a Personal Pension Plan because my income was much higher then than it is now and I want to maximise my personal savings. Will the new rules allow me to pay more?**

**A:** Most likely yes, but it depends on how much you are earning now compared to how much you earned in 2002. See the case study below.

### CONTRIBUTIONS: CASE STUDY

John is currently aged 54 and earned £80,000 in the tax year 2001/02 as a successful salesman for a large technology company. He decided to become self-employed in June 2002, and has been building his business gradually over the last few years. However, his taxable profits have dropped substantially in the last year, falling to £15,000 for the tax year 2004/05. He still wanted to maximise his pension contributions, and has been able to do this by using tax year 2001/02 as a 'basis year' under current legislation.

Based on his age, the maximum contribution John can make is 30% of his net relevant earnings. The current 'basis year' rule therefore allows for John to contribute a maximum of £24,000 to his pension plan in the tax year 2005/06. This is 30% of the £80,000 he earned in 2001/02.

From 6<sup>th</sup> April 2006, the basis year rule will cease to exist. His relievable individual contributions will then be restricted to the higher of £3,600, or 100% of his UK relevant earnings. John could therefore only receive tax relief on personal contributions of up to 100% of his relevant earnings each year. If John's profits remain static in 2006/07, his tax relievable contributions will be limited to £15,000, considerably less than his current maximum contribution. It is therefore important that John considers maximising his contributions in the 2005/06 tax year, to take advantage of the basis year rules.

### Important Information

Please note that the information provided in this document is based on Stirling House Financial Services' understanding of existing and proposed legislation and HMRC practice, all of which may be subject to change in the future. The information is based on the assumption that tax legislation is not changed.