

# Independent Financial Advice

# Pension News

from Johnston Financial

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In these recessionary times it is even more important than usual to make sure you get maximum value from your money. And this applies to saving for retirement as much as for your weekly shopping or any other expenditure.

We are all familiar with the fact that contributions to a registered pension scheme usually qualify for tax relief, but perhaps less well known is the possibility of making savings on National Insurance Contributions as well. This can mean that contributions can be geared up by as much as 63.5% for standard rate tax payers and up to 91% for higher rate taxpayers, without any cost to the employer apart from a small amount of additional administration.



Adrian Johnston  
Managing Director

## Making your money go further

### How does it work?

It's called 'salary sacrifice' or 'salary exchange'. Essentially the employee agrees with the employer to give up some of his normal salary entitlement. This can be in the form of a fixed amount each month or a percentage of salary, a proposed increase or a future bonus payment.

In return, the employer agrees to make a contribution on behalf of the member to the company pension scheme, equal to the amount given up.

Because the employee hasn't received this amount as income there is no income tax due and no National Insurance Contributions payable, either by the employee or by the employer.

The payment to the pension scheme is a qualifying business expense and can therefore be set against profits for corporation tax purposes.

Let's look at a couple of examples.

#### Example 1

Mr Jones earns £50,000 per annum and is expecting an end of year bonus of £6000. If he took this as salary it would all be subject to higher rate tax and an NI contribution deduction of £60, (1%).

Net income before salary exchange	
Gross bonus .....	£6000
less 40% income tax relief .....	£2400
less 1% national insurance contributions .....	£60
Net income .....	£3540

If instead, Mr Jones took his bonus as a pension contribution under a 'salary exchange arrangement' the whole amount of £6000 could be invested. An uplift of £2460 or 69%.

**Add in the saving that the employer makes by not having to pay NI contributions on the payment - 12.8% of £6000 or £768 - and Mr Jones' net income of £3540 can be exchanged for a pension contribution of £6768. An uplift of £3228 or 91%.**

#### Example 2

Mrs Smith has just been promoted and decides that instead of taking all the increase as income she will use £300 per month to boost her pension pot as she would like to retire early. She is a standard rate tax payer earning £25,000 per annum.

Net income before salary exchange	
Gross income .....	£300
Less income tax @ 20% .....	£60
Less national insurance contributions @ 11% .....	£33
Net increase in income .....	£207

The saving in employer's national insurance contribution liability is £38.40 (12.8% of £300.00).

**Instead of a net increase in income of £207pm, Mrs Smith could have an additional contribution to her pension of £300 - an uplift of £93 or 45% - or £338.40 if her employer agrees to add in his saving on NI contributions, an uplift of 63.5%.**

Of course, any benefits taken from the pension plan in the future will be subject to income tax but up to 25% can taken as a tax free lump sum and income is not subject to national insurance contributions so deferring income in this way still has considerable tax savings.

“ We are all familiar with the fact that contributions to a registered pension scheme usually qualify for tax relief, but perhaps less well known is the possibility of making savings on National Insurance Contributions as well. ”

## Too good to be true?

Well not really, though there are some rules you need to be aware of if the Revenue are not to treat the payment as a 'money's worth' payment and therefore taxable.



1. The 'sacrifice' must be from earnings the employee would otherwise be entitled to. In other words it must form part of the employee's contractual agreement.
2. The employee must request, or agree to, the salary exchange before it takes effect.
3. The salary exchange and pension contribution must be seen to be independent of each other. In other words, an agreement to give up salary cannot be expressed as dependent on the employer making a pension contribution.
4. The salary sacrifice should be documented as a permanent arrangement. It is possible for an employee to change his or her mind and to opt out of the arrangement if circumstances change but the Revenue are not keen on frequent changes. Any change in the rate of salary sacrifice needs to be documented as a separate agreement.
5. The 'sacrificed' amount cannot be paid to the employee in any way, nor can the employee have the right to ask for it back.
6. Any agreement for bonus or salary exchange must be in writing.

In addition it is important to remember that a reduction in gross salary may have a knock on effect to an employee's benefits in other areas, for example entitlement to holiday or sick pay, overtime pay, employer contributions to pension and to the level of certain State benefits. It is important to check to see if these would apply before implementing salary exchange. Many of these problems can be avoided by procedural changes.

## How can Johnston Financial help you?

- We will discuss with you how salary sacrifice could work for your company and your employees.
- We will provide you with draft wording for the letter which employees have to sign asking the employer to reduce their gross salary by the appropriate amount. We also provide your employees with an explanatory leaflet.
- We will provide a spreadsheet which calculates the amount of pension contribution due based on the salary sacrifice formula agreed with each employee. This takes into account basic rate tax relief and Class 1 employee's NI Contributions.
- We provide a separate worksheet for employees subject to higher rate tax, showing the impact of the NI Contribution threshold and higher rate tax relief.
- We will remind you at each renewal date to check if any employees want to change the rate of salary sacrifice, and will provide you with appropriate draft letters and a revised contribution spreadsheet.

## Owner Directors

The salary exchange process described above is a very effective way for employees to boost their retirement savings. However for owner directors there is no need to go through the salary sacrifice procedure as it is much easier to simply make an employer contribution to your pension plan. As a business expense it can be set against Corporation Tax liability and as it is not income to the director there is no liability for income tax or NI contributions (employer and employee).

In the next Newsletter we will look in more detail at how a pension plan can be used as a tax planning tool for company directors and whether it is better to take profits from the company as income, dividends or pension contributions.

## More information

If you want more information on the topics covered in the Newsletter - or any other pension query - please contact us on 0845 166 4540 or e-mail [mail@johnstonfinancial.co.uk](mailto:mail@johnstonfinancial.co.uk). We're here to give you advice and help with your pension problems or issues.



Johnston Financial  
49 Northumberland Street  
Edinburgh, EH3 6JQ  
T: 0845 166 7095 F: 0845 166 7093  
E: [mail@johnstonfinancial.co.uk](mailto:mail@johnstonfinancial.co.uk)  
W: [www.johnstonfinancial.co.uk](http://www.johnstonfinancial.co.uk)  
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