There's a different approach to paying pension contributions, Ray Best suggests:

Think outside THE CASH BOX

We are living in extraordinary times: the value of investments in all four main asset groups – equities, bonds, property and cash – have all dropped simultaneously. This was not supposed to happen, but it has, so the economists will have to rewrite their rule books. Meanwhile, back in the real world, we need to find a strategy to cope with the devastating loss of value in our own and our clients' pension funds.

Those individuals who are close to retirement have few options other than to boost their pension contributions, and possibly delay taking any benefits out of the fund. That inevitably means delaying retirement. Younger clients may want to sit on their investments and wait for the upturn. However, the depressed value of personally-held investments does offer opportunities to freeze the tax gain, or loss, and take some tax relief immediately.

Example 1

Sidney, aged 51, is a higher-rate taxpayer with earnings of £250,000 in 2008/09. His portfolio of quoted shares stands at £200,000, which is way below the base cost of the shares of £260,000. Sidney decides to cut his losses and sell his entire portfolio, reinvesting the proceeds of £200,000 in his self-invested pension plan (SIPP). Since Sidney is already over the retirement age for this pension scheme (50), he can take a 25% cash draw-down from the fund as soon as the trustees have received the tax rebate from HMRC. (For the overall cash effect, see the box below.)

As Sidney has relevant earnings in excess of the annual allowance of £235,000 for 2008/09, his pension fund can receive up to that amount on his behalf and reclaim basic rate tax at 20% from HMRC. Any contribution in excess of the annual allowance does not qualify for tax relief, but it does not debar Sidney from making further contributions, in this case £12,000, without income tax relief.

Example 1

2008/09	£	£
Pension fund receives:		
Net contribution to SIPP qualifying for tax relief	80% x £235,000	188,000
Contribution with no tax relief at source	200,000 – 188,000	12,000
Tax refund claimed by SIPP trustees	25% x 188,000	47,000
Total value in pension fund		**247,000**
Sidney receives:		
Tax-free cash draw-down	25% x 247,000	61,750
Higher-rate tax relief on tax privileged contribution	20% x 235,000	47,000
Total cash received		**108,750**
Less capital loss on portfolio (available to set against future capital gains)	260,000 – 200,000	(60,000)
Sidney's net cash position:		**48,750**

Alternative method

Sidney sold his share portfolio and invested the cash proceeds in his SIPP; but the same effect can be obtained if Sidney transfers his quoted shares into the SIPP as an in-specie contribution. The SIPP provider must agree to receive the shares in satisfaction of a promised contribution from the individual, and may require an independent valuation of the shares where there is no obvious market value. The advantage of transferring the shares themselves to the pension fund is that Sidney effectively retains control of those investments, but any future increase in the value of those shares is protected from capital gains tax.

Small company director

Sidney is fortunate to have a high level of relevant earnings, but many small company shareholder/directors extract most of their income from their companies as dividends that do not qualify as relevant earnings. The level of pension contributions they can make personally in any tax year is thus limited by the level of their gross earnings, once the minimum threshold of £3,600 is exceeded. This problem can be circumvented by the employing company making the pension contributions on the director's behalf.

Example 2

Adrian draws a regular salary of £25,000 plus dividends of £40,000 (gross) from his company Fine City Ltd, which has a 31 December year end. Adrian's investments have suffered in the downturn, so he decides to cash-in his corporate bonds generating proceeds of £140,000.

Adrian's relevant earnings for the year are just £25,000, which gives him scope to contribute £20,000 (net) to his SIPP in 2008/09. This contribution reduces his taxable earnings for 2008/09 to within the basic rate band. He will receive tax relief of £5,000 on his pension contribution, and the SIPP will reclaim a further £5,000 from HMRC. Adrian lends the balance of the proceeds of £120,000 to his company, where it is held as a positive balance on his directors' loan account.

Fine City Ltd uses the cash from Adrian to make an employer's contribution of £60,000 into the SIPP in December 2008, and a similar contribution in January 2009. As long as Fine City Ltd has taxable profits of at least £60,000 in both 2008 and 2009, it should receive full tax relief for the pension contributions. If HMRC query the payment, the company will need to show that Adrian's total remuneration package for each year is not excessive in relation to the work he undertakes for the company, as described in the HMRC Business Income manual at para BIM 46035.

When Fine City Ltd has sufficient cash to repay Adrian's loan account he can withdraw the balance of £120,000 from his loan account tax free. (For the cash position, see the box below.)

Example 2

2008/09	£	£
Pension fund receives:		
Net contribution to SIPP qualifying for tax relief		20,000
Employer contributions with no tax relief at source	2 x 60,000	120,000
Tax refund claimed by SIPP trustees	25% x 20,000	5,000
Total value in pension fund		**145,000**
Adrian receives:		
Tax-free cash repaid by Fine City		120,000
Higher-rate tax relief on personal contribution	20% x £25,000	5,000
Total cash received		**125,000**

The no-cash solution

Many companies do not have large cash reserves, but they may hold other assets, such as commercial property that could be transferred into the pension fund as an in-specie contribution. Registered pension funds are penalised if they hold residential property or tangible movable property as part of their investments, so transferring residential property to the pension fund is not an option.

Example 3

Mary Loo and Andy Pandy are the directors and shareholders of Toybox Ltd, which owns a commercial property worth £400,000. The company has agreed to pay contributions to a registered pension fund totalling £400,000 on behalf of Mary and Andy. This contribution promise is satisfied by the transfer of the commercial property at its market value. Although this value exceeds one personal annual allowance for 2008/09, the total value of the transaction is deemed to satisfy the promise to make two contributions of £200,000 each for Mary and Andy, which are within the annual allowances for those individuals. As long as the directors' total remuneration packages, including the value of the pension contributions, are reasonable compared to the value of work those directors do for the company, no income tax or NI charges are triggered by these pension contributions.

Toybox Ltd arranges for an independent valuation of the property to be carried out, and the transfer of the property is completed on 20 March 2009. The pension fund must pay stamp duty land tax of £12,000 (3% x £400,000) on completion of the contract. The pension fund takes ownership of the property within the pension input period for which sufficient annual allowance is available. Stephen Ward illustrated how pension input periods can be manipulated to achieve higher pension contributions within short periods in his article in the November 2008 issue of Tax Adviser (p35).

The capital gain or loss that Toybox Ltd made on the disposal of the commercial property is calculated based on the exchange date for the unconditional contract

for the property transfer, not on the completion date.

Companies can still deduct from the gain an indexation allowance based on the acquisition cost of the property, or on the market value at 31 March 1982 if the property was acquired before that date and a rebasing election has been made. The indexation allowance cannot turn a gain into a loss. The result in that case is a nil gain.

Where the value of the property is so depressed that it produces a capital loss, that loss may only be set against capital gains arising in the same accounting period or carried forward to set against gains in subsequent accounting periods. A capital loss a trading company makes cannot be carried back or surrendered to other group companies. A capital gain a company makes is subject to corporation tax at the same rate as the trading profits for the period.

Other assets to be considered

Since 6 April 2006 there is only one set of rules governing the permitted investments for all registered pension schemes, although there are some restrictions for SIPP and SASS schemes (see below). In brief, the following types of investment may be transferred as in-specie contributions into a pension fund:

- commercial property in the UK or located overseas;
- hotels, guest houses and nursing homes;
- riding stables and golf courses; forestry, woodland and agricultural land;
- non-income producing land;
- shares in unrelated companies, including:
  - VCT shares
  - EIS shares
  - shares acquired from employee share schemes
  - shares in real estate investment trusts (REITS).

Shares held as investments do not have to be quoted shares, but unquoted shares must be valued on a fair market value basis before transfer. A SASS can hold up to 5% of its fund value in shares of the sponsoring employer or an associated company, or up to 20% of the fund where the shares relate to more than one sponsoring employer. A SIPP can hold up to 100% of its fund in the shares of the scheme members' employer, but not where that company has established a trust to run the SIPP – that would make the pension scheme an occupational scheme.

Conclusion

A transfer of investments held by the individual or the employing company into a self-invested pension fund should be considered as part of any comprehensive financial planning exercise. Transfers made while asset values are depressed may generate little or no tax for the individual, although the stamp duty and SDLT charges should not be overlooked.

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