

Tax deductibility of special one-off employer pension payments

New rules for obtaining and spreading relief

Update: 12 September 2006

The new corporate tax regime changed the rules for deducting expenses and spreading tax relief on employer contributions, with effect from the first corporation tax accounting period ending on or after 6 April 2006. Employer contributions will now only be deducted as an expense provided they are incurred '*wholly and exclusively for the purposes of the employer's trade or profession*'. Tax relief is no longer automatic - as it generally was in the past - and, where it is granted, new spreading rules apply. These changes are particularly relevant if you are planning to pay a deficit payment in the near future and have more than one employer (or paying entity) in your scheme.

What you need to know

Prior to 6 April 2006

1. Under the previous tax regime, pension contributions paid by each employer and to each scheme were considered separately. There was a distinction made between 'ordinary annual contributions' (regular annual payments such as ongoing benefit accrual costs) and 'special contributions' (such as for deficit correction).
2. Provided there was a relationship between an employer and employee, a deduction was given automatically but subject to spreading for large special contributions. Her Majesty's Revenue and Customs (HMRC) was also relaxed about which entity in a group made the payments provided that all relevant employers in the group were under common ownership (on the basis of over 50% ownership).

Current Tax Deductibility

3. As mentioned in the *Pension file* dated 1 March 2006, the rules have changed, although the underlying intent on spreading relief on large contributions remains broadly as before. So although there is now no distinction between ordinary and special contributions, the effect of a four year spread for large contributions remains (see overleaf).
4. Employers now have to satisfy a general requirement that contributions made are 'wholly and exclusively' for the purposes of the business.

Spreading

5. For chargeable periods ending on or after 6 April 2006, the definitions of ordinary and special contributions have been dropped, with there being a more objective test for possible spreading of tax relief. As before, contributions by each employer and to each scheme are considered separately.
6. Where deductions are granted, tax relief now needs to be spread over a number of years, where:
 - total employer contributions in the current year is **more than 210%** of total employer contributions in the previous year; and
 - Relevant Excess Contributions (RECs) are **£500,000 or more**.RECs are the difference between this year's employer contributions and 110% of last year's contributions.
7. If an employer has paid no contributions in a chargeable period (e.g. a contribution holiday coming to an end), tax relief in the next chargeable period will not need to be spread. Care is needed to check on the timings of the chargeable period, which may not be the same as the scheme year.
8. Where spreading is applied, the test is based on employer contributions actually paid, and excludes contributions in respect of:
 - funding cost of living increases for current pensioners, and
 - funding future service benefits for employees who join the scheme this year.

These two amounts would normally qualify for tax relief in the year of payment.

9. Pro-rating adjustments apply where this and last year's accounting periods differ.
10. The following spreading periods now apply:

Relevant Excess Contributions	Spreading period
£500,000 to £999,999	• equally over 2 years
£1,000,000 to £1,999,999	• equally over 3 years
£2,000,000 +	• equally over 4 years

The PricewaterhouseCoopers pension solutions team is uniquely placed to advise you on your pension issues because of our breadth of commercial, financial, HR and pensions expertise.

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What you need to do

1. You should analyse the spreading position for one-off deficit payments in relation to each employer and each scheme, and determine the most effective approach.
2. You should consider ending any current contribution holiday at the end of a company financial year. This will avoid the situation where a small amount of contributions are paid in one financial year, creating spreading in the next year.
3. See our Pension file dated 09 September 2006 on Employer Pension Contributions for detail on how the new rules mean employer pension contributions no longer receive automatic tax relief and have to meet the 'wholly and exclusively' test.

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