End Of Year Tax Planning

Using an Executive Pension to extract wealth for business owners

Today, despite the many challenges faced by customers because of high inflation and the cost of living rises, many SME businesses have shown remarkable resilience and flourished with the result that they have accumulated cash assets in the company.

Good forward thinking business planning means that these same SME owners should look at options for extracting profits from their business in the most tax efficient manner. Better known as Wealth Extraction, this is the efficient means of withdrawing profits for the benefit of the business owner in the most tax efficient means possible which if done well, could lead to greater financial freedom in retirement.

Extracting profits from a business – the options available

There are three main options for a business owner to extract profits from their Company:

A Leave profits in the company and extract proceeds through sale of the company at some future date.

B Withdraw profits as salary or dividends.

C Withdraw profits via Employer contribution to an Executive Pension via the Zurich Master Trust.

We have looked at the tax consequences of each option below.

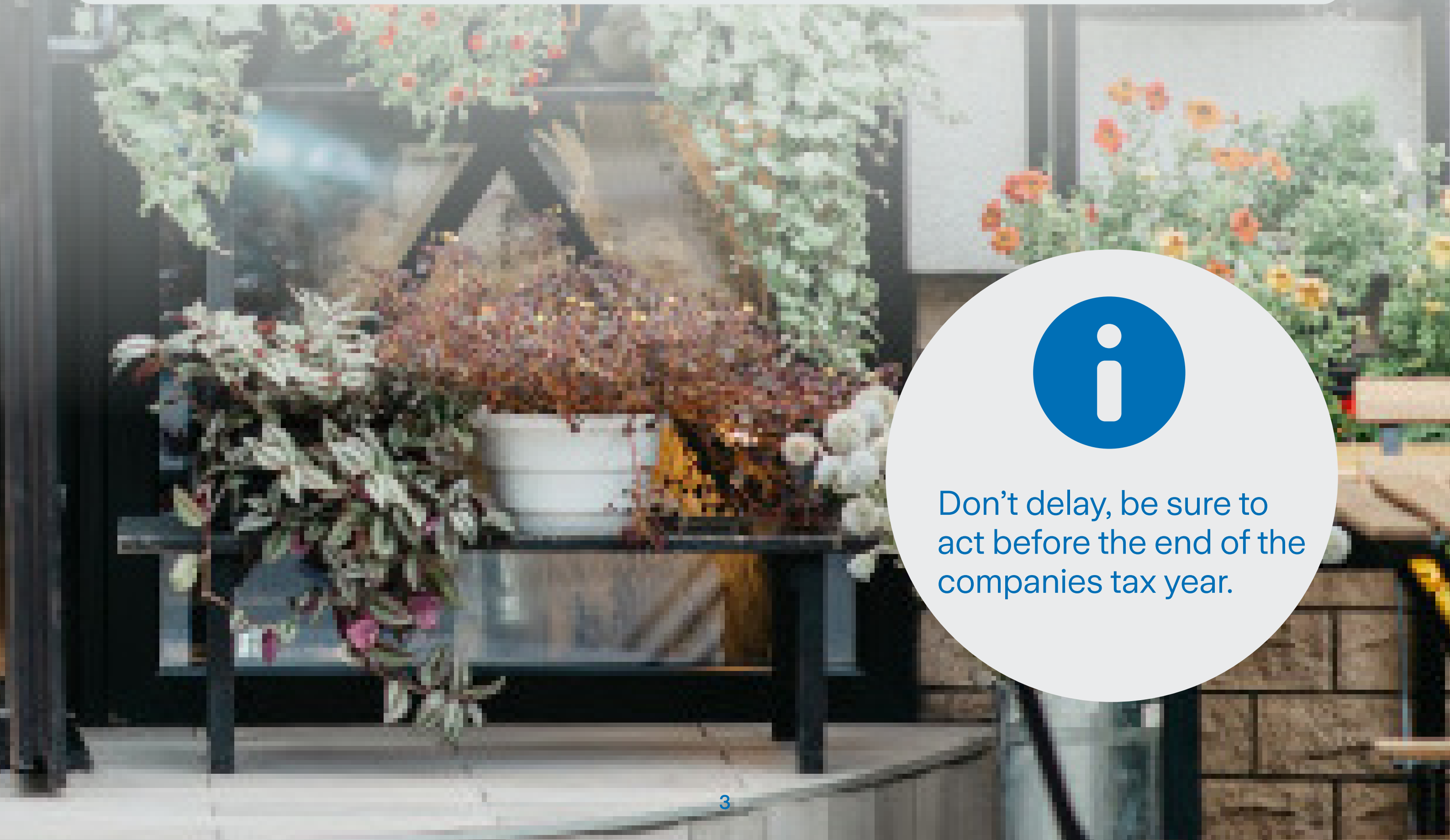
Wealth Extraction Options from a Business

Profits in a company

A Retain within company with Profits subject to Corporation Tax @ 12.5% with potential for further surcharge of 20% if undistributed within 18 months and Capital Gains Tax @ 33% on Sale of Shares.

B Withdraw as salary or dividends which will result in Income Tax, PRSI & USC potentially as high as 52% for the employee.

C Withdraw as Employer Pension Contribution to an Executive Pension via the Zurich Master Trust with Tax Relief for the Company & no Income Tax, PRSI or USC for employee.



Don't delay, be sure to act before the end of the companies tax year.

A Leave profits within the business

Profits retained in the company will be subject to Corporation Tax @ 12.5% and for close companies a further surcharge of 20% if they are not distributed within 18 months. In addition, on the sale of the company Capital Gains Tax (CGT) of 33% will apply unless a CGT Relief can be obtained.

B Withdraw profits as salary

Profits withdrawn in this manner will be subject to Income Tax, PRSI and USC which would be as high as 52% (Income Tax 40%, PRSI 4%, USC 8%).

C Withdraw profits via an Executive Pension via the Zurich Master Trust

Extraction of company profits via an employer contribution to an executive pension is very popular with business owners. Profits withdrawn via an Employer contribution to an Executive Pension Plan result in tax relief for the Employer (subject to Revenue limits) and no immediate tax liability for the employee.

The Key Advantages

- Corporation Tax Relief for the Employer @ 12.5% (Subject to Contribution Limits)
- Generous Limits for Employer's to contribute.
- No Income Tax, PRSI or USC liability for the employee following the contribution.
- No PRSI Liability for the Employer as a result of remunerating the employee in this way.
- Profits invested in pension fund which allows tax free growth until retirement.
- Opportunity to plan for business exit strategy with access to funds available as early as age 50 if all links with the business are severed or anytime between age 60 – 70 without having to sever any links with the business.
- Pension lump sum at retirement which is tax free up to the first €200,000 and subject to favourable rate of 20% for the next €300,000.
- Income in retirement via Pension Annuity or Approved Retirement Fund.
- Possibility to pass wealth to spouse and children via Approved Retirement Fund.

"Executive Pension arrangements are not restricted by the age related limits... resulting in very generous scope for employer contributions."

Perhaps the most important advantage of Executive Pension arrangements is that employer contributions are not restricted by the age related limits that apply to personal contributions, but instead are related to the cost of providing retirement benefits based on "two thirds" of salary (where there is at least 10 years' service at retirement).

This can result in very generous scope for employer contributions. To best illustrate the scope for contributions to an Executive Pension arrangement simply use the Zurich Max Funding Calculator with your Financial Broker. This calculator produces a comprehensive, personalised client report showing the maximum allowable contributions

The Max Funding Calculator allows you to consider all the relevant information to determine the maximum contribution the company can make for a director.

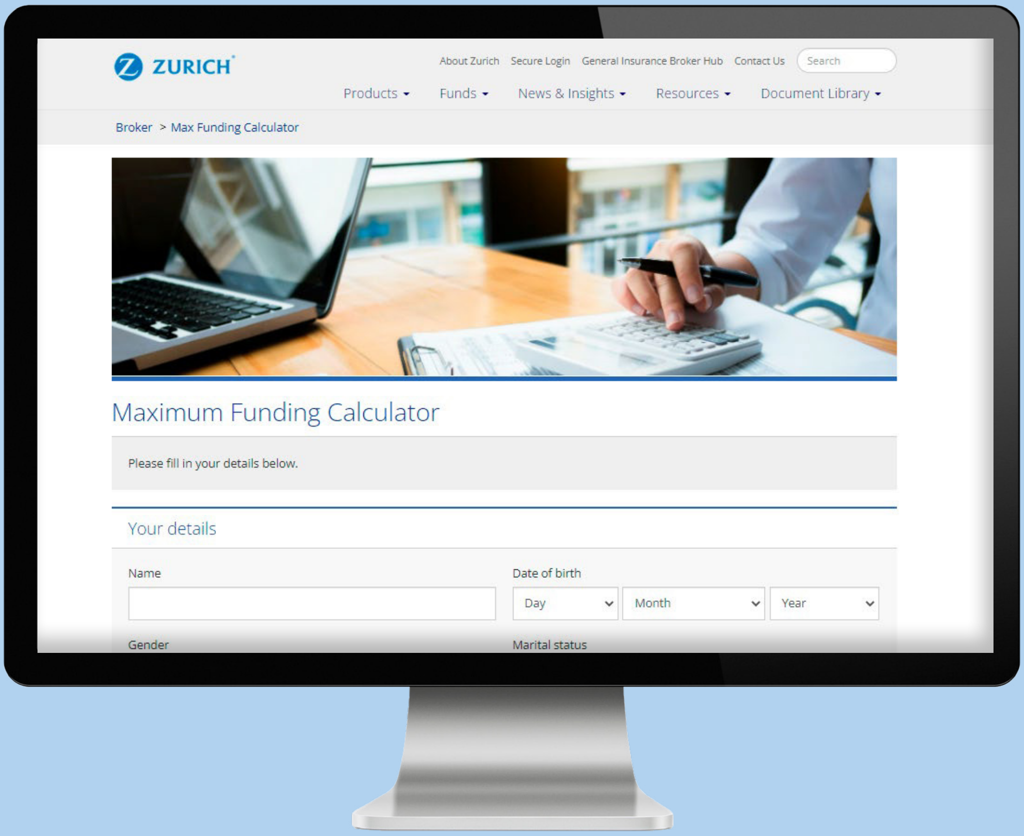
Understanding contribution types

The report outlines the options for funding in respect of the two different contribution types which are - Ordinary Annual Contributions and Special Contributions.

Ordinary Annual Contributions are forward looking – they cover the contributions that can be made to the scheme each year from now to retirement. Tax relief can always be attained on Ordinary Annual Contributions in the year in which they are made.

Special Contributions are backward looking – they can be used to backdate periods of salaried service which were previously not pensioned. Tax Relief on Special Contributions can also be attained in the year in which they are made if the Special Contribution is either equal to or less than the Employers Ordinary Annual Contributions.

Tax Relief on any Special Contributions in excess of the Employers Ordinary Annual Contributions will need to be spread forward to future company accounting periods up to a maximum of 5 years, however tax relief will be available in those future years.



Let's look at a case study below

John (45) has been running his company for the past 4 years and has built up a pension fund of €100,000 in that period. His current salary is €60,000. The company is cash rich and John wants to understand how much of a contribution the company could make to an Executive Pension for his benefit. By using the Max Funding Calculator on ZurichBroker.ie, we can quickly work out what John's contributions options will be.

Option 1 Ordinary Annual Contribution of €79,000.

This contribution could be made using a monthly/annual premium or a Single Premium Contract. Tax Relief would be available to the Employer in the accounting period in which the contribution is made.

Option 2 Special Contribution of €194,000 and Ordinary Annual Contribution of €66,000 – Total €260,000

The Ordinary Annual Contribution of €66,000 could be made using a monthly/annual premium or a Single Premium Contract. Tax Relief would be available to the Employer on that contribution in the accounting period in which the contribution is made.

The Special Contribution of €194,000 would be made using a Single Premium Contract. Tax relief on part of the Special Contribution would need to be spread forward as it is greater than the Ordinary Annual Contribution.

The calculation to determine the period for spreading forward of relief would be determined by dividing the Special Contribution by the Ordinary Annual Contribution. The factor after doing so, is then rounded up or down to the nearest whole number to determine the period over which relief must be spread.

How does this calculation work?

€194,000/€66,000 = 2.94 (Rounded up to 3 which is nearest whole number)

So Tax Relief on the Special Contribution must be spread over a three year period.

The process for spreading forward tax relief is determined by whether the factor is rounded up or down.

Relief on a Special Contribution is given evenly over the relevant period where the factor is rounded down to a number between 2 and 5.

However as in this case here, where the figure is rounded up relief in all the years except the last will be the amount equal to the employers corresponding Ordinary Annual Contribution. The amount available in the final period will be the balance of the Special Contribution.

Tax Relief on the Contribution of €260,000

Year 1: €132,000 (€66,000 Ordinary Annual Contribution + €66,000 Special Contribution)

Year 2: €66,000 (Special Contribution)

Year 3: €62,000 (Remaining Special Contribution)

Total: €260,000

Option 3 Matching Special Contribution of €74,250 and Ordinary Annual Contribution of €74,250 Total €148,500.

The Ordinary Annual Contribution could be made using a monthly/annual premium or a Single Premium Contract. The Special Contribution would be made using a Single Premium Contract.

Tax Relief would be available to the Employer on the contributions in the accounting period in which they are made with no requirement to spread any relief forward.

Conclusion

End of year tax planning is key for SME's and maximising wealth extraction is high on the list. At Zurich, we see significant volumes of Executive Pension contributions in the months of November and December as SME's close out their accounts.

For more information, speak to your Financial Broker or Advisor today.

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