SFIA
27 Moorbridge
Maidenhead
Berkshire SL6 8LT

Tel: 0845 458 3690
Fax: 0333 444 1550
Web: www.sfia.uk
Email: enquiries@sfia.co.uk

FACTSHEET

Retirement income

Plan to enjoy the kind of lifestyle you want in later life

'Will I be able to afford the retirement lifestyle I want?' is a question that many people ask but struggle to figure out. There are many ways to assess your likely income in retirement and work out how much you need to put away now to enjoy the kind of lifestyle you want in later life. This is why more and more people, where appropriate, are turning to private pensions as a tax-effective way to build or enhance their retirement income.

A private pension is a product that you can use to save money for retirement. Private pensions are usually defined contribution pensions, which means the money you receive at retirement is based on the money you've paid in and the performance of your investments.

There are several different types of private pension to choose from. However, in light of government changes, the tax aspects can require careful planning. In the meantime, here are seven important things to know about private pensions.

1. NO PENSION SCHEME RESTRICTIONS

The term 'private pension' covers both workplace pensions and personal pensions. The UK Government currently places no restrictions on the number of different pension schemes you can be a member of.

Even if you already have a workplace pension, you can have a personal pension too, or even multiple personal pensions. These can be a useful alternative to workplace pensions if you're self-employed or not earning, or simply another way to save for retirement.

Any UK resident between the ages of 18 and 75 can pay into a personal pension – although the earlier you invest, the more likely you are to be able to build up a substantial pension pot.

2. TAX RELIEF ON PENSION CONTRIBUTIONS

A private pension is designed to be a tax-efficient savings scheme. The Government encourages this kind of saving through tax relief on pension contributions.

In the current 2018/19 tax year, pension-related tax relief is limited to either 100% of your UK earnings, or £3,600 per annum.

The current pension tax relief rates are:

- Basic rate taxpayers will receive 20% tax relief on pension contributions
- Higher rate taxpayers also receive 20% tax relief, but they can claim back up to an additional 20% through their tax return
- Additional rate taxpayers again pay 20% tax relief, but they can claim back up to a further 25% through their tax return
- Non-taxpayers receive basic rate tax relief, but the maximum payment they can make is £2,880, to which the Government adds £720 in tax relief, making a total gross contribution of £3,600

If you are a Scottish taxpayer, the tax relief you will be entitled to will be at the Scottish Rate of Income Tax, which may differ from the rest of the UK.

3. ANNUAL ALLOWANCE

The annual allowance is the maximum amount that you can contribute to your pension each year while still receiving tax relief. The current annual allowance is capped at £40,000, but may be lower depending on your personal circumstances.

In April 2016, the Government introduced the tapered annual allowance for high earners, which states that for every £2 of income earned above £150,000 each year, £1 of annual allowance will be forfeited. The maximum reduction will, however, be £30,000 – taking the highest earners' annual allowance down to £10,000.

Any contributions over the annual allowance won't be eligible for tax relief, and you will need to pay an annual allowance charge. This charge will form part of your overall tax liability for that year, although there is the option to ask your pension scheme to pay the charge from your benefits if it is more than £2,000.

It is worth noting that you may be able to carry forward any unused annual allowances from the previous three tax years.

If you have accessed any of your pensions, you can only pay a maximum of £4,000 into any un-accessed pension(s) you have. This is called the 'Money Purchase Annual Allowance' (MPAA). The MPAA applies only if you have accessed one of your pensions.

4. LIFETIME ALLOWANCE

The lifetime allowance (LTA) is the maximum amount of pension benefit that can be drawn without incurring an additional tax charge. From 6 April 2018, the lifetime allowance is £1,030,000.

What counts towards your LTA depends on the type of pension you have:

Defined contribution – personal, stakeholder and most workplace schemes. The money in pension pots that goes towards paying you, however you decide to take the money.
Defined benefit (also known as 'Final Salary') – some workplace schemes. Usually 20 times the pension you get in the first year plus your lump sum – check with your pension provider.

Your pension provider will be able to help you determine how much of your LTA you have already used up. This is important, because exceeding the LTA will result in a charge of 55% on any lump sum and 25% on any other pension income such as cash withdrawals.

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This charge will usually be deducted by your pension provider when you access your pension.

5. PENSION PROTECTION

It's easier than you think to exceed the LTA, especially if you have been diligent about building up your pension pot. If you are concerned about exceeding your LTA, or have already done so, you should seek professional financial advice.

It may be that you can apply for pension protection. This could enable you to retain a larger LTA and keep paying into your pension:

- Individual protection 2016 – this protects your lifetime allowance to the lower of the value of your pension(s) at 5 April 2016 and/or £1.25 million. You can keep building up your pension with this type of protection, but you must pay tax on money taken from your pension(s) that exceeds your protected lifetime allowance
- Fixed protection 2016 – this fixes your lifetime allowance at £1.25 million. You can only apply for this if you haven't made any pension contributions after 5 April

OTHER WAYS TO SAVE

In addition to pension protection, if you have reached your LTA (or are close to doing so), it may also be worth considering other tax-effective vehicles for retirement savings, such as ISAs. In the current tax year, individuals can invest up to £20,000 into an ISA.

The Lifetime ISA, launched in April 2017, is open to UK residents aged 18–40 and will enable younger savers to invest up to £4,000 a year tax-free – and any savings you put into the ISA before your 50th birthday will receive an added 25% bonus from the Government. After your 60th birthday, you can take out all the savings tax-free, making this an interesting alternative for those saving for retirement.

PASSING ON YOUR PENSION

Finally, it is worth noting that there will normally be no tax to pay on pension assets passed on to your beneficiaries if you die before the age of 75 and before you take anything from your pension pot – as long as the total assets are less than the LTA. If you die aged 75 or older, the beneficiary will typically be taxed at their marginal rate. ■

WHAT ARE THE NEXT STEPS?

As life expectancy rises, we're all likely to spend more time in retirement than our parents and grandparents before us. That means it's never been more important to sort out your pension. There is no one-size-fits-all tax-efficient solution for private pensions, so if you want further information about changes to pensions taxes and the variety of schemes on offer, please contact us – we look forward to hearing from you.