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EDITOR

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WELCOME TO THE TAX YEAR END SPECIAL EDITION OF TECHTALK

We’ve highlighted some key tax planning areas to focus on in the lead up to the tax year end on 5 April.

For many clients tax year end planning will have an even greater importance than usual this year because new restrictions to the pension annual allowance and the reduced pension lifetime allowance will apply from 6 April. Also, for clients already taking, or planning to take, their pension under the ‘Freedom and Choice in pensions’ reforms now is a good time for them to prepare their tax affairs and review their income so that they can maximise the amount they can draw from their pension tax efficiently. And as the majority of company year ends fall on 31 March, now is also a key time for reviewing employer pension contributions for company owners.

Whether it’s making sure they can maximise pension contributions or helping them to take their pension benefits in the most tax efficient way sound financial advice will be key to ensuring your clients can safely navigate these complex technical issues.

In this comprehensive guide Tom reminds us about the opportunity to maximise pension funding in 2015/16 using the current year’s annual allowance. He also explains carry forward of unused pension annual allowances, using examples to show how to make the maximum tax-advantaged contribution under the current rules. This takes account of the changes to pension input periods that were announced in the Summer Budget. Whilst there should be no detriment to any individual’s pension funding because of this change – in fact many will benefit from an enhancement – the impact will need to be determined for each client, and earlier carry forward exercises recalculated.

Tom also looks ahead at the impact of the forthcoming restrictions for high earners - the tapered annual allowance - and how to maximise funding in advance of the changes.

He reminds us why employer pension contributions can be highly tax-efficient for company owners, and explains the timing requirements.

And finally, he rounds off this edition by covering tax year end pension planning for the self-employed, highlighting the impact of the accounting period in determining the level of income available to support self-employed contributions and considering the deadlines in detail.

I hope you will find this tax year end special edition both a useful guide and an interesting read and that we will have helped you in your planning and in your discussions with your clients on these important topics.

To help you further the Financial Planning team has also produced an in-depth article covering salary exchange, in light of the Government’s recent announcements that it is continuing to review the growth of these arrangements. This article is available on our Adviser Extranet at: www.scottishwidows.co.uk/extranet/financial-planning/budget/2015-autumn-statement :

And for more information on workplace pension planning and pension freedoms please also take a look at our extensive range of support at:
www.scottishwidows.co.uk/adviser-automaticenrolment

And

www.scottishwidows.co.uk/extranet/financial-planning/pension-planning/retirement-income-planning

Enjoy the read.

Sandra Hogg
The last few months of the tax year often see a surge in the use of annual tax exemptions, allowances and reliefs as clients attempt to squeeze the maximum available benefit out of the tax system. Many allowances operate on an annual basis and only some allow limited carry forward of unused amounts to later tax years. Consequently, the run up to the 5th April is the time to review clients’ financial and tax planning for the year and put together a plan to make sure the bill is minimised where possible. Assuming the required outlay is affordable, maximising pension contributions, the ISA allowances, fully utilising tax bands and allowances, and ensuring transactions are well timed should all be encouraged with guidance on how these are done, the application process and any relevant deadlines.
There are two approaches to tax planning: end of year tax planning and forward planning for the next tax year. End of year planning should aim to ensure that maximum use has been made of tax reliefs, exemptions and allowances, provided that clients have the financial means to do so. With no more than two months of the tax year remaining, this often means making larger than usual contributions / investments.

Planning for next year will involve clients spreading the cost of tax planning; avoiding the need to concentrate the cost into the final few months of the tax year. This will be beneficial where clients will be using surplus monthly income to fund contributions or new investments.

Here is a quick summary of some of the tax planning opportunities for the current tax year:

**ISAs** can allow clients to preserve their income tax allowances and CGT annual exemptions when compared with taxable investments. The current ISA limit is £15,240.

**Pension contributions** made before 6 April 2016 obtain higher / additional rate income tax relief depending on the individual’s income tax position. Furthermore, some clients may be able to exploit an annual allowance greater than £40,000 in 2015/2016 following the Budget in July. This is explained in more detail in ‘Maximum Funding in 2015/2016’ later in this edition of Techtalk.

**Carry forward** can be used to bring forward unused annual allowances from the three previous tax years to make pension contributions in excess of the annual allowance in 2015/2016. Carry forward must be used before 6 April 2016 to make sure the 2012/2013 annual allowance is fully used up.

**Other pension planning points include:**

- Those with income expected to fluctuate around the higher rate income tax threshold could consider delaying contributions until later in the year when higher rates of tax relief might be achieved. But those with income and employer pension contributions above £150,000 per annum must consider the restriction in the annual allowance they may suffer from 6 April 2016.

- A client considering cashing in an investment bond may be able to save higher rate income tax on the encashment by combining it with a pension contribution. The encashment and the pension contribution must both be made before 6 April 2016.

- The income tax personal allowance can be reclaimed by making a pension contribution to reduce ”adjusted net income” below £100,000 in 2015/2016.

- Equally, child benefit claimants who are set to lose some or all of their entitlement for the year should consider whether a pension contribution will enable them to retain some or all of this benefit. Contributions must be made before 6 April 2016.

**FORTHCOMING CHANGES TO THE ANNUAL AND LIFETIME ALLOWANCES**

Current pension planning is more important than ever due to imminent changes to the major limits on pension funding. Planning for affected clients must take account of the restriction to the annual allowance for high earners and the reduction in the lifetime allowance to £1 million, both from 6 April 2016. Recent Techtalk articles have looked at these issues in detail so will only be covered in brief here. Once again, high earners and large pension funds will be on the receiving end. The impact of the changes on pension accumulation and decumulation must be looked at and decisions made before 6 April 2016.
Firstly, the level of tax-advantaged contributions will be restricted from 6 April 2016 for those with income – drawn widely to include employer pension provision – of at least £150,000 per annum. And secondly, generous pension benefits will be put under more pressure by another reduction in the Lifetime Allowance; this time to £1 million. Planning around the former is severely limited, but there is an opportunity to use up the full annual allowance of this tax year and the previous three before 6 April 2016. The latter will benefit from transitional protection – as with previous reductions – to ensure that those funding within the current allowance are not unfairly penalised.

The impact of these restrictions will largely fall upon the wealthy and, set against the backdrop of the Freedom & Choice reforms, will do little to dampen the appeal of pensions as a tax-efficient retirement planning vehicle. They still remain the most tax-efficient savings product and should be at the centre of your clients’ end of year planning.

To aid your understanding of all aspects of pensions, we have produced a range of technical materials including webinars, podcasts, technical guides, case studies and Techtalk articles covering existing and forthcoming pension rules. This material can be found on the Scottish Widow Adviser Extranet under Financial Planning > Retirement Planning:

TECHNICAL MASTERCLASSES (WEBINARS):
The Budget and the tapered annual allowance
Lifetime allowance protection
Carry forward involving 2015/2016.
http://www.scottishwidows.co.uk/extranet/business/adviser-online-hub/webinars

PODCASTS
Pension Death Benefits – Estate Planning With Your Pension
Fading Away – Tapered Annual Allowance and Pension Input Periods
http://www.scottishwidows.co.uk/extranet/business/adviser-online-hub

RETIREMENT PLANNING SUPPORT MATERIAL
Essentials & FAQs
Technical Guidance
Case Studies
Quarterly Updates
http://www.scottishwidows.co.uk/extranet/financial-planning/pension-planning/retirement-income-planning

PENSION FAQS
http://www.scottishwidows.co.uk/extranet/financial-planning/Techtalk/frequently-asked-questions

TOPICAL NEWS
Lifetime Allowance Protection 2016 – 5 November. For the latest developments please see:
http://www.scottishwidows.co.uk/extranet/financial-planning/Techtalk/news

BUDGET ANALYSIS
http://www.scottishwidows.co.uk/extranet/financial-planning/budget

TAX CARD
http://www.scottishwidows.co.uk/Extranet/Literature/Category/219

In addition, we have an extensive library of technical articles written for our Techtalk magazine. These in-depth articles cover many technical aspects of pension rules including the annual allowance, lifetime allowance, pension input periods, carry forward and tax relief.

For further reading beyond this edition, search for the articles below using our ‘Index to Techtalk articles’ on the Scottish Widows Adviser Extranet under Financial Planning > Techtalk.

PENSION ACCUMULATION TECHTALK ARTICLES
http://www.scottishwidows.co.uk/Extranet/Literature/Category/627

PENSION DECUMULATION TECHTALK ARTICLES
http://www.scottishwidows.co.uk/Extranet/Literature/Category/628
It was originally planned that the annual allowance in 2015/2016 would be £40,000. And indeed this was the case until the Summer Budget when the tax year was split into two periods, each with a different allowance ahead of the forthcoming restrictions for high earners. There should be no detriment to any individual’s pension funding because of this change – in fact many will benefit from an enhancement – but the impact for each client should be determined, and earlier carry forward exercises recalculated.
CHANGES TO THE ANNUAL ALLOWANCE AND PENSION INPUT PERIODS

On 8 July 2015, the tax year 2015/2016 was split into two periods: the first started on 6 April 2015, ended on 8 July 2015 and is referred to as the ‘pre-alignment tax year’; the second started on 9 July 2015, will end on 5 April 2016 and is called the ‘post-alignment tax year’. A corresponding amendment was made to pension input periods to ensure all are tax-year aligned from April 2016. Thus, all open pension input periods were closed on Budget day and a new period started from 9 July 2015 that will end on 5 April 2016. Pension input periods will then be tax-year aligned from 6 April 2016 with no option to vary them, which means they can effectively be forgotten for current year funding from April 2016. The pension input period changes are discussed further in the Appendix to this article.

A revision to the annual allowance for the tax year was also required: instead of a £40,000 allowance for the whole year, each separate part of the tax year was given its own specific allowance. For the pre-alignment tax year this was £80,000, and for the post-alignment tax year it is technically £0, but contributions can be made in the post-alignment period by carry forward of unused allowance – capped at £40,000 – from the pre-alignment period.

As a consequence, all defined contribution pension members are currently part way through their 9 July 2015 to 5 April 2016 pension input period covering the whole of the post-alignment tax year, during which their effective annual allowance is a maximum of £40,000 but may be less dependant on how much of their annual allowance was used in the pre-alignment tax year.

EXAMPLE

Tim is funding a personal pension with contributions of £3,500 gross paid on the 1st of each month. The current level of monthly contributions has been in place since April 2014. The plan's pension input period originally ran until 31 May each year. To work out the available annual allowance for the post-alignment tax year we must work out how much annual allowance was used before the Budget.

For this we need to know how much was paid in the pension input periods that ended between 6 April 2015 and 8 July 2015 – not just what was paid in that period. There are two pension input periods to look at:

- Period 1 June 2014 to 31 May 2015: contributions were: 12 x £3,500 = £42,000
- Period 1 June 2015 to 8 July 2015: contributions were: 2 x £3,500 = £7,000

The total pension input for the pre-alignment tax year was £49,000, which means the annual allowance available for the post-alignment year, which is the lower of the remainder of the £80,000 allowance or £40,000, is:

£31,000 (£80,000 – £49,000)

If Tim wants to fully use up his annual allowance for the current year, he must pay a £31,000 contribution before 6 April 2016 and meet the pension provider’s requirements for end of tax year contributions. Additionally, if he wants to make sure any unused annual allowance for 2012/2013 is not lost at the end of the tax year he will need to make a larger contribution – one that covers the unused annual allowance for that year as well. Carry forward is covered in more detail later in this edition of Techtalk.

Tim was fortunate in that he had paid more than £40,000 against the annual allowance in the pre-alignment tax year. The effect of this was to ensure that he can access the maximum £80,000 annual allowance for 2015/2016. The same is true for all clients who used at least £40,000 of the annual allowance in the pre-alignment tax-year. What about clients who had paid less than £40,000 or nothing at all?

EXAMPLE

Lily was funding a personal pension with contributions of £750 gross paid on the 7th of each month. The plan’s pension input period ran in line with the tax year. We must work out how much annual allowance was used before the Budget.

There is only one pension input period that ended between 6 April 2015 and 8 July 2015:

- 6 April 2015 to 8 July 2015: contributions were: 4 x £750 = £3,000

The total pension input for the pre-alignment tax-year was £3,000, which means the annual allowance available for the post-alignment tax-year, which is the lower of the remainder of the £80,000 allowance or £40,000, is:

£40,000.

Again, to use this up before the end of the tax year, a £40,000 contribution must be made before 6 April 2016.

Lily is less fortunate than Tim. She had paid a much lower level of contributions in the pre-alignment tax year, so she can not access the maximum £80,000 annual allowance for 2015/2016. She does, however, benefit from a small enhancement in her annual allowance to £43,000 in 2015/2016.
Lily is less fortunate than Tim. She had paid a much lower contribution – one that covers the unused annual allowance of £3,000.

If Tim wants to fully use up his annual allowance for the tax year, he must pay a £31,000 contribution before 6 April 2016 and meet the pension provider's requirements for the plan.

Clients that wish to use the full annual allowance in the tax year must do so before 6 April 2016. However, any unused annual allowance from 2015/2016 can still be carried forward until 2018/2019.

APPENDIX: ONE, TWO OR THREE PIPS?

The changes in the Summer Budget mean that clients will have one, two or three pension input periods ending in 2015/2016 for each of their schemes or arrangements. The amounts paid during each of these periods are required to determine the client's maximum annual allowance for 2015/2016.

New plans taken out after the Summer Budget will only have one pension input period ending in the tax year. Plans that were in force on Budget day are more complicated. Generally speaking, a plan with a tax-year aligned pension input period before the Budget or a pension input period that was originally due to end in the tax year after 8 July 2015 will have two pension input periods for the year. A client with a plan that had already had a pension input period end in 2015/2016 before the Budget will have three:

- The first ran from 1 January 2015 to 8 July 2015
- The second from 9 July 2015 to 5 April 2016
- The third from 9 July 2015 to 5 April 2016
CARRY FORWARD

Thomas Coughlan

The Summer Budget in July split the current tax year into two periods. This modified carry forward to 2015/2016, allowing unused annual allowances to be carried forward to each period separately. The other aspects of carry forward remain the same.

THE CARRY FORWARD RULES

To be eligible for carry forward, the individual must have been a member of a registered pension scheme in the tax year they wish to carry forward from. Almost any registered scheme confers eligibility; a paid up personal pension; deferred final salary scheme; rebate-only personal pension and others.

Once eligibility has been established, the maximum unused allowances should be calculated. This is the remaining annual allowance of the current year plus the remaining amounts from each of the three previous years. The current year must be used first before the unused amounts from earlier years can be carried forward. Of the previous years, earlier ones are used in preference to later years, ensuring that the unused allowance remains available for up to three years.

No application form is required for carry forward; any excess above the standard annual allowance of a particular year automatically triggers carry forward of unused allowances from eligible years. Nor does it need to be declared on the self-assessment tax return, unless there is an excess above the annual allowances plus carry forward, in which case it must be declared on the supplementary form. This is separate from the normal requirement to declare on the main self assessment form all personal contributions paid to registered pension schemes during the tax year.
THE SUMMER BUDGET

The changes to pensions in 2015/2016, including those to pension input periods, are summarised in the previous article: 'Maximise Funding in 2015/2016'. One of the key changes in the Summer Budget was the increase in the annual allowance to £80,000 in the pre-Budget part of the tax year – the ‘pre-alignment tax year’. This increase was necessary to ensure that no individual taxpayer suffered an unfair tax charge as a result of the changes. Without this increase, a client who had paid £40,000 to each of two arrangements – one that was originally due to end in 2015/2016, the other in 2016/2017 – would have paid more than the £40,000 annual allowance when those PIPs were closed early on 8 July 2015. As the original funding was within available limits under the prevailing rules, it would have been unfair to retrospectively raise a tax charge under the new rules, hence the temporary increase in the annual allowance.

Taking the annual allowance for the current year into account, we’ll now look at carry forward calculations to the pre-alignment tax year and the later part of the tax year – the post-alignment tax year.

CARRY FORWARD TO THE PRE-ALIGNMENT TAX YEAR

There was very little opportunity to plan carry forward to the pre-alignment tax year as the announcement was made just a few hours before the pension input period closed. In any case, the £80,000 annual allowance meant that contributions as high as twice the normal annual allowance wouldn’t have required carry forward. However, if a client had already utilised carry forward to a pension input period that ended between 6 April 2015 and 8 July 2015, this must be revisited as contributions above £80,000 will use up previous years’ allowances. In many cases, the outcome of this will be that more annual allowance is available than expected, which can be used to make further contributions before the end of the tax year.

EXAMPLE

In April 2015, Mina paid £135,000 to her personal pension to use up her unused annual allowances from 2012/2013 to 2015/2016. The original carry forward calculation was as follows:

<table>
<thead>
<tr>
<th>Tax year</th>
<th>Annual Allowance</th>
<th>Pension Input</th>
<th>Unused / excess</th>
<th>CF to 15/16</th>
<th>Revised allowances</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012/13</td>
<td>£50,000</td>
<td>£15,000</td>
<td>£35,000</td>
<td>£35,000</td>
<td>£0</td>
</tr>
<tr>
<td>2013/14</td>
<td>£50,000</td>
<td>£15,000</td>
<td>£35,000</td>
<td>£35,000</td>
<td>£0</td>
</tr>
<tr>
<td>2014/15</td>
<td>£40,000</td>
<td>£15,000</td>
<td>£25,000</td>
<td>£25,000</td>
<td>£0</td>
</tr>
<tr>
<td>2015/16</td>
<td>£40,000</td>
<td>£135,000</td>
<td>(£95,000)</td>
<td>n/a</td>
<td>£0</td>
</tr>
</tbody>
</table>

At the time this was expected to use up Mina’s full annual allowances up to the 2015/2016 tax year. The Summer Budget however, by introducing an £80,000 annual allowance, has generated additional annual allowance.

The revised calculation based on the £80,000 annual allowance in the pre-alignment tax year is as follows:

<table>
<thead>
<tr>
<th>Tax year</th>
<th>Annual Allowance</th>
<th>Pension Input</th>
<th>Unused / excess</th>
<th>CF to 15/16</th>
<th>Revised allowances</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012/13</td>
<td>£50,000</td>
<td>£15,000</td>
<td>£35,000</td>
<td>£35,000</td>
<td>£0</td>
</tr>
<tr>
<td>2013/14</td>
<td>£50,000</td>
<td>£15,000</td>
<td>£35,000</td>
<td>£20,000</td>
<td>£15,000</td>
</tr>
<tr>
<td>2014/15</td>
<td>£40,000</td>
<td>£15,000</td>
<td>£25,000</td>
<td>£0</td>
<td>£25,000</td>
</tr>
<tr>
<td>Pre-2015/16</td>
<td>£80,000</td>
<td>£135,000</td>
<td>(£55,000)</td>
<td>n/a</td>
<td>£0</td>
</tr>
<tr>
<td>Post-2015/16</td>
<td>£0</td>
<td>£0</td>
<td>£0</td>
<td>n/a</td>
<td>£0</td>
</tr>
</tbody>
</table>

The Summer Budget has benefited Mina by making a further £40,000 annual allowance available, but this won’t necessarily be the case for every client. Furthermore, she will only be able to benefit from the extra allowance if she has sufficient earnings to cover the total contributions made in the tax year or can benefit from significant employer contributions.

Using pensions for tax year end planning in 2015/2016 should start with checking how much annual allowance is available this tax year and where necessary recalculate carry forward to the pre-alignment tax year.
CARRY FORWARD TO THE POST-ALIGNMENT TAX YEAR

Technically, the post-alignment tax year has no annual allowance so before looking at carry forward from the three previous years, we must look at the amount of unused annual allowance, if any, that can be carried forward from the pre-alignment tax year. The amount available is restricted to the lower of (i) the unused annual allowance (by reference to the total allowance of £80,000) and (ii) £40,000. Added to this figure is the unused annual allowances of 2012/2013, 2013/2014 and 2014/2015, provided that the client is eligible for carry forward from those years.

EXAMPLE

Having recalculated Mina’s April 2015 carry forward, we can look at carry forward to the post-alignment tax year. As Mina paid more than £80,000 in 2015/2016 before the Budget, she has no annual allowance available in 2015/2016. Thus, carry forward will be limited to the unused allowances of the three previous years:

<table>
<thead>
<tr>
<th>Tax year</th>
<th>Annual Allowance</th>
<th>Pension Input</th>
<th>CF in pre-alignment</th>
<th>Revised allowances</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012/2013</td>
<td>£50,000</td>
<td>£15,000</td>
<td>£35,000</td>
<td>£0</td>
</tr>
<tr>
<td>2013/2014</td>
<td>£50,000</td>
<td>£15,000</td>
<td>£20,000</td>
<td>£15,000</td>
</tr>
<tr>
<td>2014/2015</td>
<td>£40,000</td>
<td>£15,000</td>
<td>£0</td>
<td>£25,000</td>
</tr>
<tr>
<td>Pre-2015/16</td>
<td>£80,000</td>
<td>£135,000</td>
<td>n/a</td>
<td>£0</td>
</tr>
<tr>
<td>Post-2015/16</td>
<td>£0</td>
<td>£0</td>
<td>n/a</td>
<td>£0</td>
</tr>
</tbody>
</table>

If all amounts are to be used up this tax year, the contribution must be paid before 6 April 2016. Earnings must cover the total value of personal contributions paid during the tax year, including carry forward amounts, or the member must be able to benefit from employer contributions.

Many clients will have available allowance that can be brought forward from the pre-alignment to the post-alignment tax year. In which case, pre-to-post-alignment carry forward precedes carry forward from earlier tax years.

EXAMPLE

Ralph earns £285,000 per annum and has total pension contributions of £30,000 in each of 2012/2013, 2013/2014 and 2014/2015. In 2015/2016 he paid £20,000 in the pre-alignment tax year.

The maximum annual allowance that can be carried from the pre-alignment to the post-alignment tax year is £40,000, which is the lower of £40,000 and £60,000 (£80,000 – £20,000).

What is the maximum contribution he can now pay in 2015/2016 without breaching the annual allowance?

<table>
<thead>
<tr>
<th>Tax year</th>
<th>Annual Allowance</th>
<th>Pension Input</th>
<th>Unused / excess</th>
<th>CF to Post-15/16</th>
<th>Maximum contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012/2013</td>
<td>£50,000</td>
<td>£30,000</td>
<td>£20,000</td>
<td>£20,000</td>
<td>£20,000</td>
</tr>
<tr>
<td>2013/2014</td>
<td>£50,000</td>
<td>£30,000</td>
<td>£20,000</td>
<td>£20,000</td>
<td>£20,000</td>
</tr>
<tr>
<td>2014/2015</td>
<td>£40,000</td>
<td>£30,000</td>
<td>£10,000</td>
<td>£10,000</td>
<td>£10,000</td>
</tr>
<tr>
<td>Pre-2015/16</td>
<td>£80,000</td>
<td>£20,000</td>
<td>£60,000</td>
<td>£40,000</td>
<td>£40,000</td>
</tr>
<tr>
<td>Post-2015/16</td>
<td>£0</td>
<td>£0</td>
<td>n/a</td>
<td>n/a</td>
<td>£90,000</td>
</tr>
</tbody>
</table>

The maximum annual allowance in the post-alignment tax-year is £40,000. In addition, Ralph can carry forward the unused £20,000, £20,000 and £10,000 from 2012/2013, 2013/2014 and 2014/2015 respectively, allowing a further contribution of £90,000 within the annual allowance in 2015/2016.

Once again, if the plan is to ensure that all amounts are used up this tax year, the contribution must be paid before 6 April 2016. Ralph’s situation is more urgent than Mina’s because without a contribution before 6 April 2016, the £20,000 annual allowance from 2012/2013 will be lost for good. At the very least he should pay £60,000 to use up the current year’s annual allowance and that of 2012/2013. The allowances from 2013/2014 and 2014/2015 can be carried forward to 2016/2017 and 2017/2018 if preferred.
CARRY FORWARD TO 2016/2017

Carry forward of the unused annual allowance from 2015/2016 to a later year will always be from the pre-alignment tax year. The maximum amount available for carry forward will be restricted to the lower of (i) the unused annual allowance (by reference to the total allowance of £80,000) and (ii) £40,000. In other words, it is the same as the amount that would have been available for carry forward to the post-alignment tax year, which means it is reduced by contributions paid in the post-alignment period.

EXAMPLE

Following on from the above example, Ralph decided to only pay a further £25,000 in the post-alignment tax year. In 2016/2017, realising he has lost the unused annual allowance of 2012/2013 he decides to make full use of his allowances from 2013/2014.

The maximum amount he can pay is as follows:

<table>
<thead>
<tr>
<th>Tax year</th>
<th>Annual Allowance</th>
<th>Pension Input</th>
<th>Unused / excess</th>
<th>CF to 16/17</th>
<th>Maximum contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013/14</td>
<td>£50,000</td>
<td>£30,000</td>
<td>£20,000</td>
<td>£20,000</td>
<td></td>
</tr>
<tr>
<td>2014/15</td>
<td>£40,000</td>
<td>£30,000</td>
<td>£10,000</td>
<td>£10,000</td>
<td></td>
</tr>
<tr>
<td>Pre-2015/16</td>
<td>£80,000</td>
<td>£20,000</td>
<td>£60,000</td>
<td>£15,000</td>
<td></td>
</tr>
<tr>
<td>Post-2015/16</td>
<td>£0</td>
<td>£25,000</td>
<td>£0</td>
<td>n/a</td>
<td></td>
</tr>
<tr>
<td>2016/17</td>
<td>£10,000</td>
<td>£10,000</td>
<td>£0</td>
<td>n/a</td>
<td>£55,000</td>
</tr>
</tbody>
</table>

In 2016/2017 his annual allowance is restricted to £10,000 because his income is greater than £210,000. In addition to this he can carry forward £20,000 and £10,000 from 2013/2014 and 2014/2015, respectively.

The maximum unused annual allowance from the 2015/2016 pre-alignment tax year is a further £15,000, which is the capped amount of £40,000 less the £25,000 contributions he paid in the post-alignment tax year.

Ralph can make total contributions of £55,000 within the annual allowance in 2016/2017.

Ralph could spread the cost of the contributions over the 2016/2017 tax year. This will be particularly relevant where surplus monthly income is being used to fund retirement provision.


LOOKING FURTHER AHEAD

Carry forward to 2017/2018 and later years

We don’t yet know how carry forward from a year during which the tapered annual allowance applies to a later year will work e.g. carrying forward from 2016/2017 to 2017/2018. To prevent tax avoidance, it would make sense that any restriction in the annual allowance that applies in a particular tax year also limits the annual allowance that can be carried forward from that year. Limited details are as yet available, however.

This will be expanded on further in a future Techtalk article.
TAX PLANNING AHEAD OF THE TAPERED ANNUAL ALLOWANCE

Thomas Coughlan

From 6 April 2016, high earners will see their annual allowance restricted to as low as £10,000. A high earner in this context is someone with income greater than £150,000 who will suffer a £1 reduction in their annual allowance for every £2 of income above this threshold. The minimum allowance of £10,000 will apply to those with income of at least £210,000.

Those unable to avoid a significant reduction in their future annual allowances will have more than the usual incentive to maximise their pension contributions at the end of the tax year.
THE DETAILS

The measure that will be used to determine whether an individual’s income exceeds £150,000 is ‘adjusted income’. This includes net income for the year such as earnings and interest and the value of any pension contributions / pension input during the tax year. Employer pension contributions, therefore, are included along with personal contributions that reduce taxable income, such as those made to net pay schemes and to retirement annuity contracts. Personal contributions that benefit from relief at source are not added in separately as they are already included within net income.

The effect of including employer contributions and personal contributions that reduce taxable income in adjusted income is that it cannot then be reduced either by entering into a salary sacrifice agreement or by increasing pension contributions. Exchanging salary for employer pension contributions will not affect the client’s adjusted income figure for the year because either the salary or the employer pension contribution that it is exchanged for (which will usually be the same amount) will be included and tested against the £150,000 threshold.

An exception aimed at preventing those with a one-off spike in adjusted income – perhaps because of a high rate of DB accrual in a particular year – is that where threshold income is not more than £110,000, the annual allowance is not tapered. Threshold income is an income measure that includes taxable income but excludes pension contributions, except those that result from a new salary sacrifice agreement entered into on or after 9 July 2015.
EXAMPLE 1

Robin earns £146,000 in 2016/2017. He also benefits from a 5% matched employer pension contribution to a group personal pension in the tax year.

His adjusted income for the year is his net income plus the employer contribution:

£146,000 + 5% x £146,000 = £153,300.

As adjusted income is greater than £150,000 and threshold income (£138,700, which is £146,000 less the 5% personal contribution to the GPP) is greater than £110,000, the annual allowance will be tapered as follows:

<table>
<thead>
<tr>
<th>Amount of excess income</th>
<th>£153,300 – £150,000</th>
<th>£3,300</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual allowance reduction</td>
<td>£3,300 / 2</td>
<td>£1,650</td>
</tr>
<tr>
<td>Tapered annual allowance</td>
<td>£40,000 – £1,650</td>
<td>£38,350</td>
</tr>
</tbody>
</table>

*the employee contribution is not included in adjusted income as it is paid to a scheme that operates relief at source and so is already included in Robin’s net income of £146,000.

EXAMPLE 2

Lisa earns £250,000 in 2016/2017. She also benefits from a 15% employer pension contribution provided that she pays at least 5% to her employer’s net pay pension scheme. In the year she also became entitled to a one-off employer contribution of £20,000.

Her adjusted income for the tax year is her net income plus employer and employee contributions. Her threshold income is £237,500, which is her salary of £250,000 less the 5% net pay contribution of £12,500. The calculation of adjusted income is as follows:

£237,500 + £12,500 + £37,500 + £20,000 = £307,500

Adjusted income is greater than £150,000 and threshold income is greater than £110,000, so the tapered annual allowance applies. Her annual allowance is reduced to £10,000 because adjusted income is greater than £210,000.

Pension input for the year is £70,000 which exceeds the tapered annual allowance in the tax year and so will lead to an annual allowance charge unless carry forward of unused annual allowances is available to cover the excess pension input.

EXAMPLE 3

Jack earns £160,000 in 2016/2017. He benefits from a 10% matched employer pension contribution to a money purchase occupational pension scheme. On 9 July 2015 he entered into a salary sacrifice agreement with his employer to reduce his salary by £35,000 and increase his employer’s pension contributions by the same amount. This was an attempt to reduce threshold income below £110,000 to avoid the tapered annual allowance.

Adjusted income for the year is his net income, which includes the sacrificed salary plus the usual employee and employer contributions. Net income is £144,000, which includes the salary sacrifice contributions but excludes the net pay contributions. The calculation of adjusted income is as follows:

£144,000 + 20% x £160,000 = £176,000.

As adjusted income is greater than £150,000 and threshold income is greater than £110,000 – the salary sacrifice did not reduce this below the threshold – the annual allowance will be tapered as follows:

<table>
<thead>
<tr>
<th>Amount of excess income</th>
<th>£176,000 – £150,000</th>
<th>£26,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual allowance reduction</td>
<td>£26,000 / 2</td>
<td>£13,000</td>
</tr>
<tr>
<td>Tapered annual allowance</td>
<td>£40,000 – £13,000</td>
<td>£27,000</td>
</tr>
</tbody>
</table>

His pension input is likely to exceed the tapered annual allowance in the tax year and so will lead to an annual allowance charge unless carry forward of unused annual allowances is available to cover the pension input above £27,000.

The inclusion of pension provision when testing adjusted income against the £150,000 limit and the similar inclusion of salary sacrifice when testing threshold income against the £110,000 threshold severely restricts planning opportunities to avoid the tapered annual allowance. It may be possible to maximise net pay contributions, contributions to retirement annuity contracts or personal contributions to a relief at source pensions scheme to ensure threshold income is below £110,000 but the range of circumstances in which this will generate even moderate benefit is narrow.
MAXIMISING THE FULL ALLOWANCE BEFORE THE END OF THE TAX YEAR

Given the severely limited opportunities for mitigating the tapered annual allowance, those that will definitely suffer a restriction should look to maximise their full allowance now before the end of the tax year.

LISA – CONTINUED

Lisa’s earnings are sufficient to allow her to make significant contributions utilising carry forward from earlier tax years. She has most of her annual allowances available from 2012/2013 onwards:

<table>
<thead>
<tr>
<th>Tax year</th>
<th>Annual Allowance</th>
<th>Pension Input</th>
<th>Unused / excess</th>
<th>CF to 16/17</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012/2013</td>
<td>£50,000</td>
<td>£10,000</td>
<td>£40,000</td>
<td></td>
</tr>
<tr>
<td>2013/2014</td>
<td>£50,000</td>
<td>£30,000</td>
<td>£20,000</td>
<td>£20,000</td>
</tr>
<tr>
<td>2014/2015</td>
<td>£40,000</td>
<td>£10,000</td>
<td>£30,000</td>
<td>£30,000</td>
</tr>
<tr>
<td>2015/2016</td>
<td>£40,000*</td>
<td>£5,000</td>
<td>£35,000</td>
<td></td>
</tr>
</tbody>
</table>

*no annual allowance was used in the pre-alignment tax year

She pays a contribution of £75,000 before 6 April 2016: this is to make sure that her current year’s annual allowance and that of 2012/2013 are used up.

In 2016/2017, she pays further contributions of £60,000 to maximise her annual allowances.

<table>
<thead>
<tr>
<th>Tax year</th>
<th>Annual Allowance</th>
<th>Pension Input</th>
<th>Unused / excess</th>
<th>CF to 16/17</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013/2014</td>
<td>£50,000</td>
<td>£30,000</td>
<td>£20,000</td>
<td>£20,000</td>
</tr>
<tr>
<td>2014/2015</td>
<td>£40,000</td>
<td>£10,000</td>
<td>£30,000</td>
<td>£30,000</td>
</tr>
<tr>
<td>2015/2016</td>
<td>£40,000</td>
<td>£40,000</td>
<td>£0</td>
<td>£0</td>
</tr>
<tr>
<td>2016/2017</td>
<td>£10,000</td>
<td>£60,000</td>
<td>(£50,000)</td>
<td>n/a</td>
</tr>
</tbody>
</table>

The available carry forward from 2013/2014 and 2014/2015 is sufficient to cover the excess contributions above the £10,000 annual allowance in 2016/2017. This has enabled her to use her maximum annual allowances from 2012/2013 to 2016/2017.

If instead she had not paid the contributions in the first table above before 6 April 2016, the 2012/2013 annual allowance would have been lost. This would have been of significant detriment to her as based on current income the ongoing annual allowance is likely to be restricted to £10,000 a year.

Those that are certain they will be restricted to a £10,000 annual allowance from 2016/2017 onwards should ensure carry forward as far back as 2012/2013 is maximised, as per the above examples.

Those with fluctuating earnings could have a constantly changing annual allowance and should make the most of those years when the full allowance is available. For example, a client whose adjusted income fluctuates between £150,000 and £210,000 could go from having a £40,000 annual allowance one year to £10,000 in the next year and should maximise contributions in the years when a higher allowance is available.

Whilst paying the maximum pension contributions based on the available allowance is a sensible strategy, the reality for very high earners is that high levels of pension funding will no longer be possible, once available carry forward has been exhausted. Those that can control their income year to year may be able to make further allowance available – perhaps in the run up to retirement to create scope for further provision – but those that can’t, should pay what they can and then consider alternative investment vehicles, starting with ISAs.
Many employers pay contributions to pension schemes for their staff, but only with the recent advent of automatic enrolment have they been obliged to. Whether compulsory or not, the vast majority of employer contributions are deductible expenses providing a significant incentive to employers to add them to the business’s remuneration package. Employers can make significant savings towards the end of the tax year by maximising these contributions.

**EMPLOYER PENSION CONTRIBUTIONS**

At this time of year, employers often ask two questions: *What level of pension contributions benefit from corporation tax (or income tax) relief? and When must contributions be paid to generate relief in the current year?*

The primary source to answer the first question is HM Revenue and Customs’ Business Income Manual. This contains some useful assurances on employer pension contributions as a tax-deductible business expense. Amongst other things, it states:

“As part of the cost of employing staff, pension contributions are likely to be allowable.”

The manual also further qualifies the position for former employees and those employed elsewhere:

“A pension payment by an employer is normally wholly and exclusively for the purposes of its trade even when the employees in respect of which the contribution is being made are retired or those of another employer.”

It is clear from these statements that pension contributions made by employers will normally be wholly and exclusively for the purposes of its trade and only rarely will they have to consider if there is a non-trade purpose. However, this does not mean that employers can make any level of contributions they wish and still obtain tax relief.
It remains a question of fact as to whether a non-trade purpose exists. There are certain circumstances where there may be a non-trade purpose – e.g. contributions paid to an employee who is related to the business proprietor – and these are examined more closely in BIM46030, but employers should discuss any specific cases with their accountant.

We will now look at the aspect of employer pension contributions that generates the majority of questions on this topic to our technical helpdesk.

CONTRIBUTIONS IN RESPECT OF DIRECTORS OR CONNECTED PERSONS

Pension contributions for directors or other employees who are connected to the business must also meet the 'wholly and exclusively' test to be treated as a deductible expense. This will normally be the case, but there are exceptions. One is where the total remuneration package – not just the pension contribution in isolation – is excessive in relation to the value of work that the employee undertakes. If it is, full relief may not be available on the contribution. One test that HMRC carry out in these circumstances is to check whether the remuneration package being paid to the director of a close company or someone who is a close relative of the director or proprietor (unincorporated businesses) is comparable with that paid to an unconnected employee performing similar duties.

HMRC provides additional guidance covering the situation where there are no employees with whom duties are genuinely comparable. In these cases, a comparison between the value of the work undertaken and the value of the total remuneration package may be required as explained in BIM47105.

The Business Income Manual also clarifies the position for directors that are the driving force behind the business stating:

Controlling directors

"Controlling directors are often the driving force behind a company. Where the controlling director is also the person whose work generates the company's income then the level of the remuneration package is a commercial decision and it is unlikely that there will be a non-trade purpose for the level of the remuneration package. It should be noted that remuneration does not include entitlement to dividends etc arising in the capacity of shareholder."

For those directors, there is no theoretical limit to the total remuneration they can receive. In practice though the employer pension contributions that form part of that package should be within the annual allowance to prevent a tax charge arising and take the lifetime allowance into account where the fund is approaching the current limit. Lifetime allowance issues aside, one-person companies and small businesses with one or more key directors/employees can make large employer pension contributions, using carry forward where available. Another important point is that employer contributions are not limited by earnings in the tax year, allowing directors who receive only dividends or a small salary to benefit from employer pension contributions as the main part or one of the main parts of their remuneration package.

Not all directors, however, are responsible for generating the company's profits, so this logic cannot be extended to all. E.g. the spouse of a director who, whilst a director themselves, only carries out minimal office administration duties each week. In these circumstances, the overall remuneration package should reflect the value of the work carried out. Anything above that paid to other non-connected employees or above a 'commercial' level may not be tax deductible. Again, the view of an accountant should be sought to determine what is actually allowable in respect of a specific case.

Remuneration paid to other connected individuals will only be allowable where they correspond with the duties undertaken as the Business Income Manual confirms.

"Precise comparisons are not always possible. Careful consideration of the facts will be required in worthwhile cases to establish whether the level of the remuneration paid to a friend or relative of the proprietor is commercial and commensurate with the duties undertaken. The chosen comparators need to have similar qualifications, experience and job description."

END OF YEAR EMPLOYER CONTRIBUTIONS

When the acceptable level of employer contribution has been established, the financial or tax year that those contributions will be assessed in should be considered.

The rules are relatively straightforward: the deduction takes place in the company or business year that the pension contribution is paid. If the company would prefer that the contribution is deducted in this year’s accounts they should pay it before or on the last day of the current period. If they would prefer for it to be deducted in the next year then deferral to a day in that period will suffice. It is not usually possible to pay the contribution in one year and have it deducted in the accounts of a different year. However, if the pension contribution generates or enhances a loss, then that can be carried forward and offset against profits of a later year.

PLANNING OPPORTUNITY

Mark is the sole director and employee of a private limited company. The company accounts are prepared to 31 March each year. Mark wishes to reduce profits of £130,000 to £0 by making an employer pension contribution. He has minimal pension benefits and has not used any of his annual allowances in recent years, but he has been a member of a contracted out plan for many years, making him eligible for carry forward.

An employer contribution of up to £180,000 could be paid before 1 April 2016, utilising the £40,000 annual allowance of 2015/2016 and the allowances of the previous three tax years (£50,000, £50,000 and £40,000, respectively).

Mark decides to pay £140,000 and his accountant confirms that this will be a deductible expense. The contribution will turn the profit into a £10,000 loss for the year, which can be carried forward and offset against profits in future years. As a result the company will pay no corporation tax for the financial year starting 1 April 2015 and Mark will not suffer any tax in respect of the pension contribution as it is within the annual allowance plus carry forward.
PLANNING OPPORTUNITY

Rhian runs her own limited company, employing two full-time members of staff. She wishes to maximise her pension provision and also reward her staff with a pension contribution before the year end. Company accounts are made up to 31 March each year and the profit for the current year is likely to be £240,000.

She has paid £6,000 each year to a personal pension since 2010. Her maximum annual allowance is:

<table>
<thead>
<tr>
<th>Tax year</th>
<th>Annual Allowance</th>
<th>Contributions</th>
<th>Unused</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012/2013</td>
<td>£50,000</td>
<td>£6,000</td>
<td>£44,000</td>
</tr>
<tr>
<td>2013/2014</td>
<td>£50,000</td>
<td>£6,000</td>
<td>£44,000</td>
</tr>
<tr>
<td>2014/2015</td>
<td>£40,000</td>
<td>£6,000</td>
<td>£34,000</td>
</tr>
<tr>
<td>Pre-15/16</td>
<td>£6,000*</td>
<td>£6,000</td>
<td>£0</td>
</tr>
<tr>
<td>Post-15/16</td>
<td>£40,000**</td>
<td>£0</td>
<td>£40,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td>£162,000</td>
</tr>
</tbody>
</table>

*no further allowance available from pre-alignment tax year
**by carry forward from pre to post-alignment tax year

Rhian asks a firm of accountants what pension contributions she can pay in respect of her staff. They advise £5,000 and £20,000 in the current year. Rhian decides to pay these amounts to their personal pension plans and the maximum contribution within the annual allowance to her own plan.

She arranges for her company to pay £187,000 in employer pension contributions on 25 March 2016. The company’s profit for the accounting period is reduced to £53,000. Corporation tax of £10,600 (20% x £53,000) will be due on 1 January 2017.

Employers approaching the end of their accounting period who wish to make employer contributions should decide whether to make those contributions in the current period or a later one. The usual timings are important for the payment of current year contributions. There may also be also a marginal benefit of paying company pension contributions before the rate of corporation tax drops to 19% and then 18% in future years.

Employer pension contributions may also be preferable to the payment of a bonus where it is to be used by the employee to fund personal contributions to a pension scheme. The advantage to employer contributions in this instance arises from the lack of national insurance contributions raised against them.
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<tbody>
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<td>£50,000</td>
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</tr>
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</tr>
<tr>
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<td>£40,000</td>
<td>£6,000</td>
<td>£34,000</td>
</tr>
<tr>
<td>Pre-15/16</td>
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<td>£0</td>
</tr>
<tr>
<td>Post-15/16</td>
<td>£40,000**</td>
<td>£0</td>
<td>£40,000</td>
</tr>
</tbody>
</table>

Total £162,000

*no further allowance available from pre-alignment tax year

**by carry forward from pre to post-alignment tax year

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Employer pension contributions may also be preferable to the payment of a bonus where it is to be used by the employee to fund personal contributions to a pension scheme. The advantage to employer contributions in this instance arises from the lack of national insurance contributions raised against them.

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**TAX RELIEF FOR THE SELF EMPLOYED**

Thomas Coughlan

The self-employed do not have an employer and so cannot benefit from employer pension contributions. Instead they must make personal contributions, which means that the relevant UK earnings that support them must be at least equal to the total payments in the tax year. As with personal contributions paid by employees and employer contributions, timing is critical, particularly towards the end of the tax year.
Tax relief is available on gross contributions up to the level of relevant UK earnings in the tax year, or £3,600 if this is higher. This is separate to the annual allowance, which accumulates all contributions by the individual, their employer and any third parties and raises a tax charge if the aggregate contributions exceed the annual allowance plus carry forward. The earnings limit can be much more stringent: many providers cannot accept excess contributions and any that are made must be refunded and the tax relief returned to HM Revenue & Customs.

EXAMPLE
A contribution paid between 6th April 2015 and 5th April 2016 benefits from tax relief in the 2015/2016 tax year and at the tax rates applicable. For personal pensions, including group personal pensions, basic rate relief is available immediately when the provider grosses up the net contribution by 20%.

Rates of tax relief in excess of basic rate must be claimed via self-assessment; accordingly any additional relief is available when the balancing payment for the tax year in question is made.

The due date for this payment is the 31st January following the end of that tax year. This is explained further below.

Whilst personal contributions are granted relief in the tax year in which they are paid, the earnings that support them – relevant UK earnings – don’t necessarily arise in the tax year. A self-employed individual will choose an appropriate period over which to compute their profits. A 31st March year end, for example, will normally mean that profits are calculated over the period from 1st April to 31st March, though it is possible to have a period of account that is longer or shorter than 12 months and to change the year end date, where appropriate. A 31st December year end, on the other hand, will mean profits calculated over the calendar year support pension contributions made during the tax year that begins in that period.

EXAMPLE
Continuing with the example of a 31st March year end, profits for the 12 months to 31st March 2016 will be computed and assessed in the 2015/2016 tax year; that is the tax year in which the period of account ends.

Clive is a tax adviser and operates as a sole trader. He has been in business for many years and makes up his accounts to 31 March each year. For the year to 31st March 2016, his profits are £52,000. He has not yet made any contributions this year and would like to make a contribution of £30,000. The maximum tax relievable contribution Clive can make in the tax year is £52,000; i.e. his net profits in his period of account to 31 March 2016 and accordingly his relevant UK earnings for 2015/2016.

In terms of timing, for tax relief to be granted in 2015/2016 against his earnings of £52,000, the contribution must be paid before 6th April 2016.

HOW IS TAX RELIEF CALCULATED?
The self-employed pay two payments on account of income tax on 31st January during the tax year and the next 31st July as well as a balancing payment (including any capital gains tax liability) on 31st January after the tax year. The payments on account are usually half of the previous year’s income tax liability less any amounts of tax paid by deduction at source. As a consequence, any higher or additional rate tax relief granted against a pension contribution paid in the tax year will normally be reflected in the relevant balancing payment.
EXAMPLE

Following on with the example of Clive above, a single contribution of £10,000 gross (£8,000 net) is paid on 25 March 2016 before the tax year ends.

The provider adds the initial £2,000 tax relief and claims this back from HM Revenue & Customs.

Clive’s total tax liability with and without the pension contribution is as follows:

<table>
<thead>
<tr>
<th></th>
<th>Without pension contribution</th>
<th>With pension contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Earned income</td>
<td>£52,000</td>
<td>£52,000</td>
</tr>
<tr>
<td>Deduct personal allowance</td>
<td>(£10,600)</td>
<td>(£10,600)</td>
</tr>
<tr>
<td>Taxable income</td>
<td>£41,400</td>
<td>£41,400</td>
</tr>
<tr>
<td>Basic rate band</td>
<td>£31,785</td>
<td>£31,785</td>
</tr>
<tr>
<td>Tax liability:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- basic rate: £31,785 @ 20%</td>
<td>£6,357</td>
<td>£8,280</td>
</tr>
<tr>
<td>- higher rate: £9,615 @ 40%</td>
<td>£3,846</td>
<td></td>
</tr>
<tr>
<td>Total tax liability</td>
<td>£10,203</td>
<td>£8,280</td>
</tr>
</tbody>
</table>

His total tax relief is £3,923, which is made up of £2,000 at source and £1,923 (£10,203 – £8,280) at the higher rate.

Based on the gross contribution of £10,000, this gives a rate of tax relief of 39.2%. The reason the rate of relief is not 40% is because the amount of relief given at the higher rate is restricted to amount of income tax actually paid at that rate.

If Clive is to be sure that tax relief will be given in 2015/2016 against his relevant UK earnings of £52,000, he must pay the contribution before the tax year ends on 5 April 2016.

HOW ARE THE BALANCING PAYMENT AND FUTURE PAYMENTS ON ACCOUNT AFFECTED?

The amount that must be paid via the payments on account is normally determined by the previous year’s income tax liability, however a claim can be made to reduce the payments on account if there is reason to believe this year’s tax liability will be lower than last year. The balancing payment – collected on 31st January after the end of the tax year – will cover any shortfall.

Because the payments on account are based on the previous year’s liability, they are unlikely to be affected by current year pension contributions. However, the reduced tax liability will be reflected in the balancing payment and affects next year’s payments on account.

EXAMPLE

Continuing further with the example of Clive, let’s say that his tax liability in 2014/2015 was £7,600, therefore his payments on account for 2015/2016 are:

31st January 2016 – £3,800
31st July 2016 – £3,800

Without the pension contribution, his total tax liability for 2015/2016 would be £10,203 resulting in a balancing payment of £2,603 due on 31st January 2017. With the pension contribution, his tax liability for the year is reduced to £8,280, resulting in a reduced balancing payment of £680.

The knock on effect of the pension contribution is that the payments on account for 2016/2017 will be £4,140 each (£8,280 / 2) rather than £5,102 (£10,203 / 2). However, any shortfall in the overall tax liability that this creates for that year could result in an increased balancing payment on the 31st January after the end of the tax year.

SUMMARY

With no opportunity for employer contributions, the self employed must justify tax relief on their personal contributions by reference to their trade profits. This gives an opportunity for advisers to use their knowledge of the taxation of businesses and its interaction with pension tax relief to help the self employed build up retirement benefits in a tax efficient way.

Correct timing of contributions is essential, particularly towards the end of the tax year and especially for traders that make up their accounts to 31 March. As well as utilising relevant UK earnings for the year in question and generating tax relief by reducing the client’s tax bill, well-time contributions can reduce future balancing payments and payments on account, providing cash-flow benefits whilst enabling adequate pension provision.
This publication represents Scottish Widows’ interpretation of the law and HMRC practice at the time of writing this publication.

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