Incorporating can vastly improve Clients' Ability to fund an Adequate Pension

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"A company director can fund a private pension much more tax efficiently than a sole trader"

Although businesses may decide to incorporate for different reasons, many business owners overlook the pension funding opportunities such a corporate structure can bestow on them. A little known, but significant disparity exists where a company director can fund a private pension much more tax efficiently than a sole trader. They can also have their company foot the entire bill for the pension fund, without even incurring a Benefit-in-Kind tax liability.

If a company is profitable therefore, it is possible for a director to build up a sizeable pension fund relatively quickly, if those profits are directed into an Executive Pension. Where income tax relief for a sole trader is limited to an age related percentage of Net Relevant Earnings, (and the Net Relevant Earnings themselves are also capped at €115,000), a company director has no such limits when it comes to company contributions. He or she is permitted to use whatever company contributions necessary to fund a maximum pension of ⅔ of final salary, if certain service requirements to Normal Retirement Age (NRA) are met. If service to NRA is less than ten years, a reduced limit on maximum contributions applies.

It's important to note the overall cap of €2 million applying to all private and public pensions, referred to as the Standard Fund Threshold. The Revenue Commissioners allow all company pension contributions, if within the Revenue maximum limits, to be written off fully as a business expense and, unlike a sole trader, no PRSI or Universal Social Charge (USC) applies to these contributions either. Even the earnings cap of €115,000 that is applicable to personal contributions does not apply to employer contributions.

The company director, unlike his or her sole trader counterpart, even has the option to avail of early retirement in full health from the age of 50, albeit that strict Revenue conditions apply. For 20% directors these conditions stipulate that the early retirement must be genuine, all ties with the company must be severed and the director's shareholding must be disposed of. None of these conditions apply at NRA, the lowest of which can be aged 60.

Furthermore at retirement the director, unlike his sole trader counterpart, has two retirement lump sum options: one based on 25% of the value of the fund but a second one based on final salary and service (typically 1.5 times salary with 20 years' salaried service to NRA). It is important to note that if salary and service related tax free cash is availed of, an annuity must be purchased with the balance of the fund, if any, unless it qualifies as a trivial benefit.

Company directors should be aware, though, that the pension fund cannot be accessed until retirement age, and the fund cannot ever be used to fund the business, or to lend money to the business or directors. Purely in terms of wealth accumulation and tax benefits, a director would be hard pushed to identify a superior investment alternative, albeit that there are restrictive access issues that need to be understood from the outset.

Example of maximum funding

Married, 45 year old male, company director of a profitable company, no retained benefits on a salary of €37,050.

Revenue maximum fund allowable at NRA 60	**€800,000**
Maximum Annual Contribution allowable	**€53,333**

Key differences in sole trader and company director pension funding

	Sole Trader	Company Director employer contributions
Tax relief	Subject to age related limits	Subject to Revenue max rules
Early Retirement option from age 50	No (ill health only)	Yes
Earnings cap	Yes (€115,000)	No
PRSI/USC levied on contributions	Yes	No
Two tax free cash options	No	Yes
Maximum Retirement age	75	70
Death Benefits	Value of fund on death to estate	4 times salary cap on lump sum

*Our maximum funding calculator, available on **www.bline.ie**, will quickly calculate maximum contribution levels for company director clients and/or employees.*

This article is based on current pension rules, which are subject to change. Pension plans should be reviewed regularly. Independent advice should always be sought on pension planning. To claim income tax relief, you can apply to your Inspector of Taxes to adjust your tax credits. Contributions deducted from salary will receive immediate tax relief. If you are self-employed, you must include your pension contributions in your self-assessment tax returns in order to obtain income tax relief.

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