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Pension Contributions and Redundancy

From 6th April 2006, new rules applying to pension contributions as part of "Pensions Simplification" have provided a very interesting and tax efficient opportunity for making redundancy payments.

The first £30,000 of such a payment continues to be tax free with the balance being added to the employee's income for the year to determine what rate of tax will be payable on the excess. However, if the excess is paid on behalf of the employee as a pension contribution, the employee will not suffer tax on that amount. Furthermore, it should be possible for the employer to obtain Corporation Tax relief on the whole payment, although it would be advisable to check with the company's local inspector of taxes.

This opportunity has emerged due to the new contribution rules being much more flexible than the old prescribed regimes. The following points are particularly relevant:

- Much higher pension contributions can be made by employers and employees. Although such cases may be rare, an employer can pay up to £215,000 into an employee's pension plan(s) and obtain Corporation Tax relief, subject to those payments satisfying the wholly and exclusively test. Where contributions exceed this amount, the employee will suffer a 40% tax charge on the excess
- An employee can make pension payments of up to 100% of their gross relevant earnings in a financial year and obtain Income Tax relief
- Irrespective of the type of scheme offered by the employer, the payment can be made into a Personal or Stakeholder pension plan.

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It is important to note that the payment should ideally be made before the employee leaves service, otherwise it will be classed as having been made by a third party, and for tax relief purposes, the 100% of relevant earnings rule will apply.

Other considerations need to be taken into account, such as the Lifetime Limit. Nevertheless there are planning possibilities here, proving that new legislation can offer good opportunities.

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