SAVE ON CORPORATION TAX AND INVEST IN YOUR FUTURE

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For owner-managed businesses and company directors, making pension contributions through a limited company can be one of the most tax-efficient ways to extract profits while building long-term retirement savings.

Employer pension contributions, paid by a company into a director's pension, are generally treated as an allowable business expense. This reduces the company's taxable profit and therefore its corporation tax liability.

How Corporation Tax Relief Works

When a limited company makes a pension contribution on behalf of a director, the contribution is normally deductible as an expense provided it is made "wholly and exclusively" for the purposes of the trade. In practice, this means the contribution must be commercially justifiable and not excessive compared to the director's role in the business.

The effective tax relief received depends on the rate of corporation tax the company pays. UK corporation tax has three levels depending on company profits:

- **19% small profits rate** for companies with profits of £50,000 or less.
- **25% main rate** for companies with profits above £250,000.
- **Marginal relief band** for profits between £50,000 and £250,000, where the effective rate gradually increases between the two, with an effective marginal rate of around 26.5% on additional profits within this band.

The tax relief achieved from pension contributions varies depending on the size and profitability of the business.

The **annual allowance rules still apply to the individual**, even if the company receives tax relief.

Relief for Smaller Companies

If the company contributes £10,000 into a director's pension, this reduces taxable profits by the same amount, generating a corporation tax saving of £1,900.

The contribution still provides a significant tax-efficient way of extracting value from the business without triggering income tax or national insurance for the director.

Relief in the Marginal Band

For companies with profits between £50,000 and £250,000, the corporation tax system becomes more complex. Within this band, the effective marginal rate on additional profit can be around 26.5%, meaning that reducing profits through pension contributions can deliver proportionately higher tax savings.

For example, a £10,000 pension contribution in this range could effectively reduce the company's tax bill by up to £2,650 depending on its precise profit level. Timing pension contributions can help companies reduce profits to remain within lower tax bands, improving overall tax efficiency.

Relief for Larger Companies

In these cases, employer pension contributions can generate the highest level of corporation tax relief.

For example, if a company contributes £20,000 into a director's pension, this reduces taxable profits by the same amount and could reduce the corporation tax bill by up to £5,000.

Additional Tax Advantages

Company pension contributions can also avoid other forms of taxation. Employer contributions are not treated as personal income for the director and are typically not subject to income tax or national insurance contributions. Furthermore, employer contributions are not limited by the director's salary level.

Planning Considerations

While companies can theoretically contribute any amount to a director's pension, tax-efficient contributions are normally limited by the **annual pension allowance,** currently £60,000 per tax year. Unused allowances from the previous three years may also be carried forward.

Conclusion

For company directors, pension contributions made directly by their limited company can be a powerful tax planning tool and highly tax efficient.

The level of corporation tax relief depends on the size and profitability of the business, ranging from 19% for companies within the small profits rate, up to 25% for companies paying the main rate, with an effective marginal rate of around 26.5% applying to profits within the marginal relief band.

PTM043100 - Contributions: tax relief for employers: introduction - HMRC internal manual - GOV.UK

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