

# Executive pensions

**Owner-managers, directors and senior managers have a wide choice of pension options to provide for retirement. Since April 2006 the choice has become even wider, as previous tax rules have been swept away. They have been replaced with a much simpler tax regime with a lifetime allowance (£1.65 million in 2008, rising to £1.8 million in 2010) and an annual allowance (initially set at £235,000 in 2008/2009) on tax-favoured contributions.**

These changes may make some of the rules on existing schemes redundant but there is no reason to suppose the schemes themselves will be swept away, in the short term at least. So for the time being it is advisable to make the most of the present system because lengthening life expectancy means you might need the extra income.

This briefing outlines:

- The key issues to consider in arranging pension savings.
- How to top up your company pension.
- Alternative pension schemes.
- Where to get advice.

## 1 Examine the options

**1.1** If your business operates an **approved company pension scheme**, you can take advantage of high tax relief levels on contributions.

- You can now contribute up to 100 per cent of your gross earnings to pension schemes, up to an annual limit (the 'annual allowance') of £235,000 (in 2008/09).
- If you want to make a high level of

contributions, it may make sense to put the money with three or four providers, rather than putting the whole lot into one pot.

- Your own company scheme (if any) may place a limit on the size of contributions
- Company pension schemes must be open to all eligible employees on equal terms. But you can tailor the scheme to provide different levels of benefit for different categories of employee.

Most new company pension schemes are 'money purchase' (where the eventual pension payments mainly depend on the size of the fund you have built up).

Some companies operate 'final salary' schemes (where your pension is based on a percentage of your final salary).

These have fallen out of favour with many employers as they can create unpredictable demands on companies' cashflow.

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**1.2 Approved alternatives** to making provision through the company pension scheme also qualify for high levels of tax relief.

- You could set up (or join) an executive pension plan (EPP) (see **4.1**).
- You could set up (or join) a small self-administered pension scheme (SSAS). This is only possible for limited companies and where the scheme will have fewer than 12 members (see **4.2**).
- You could invest in a personal pension plan, a stakeholder pension, (see **4.3**) or a self-invested pension plan (SIPP) (see **4.4**). Personal and stakeholder pensions and SIPPs will be 'money purchase' schemes.

## 2 Making the choice

In deciding which form of pension provision is right for you, you need to consider several factors.

**2.1 Will you and your business be contributing** the maximum possible to your pension scheme?

- The limits on the amounts qualifying for tax relief have been greatly increased (see **3** and **4**).
- Company contributions tend to be higher for 'final salary' company schemes and executive pension plans.

**2.2 Will you be making the most of tax relief** on approved schemes?

- Your personal contributions will qualify for tax relief at your top rate. For a top rate taxpayer, that effectively means £100 invested costs you £60.
- If you are paying less than the maximum permitted contributions, either increase these, or consider taking any pay increase in pension contributions rather than cash.

**2.3 How important is security** to you?

- With company final salary schemes, your pension will be a proportion of final salary, depending on the length of your service in the business. The maximum pension used to be limited to 2/3 final salary, up to the earnings limit of £105,600. Although the change in the tax regime means payments could in theory go higher, this is unlikely in the near future.
- The same overall limits used to apply to company money purchase schemes. For these, the amount you get back is directly related to how much is paid in,

how the investments perform, how high the charges are and interest rates when you convert your fund into a pension.

**2.4 Do you need ancillary benefits?**

- Final salary company pension schemes usually offer better benefits, which may include life assurance, a dependant's pension and provision for early retirement.
- There may also be a built-in element of inflation proofing.

**2.5 Do you have longer-term plans to exit the business?**

- If so, you can arrange to take your pension fund with you, but you may lose out financially.
- Personal pension plans enable you to control your own fund to a greater extent. There is no required length of saving, though the longer you save, the better your pension is likely to be.
- Earlier requirements for a given length of saving, to qualify for maximum benefits, have been swept aside as a result of the change in the tax regime.
- But there are still restrictions on how soon benefits can be taken – not before age 50 now, and that will rise to age 55 in 2010.

## 3 Company pension schemes

A company scheme will provide you with a basic pension. If you are a high earner, you may want to supplement it to maintain your standard of living (see **Company pension schemes**).

**3.1 Company schemes** now operate under a much more relaxed set of rules.

- You receive tax relief at your highest rate. Your total personal contributions are limited to 100 per cent (previously 15 per cent) of your gross earnings below the 'annual allowance' of £235,000.
- The company can set its contributions off against its tax bill.
- Pension contributions on behalf of directors of quoted companies and other long-term incentives must be disclosed in the annual report and accounts.
- There is now no legal maximum on the pension you can receive from a final salary scheme, although it will be limited by the rules of the scheme. The tax-free lump sum you can take on retirement, in exchange for part of your pension, is up to 25 per cent of your total pension funds.
- Insofar as your pension funds exceed

► Since 5th December 2005 civil partner employees must be treated in the same way as married employees. If a benefits package (such as pension survivor benefits) is available to an employee's spouse, it must also be available to an employee's civil partner.

A civil partner who is treated less favourably than a married person in similar circumstances will be able to bring a claim for discrimination on grounds of sexual orientation.

the 'lifetime allowance' (£1.65 million in 2008/09), benefits you take in the form of income will be taxed at 25 per cent, and benefits that you take as lump sum will be taxed at 55 per cent.

- Final salary (for controlling directors and high earners) is usually defined as the average total earnings over the last three years.

**3.2** You can top up a company scheme with the benefit of tax relief provided that do not exceed the **annual allowance** and stick to HM Revenue & Customs-approved schemes.

- You can use your own company's additional voluntary contributions (AVC) scheme, or AVCs from another pension provider (free-standing AVCs, or 'FSAVCs'). If you choose an FSAVC you will have to pay charges, but the investment performance might be better. FSAVCs are not available for controlling directors.

**3.3** Your company can set up an executive plan for **further benefits** (see 4.1).

**3.4** You can contribute up to **personal** or **stakeholder** pension schemes. See **Personal pension schemes** and **Stakeholder pensions**.

**3.5** You could also top up a company scheme through an **unapproved top-up** scheme.

- There are no restrictions on contributions.
- You will not get tax relief on your own contributions and will be taxed at your highest rate on contributions made by your company.
- The company can offset its contributions against corporation tax.
- Insofar as the total pension funds you have accumulated exceed the 'lifetime allowance' (£1.65 million for 2008/09), they will be taxed when they are paid as benefits: at 25 per cent if they are paid as income, and at 55 per cent if they are paid as lump sums.
- Some schemes are 'unfunded'. The company pays the pension out of its resources when you retire, but sets aside no funds in advance. If the company becomes unable to pay, you are unlikely to receive the top-up. You will be taxed on sums paid from an unfunded scheme when you retire. Unapproved top-up schemes would usually only be considered for employees who earn more than £235,000 a year or for those whose pension funds already exceed the 'lifetime allowance'.

## 4 Approved alternatives

There are alternatives to company pension schemes. The four types of pensions outlined below all qualify for tax relief.

**4.1 Executive pension plans (EPPs)** have been widely used for directors and other high earners.

- The maximum annual pension under scheme rules has been limited to two thirds of final salary, though this may now change. It may be restricted by the £235,000 'annual allowance'.
- The retirement age can be set from age 60 if scheme rules allow (as compared with 65 for most company schemes). Benefits can usually be taken at any time between 50 and 75, provided you have retired. The minimum pension age is to rise to 55 by 2010.
- The maximum tax-free lump sum you can take on retirement, in exchange for part of your pension, will be 25 per cent of the pension fund, provided it does not exceed the 'lifetime allowance'.
- The business usually pays all the contributions, although personal contributions are allowed.

**4.2 Small self-administered pension schemes (SSASs)** are suitable for directors who wish to use the pension fund to help finance the company.

Typically, SSASs are used where the members all own shares in the company. A scheme must normally have fewer than 12 members.

- Up to 50 per cent of the scheme's fund (25 per cent in the first two years) can be loaned to the company. The fund must be calculated excluding any amounts earmarked for payment to members (or their spouses) who have already retired. The loan must be repaid at a prescribed commercial rate of interest. Interest can be deducted from taxable profits.
- The fund can be used to buy a commercial property for occupation by the company. This includes buying a property from the company and leasing it back.
- The scheme can borrow to make investments. Borrowing is limited to 45 per cent of the value of the fund, plus three times annual contributions.
- The maximum annual pension was limited to 2/3 of final salary, although this may now change. It may be restricted by the £1.6 million 'lifetime allowance'.

- The maximum tax-free lump sum you can take on retirement, in exchange for part of your pension, will be 25 per cent of the value of your pension funds, provided that they do not exceed the 'lifetime allowance'.
- Within the above parameters, the members of the scheme can decide how the pension fund is divided up.  
For example, a retiring director who wishes to sell or pass on shares could exchange them in return for a larger proportion of the pension fund.
- SSAS schemes are more expensive to set up than other schemes.  
The company must employ a professional pensioner trustee. Charges include actuarial and management fees. (It may be possible to delay charges by setting up a deferred SSAS.)
- To make the SSAS financially viable, the company should be prepared to put in at least £50,000.

Trustees (usually all scheme members plus at least one professional pensioner trustee) are responsible for ensuring the scheme remains within HM Revenue & Customs guidelines.

HM Revenue & Customs classifies both EPPs and SSASs as company schemes.

**4.3 Personal pension schemes** (including stakeholder pensions) offer advantages for senior managers who change jobs frequently (see **Personal pension schemes**) and directors who receive much of their pay in dividends. Principal features of personal pensions are:

- You receive tax relief at your highest rate. Tax-favoured contributions are limited to 100 per cent of your gross annual earnings, provided they do not exceed £235,000 (for 2008/09).
- The company can set off its contributions against its corporation tax.
- These limits include contributions made by the company.
- There are no restrictions on the size of the pension that can be taken.
- The maximum tax-free lump sum you can take on retirement is 25 per cent of the fund.
- You can at present take your pension from age 50 (this will rise to 55 by 2010).
- There are no guarantees as to the size of pension you receive. What you get back is related to how much you put in, how the investments perform, what the charges are and annuity rates when you retire.

With stakeholder pensions there are limits on the level of charges. (See **Stakeholder pensions**).

**4.4** For those who wish to control their own pension investments, **self-invested pension plans** (SIPPs) are a variation on personal pension schemes.

- Tax relief and restrictions are the same as for personal pensions.
- You decide how the fund is invested within limits set by HM Revenue & Customs.
- Administration is delegated to a plan provider, but costs can be relatively high.
- SIPPs can be used to purchase commercial property.

## 5 Getting advice

Setting up a pension scheme is a long-term commitment. Good advice is essential.

**5.1** Information on setting up **any form of company scheme** can be obtained from:

- The National Association of Pension Funds ([www.napf.co.uk](http://www.napf.co.uk); 020 7808 1300).
- The Association of Pensioner Trustees (0141 248 7007).
- The Society of Pension Consultants ([www.spc.uk.com](http://www.spc.uk.com); 020 7353 1688).

**5.2** Take **professional advice** if you are taking out any form of pension scheme.

- Fee-based advisers (who charge a fee and rebate the commission they would earn) may offer better value on large investments. Your employer may be willing to pay for advice. Pensions advice to an annual value of up to £150 can now be offered as a tax-free benefit, provided it is made available to all employees.

Contact the Financial Services Authority to make sure that your adviser is regulated under the Financial Services and Markets Act (0845 606 1234 or [www.fsa.gov.uk](http://www.fsa.gov.uk)).

**5.3** **HM Revenue & Customs** can give you:

- Guidance on setting up a scheme.
- Help with obtaining approval, so that contributions qualify for tax relief.

Visit [www.hmrc.gov.uk/pensionschemes/index.htm](http://www.hmrc.gov.uk/pensionschemes/index.htm) or call 0115 974 1600.

## Further help

There are other Directors' Briefing titles that can help you. These briefings are referred to in the text by name, such as **Personal pension schemes** and **Stakeholder pensions**.

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