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Using pension funds in your business

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Using pension funds in your business

As traditional loans fall out of favour with increasing numbers of business owners, you may be looking for an alternative route for financing – and your pension could be the answer.

Data from the British Business Bank shows that in 2017 the number of small businesses seeking traditional bank loans reached a record low of only 1.7%.

In contrast, the use of alternative finance has been on the rise, with external equity finance increasing by 79% at the start of 2017, and peer-to-peer lending up by just over 50%.

Funding your business using your pension pot may be an overlooked option compared to these, but it can be well worth considering if you want more control over the way you finance your business.

Rather than relying on a traditional lender to buy into your business and provide continued support, using your pension lets you take on the responsibility yourself.

Pension-led funding
Pension-led funding allows business owners or directors to finance their business using funds from their pension. This can usually be done using a self-invested personal pension (SIPP) or a small self-administered scheme (SSAS). The flexibility of these types of pension means they can be used to provide funding either as a commercial loan, or by buying intellectual property.

Unlike pension withdrawals, there is no minimum age requirement for pension-led funding. However, as older savers are likely to have built up more funds in their pension over time, they will potentially have more finance to access.

In general, it can be suitable for pensions with funds of more than £50,000.

For business owners with a significant amount of savings in their pension, this could be a profitable and flexible finance option.

Taking a commercial loan
One option is for your business to take a commercial loan from your pension. This can only be done with a SSAS, and with the approval of the trustee or trustees.

With this method, the business borrows money from the pension and pays it back with interest.
Your business can use this money however it chooses, whether that's for purchasing commercial property, stock or machinery.

However, the loan must meet the following requirements:
- it must not exceed 50% of the pension fund's value
- it should be secured as a first charge against an asset of equal or greater value to the loan plus interest
- the interest rate must be at least 1% higher than the Bank of England base rate
- the loan term must be a maximum of five years
- it must be repaid in equal annual instalments.

Using intellectual property
The other option for pension-led funding is slightly less straightforward, but can be done with either a SIPP or SSAS. Pension funds can own intangible assets such as intellectual property. This can include any patents, trademarks, designs, copyrights, databases and domain names owned by the business.

Once you've identified these assets in your business, they must be valued by an independent expert to meet HMRC's requirements.

After this, your SIPP or SSAS can purchase the intellectual property and lease it back to your business at a commercial rate.

If your business grows (it might not) your intellectual property will increase in value, meaning your pension pot will grow – a win-win situation.

This intellectual property could also be used as security on a SSAS loan.

Purchasing property
As both SIPPs and SSAS can hold commercial property, you could put your pension funds towards buying your own business premises.

If you don't have enough in your pension, the SIPP or SSAS can also borrow up to 50% of their values from a bank to go towards the purchase.

If you own your business premises, your pension can buy the property then lease it back to your business. Keep in mind that if you or your business made a gain on the sale of the property, you may have to pay capital gains tax.

Alternatively, if you don't already own your business premises, you can use your pension to help purchase a property for your business to trade from.

Pension-led funding: benefits and risks
Benefits
Pension-led funding can provide a useful alternative for business owners who have been unsuccessful applying for traditional finance, or for those who simply want more control over their business loan.

It also means that, unlike many other finance options, you won't be required to use your personal assets as security. There's no risk of losing a personal asset like your home should you fail to repay the loan.

In addition, if your business has more than one owner-director, you can use your pension funds together to provide a greater investment.

Risks
As a business owner, you'll be used to taking some amount of risk, and finding finance is no exception. As pension-led funding is connected with both your personal and business finances, though, it's worth giving careful thought to the types of risk that could be involved.

Impact of business failures
When you're using your own pension pot for business funding, the consequences of business failure fall directly on your shoulders. Should the worst happen, both your current and future income could be impacted.

You should be absolutely certain that your business is in a strong enough position to make it a worthwhile investment, and that you'll be able to replace the funds that have been taken from your pension so your income in retirement won't be affected.

Pension benefits
Before transferring any existing pension pots into a SIPP or SSAS, make sure you're aware of any benefits you may be entitled to if you keep the pension. For example, it's usually best not to transfer out of a defined benefit pension scheme, as this will mean giving up the set income you're entitled to.

Pension lump sum
According to the Office for National Statistics, 72% of self-employed people were over the age of 50 in 2016, while the number of self-employed people over 65 increased from 159,000 to 469,000 between 2001 and 2016. As an increasingly entrepreneurial generation, one option for those aged over 55 is to use pension freedoms to provide business funding.

Anyone aged 55 or over can access their pension, with no tax to pay on the first 25% and the rest taxed at their marginal rate of income.

You could choose to take this 25% as a tax-free lump sum, and use it to invest in your business.

Again, you should be certain that your business is a suitable investment for your hard-earned pension savings, and that you'll still have enough to maintain a comfortable retirement.

Because the stakes are so high when you're making decisions about your business's future and your own savings for retirement, it's essential to get expert advice.

We can discuss your business finance options.

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