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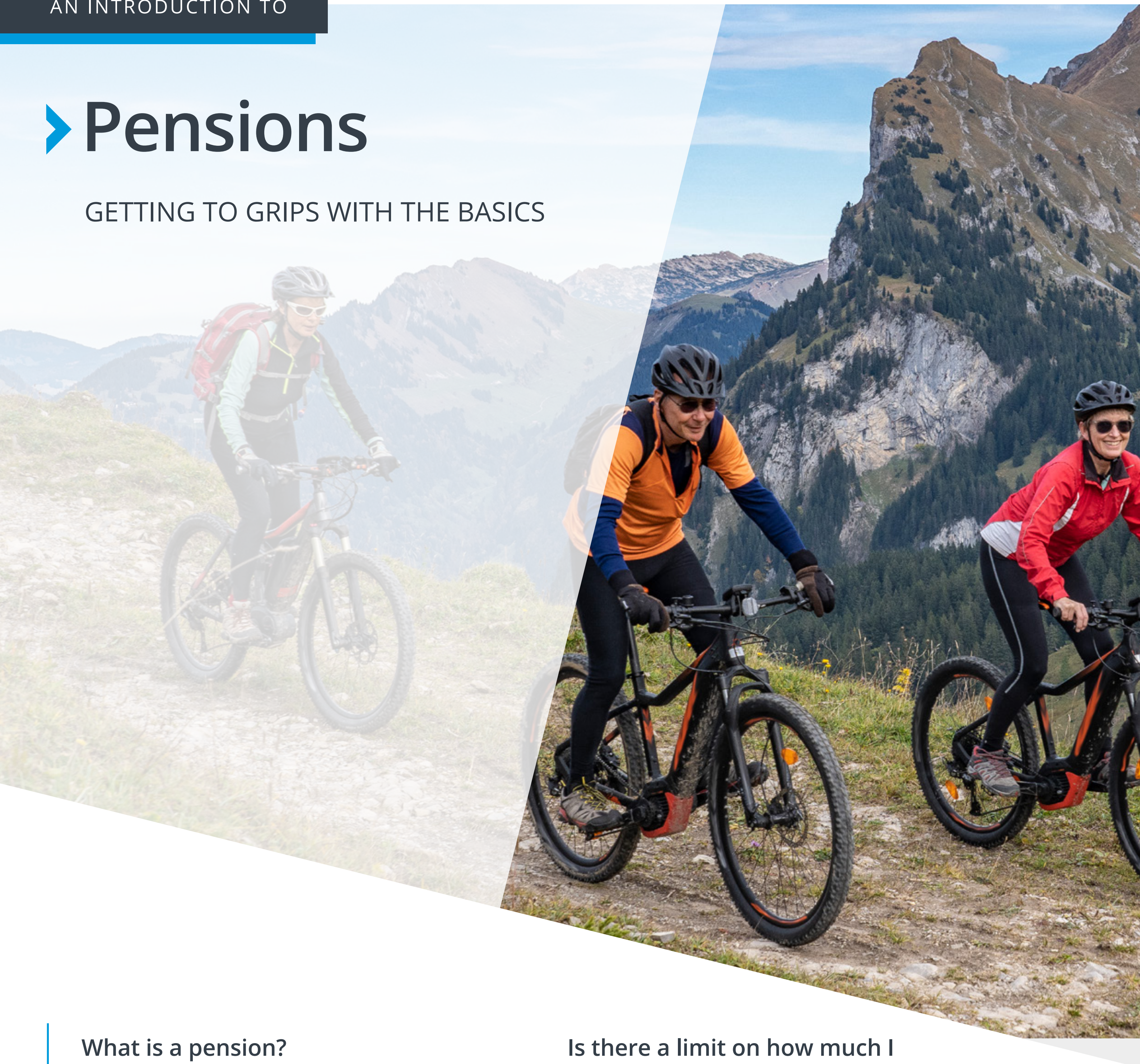
AN INTRODUCTION TO

Pensions

GETTING TO GRIPS WITH THE BASICS



Pensions are typically viewed as being complex and difficult to understand. As a result, people often delay starting one or ignore the issue altogether. In reality, though, the basics are relatively simple and taking time to understand them now could have a huge impact on your quality of retirement. Here, we'll provide answers to questions our clients commonly ask and help guide you through the pensions maze.

WHAT IS A PENSION?

A pension is simply a type of long-term savings plan designed to help you save money for later life. In essence, it allows you to regularly save some of your earnings during your working life in order to provide an income when you decide to retire or work fewer hours. The money contributed to your pension is usually invested, along with other pension savers' cash, in some form of investment product, funds or assets. Pension contributions also benefit from particularly favourable tax treatment, which makes them an extremely appealing investment proposition.

WHAT TYPES OF PENSIONS ARE THERE?

There are three major pension routes and most people fund their retirement through a combination of one, two or all three of these types.

Workplace pensions: These are arranged for you by your employer and are sometimes called 'company pensions' or 'occupational pension schemes'. The employer is required by law to pay a contribution where the employee is classed as an 'eligible jobholder' and automatically enrolled into the workplace pension. You will also receive tax relief from the government. The phased introduction of automatic enrolment since 2012 has now resulted in companies enrolling the vast majority of their staff into a workplace pension.

Personal pensions: You arrange these yourself and they are sometimes called 'defined contribution' or 'money purchase' pensions. Basically, you pay a portion of your earnings into your pension pot which, along with tax relief, is then placed by your pension provider into a range of investments, such as shares or bonds.

The amount you ultimately receive in retirement will depend upon: how much you pay into your pot; the performance of your investment fund; the administration fees charged by your provider, and how you ultimately take your cash.

The State Pension: This is a weekly payment from the government for people who reach State Pension age. Entitlement is built up by either paying or being credited with National Insurance contributions (NICs) during your working life.

During the Autumn Budget, the Chancellor announced that the state pension will increase in line with average earnings, rising by 4.1% in April 2025. This means the full, new flat rate State Pension (for those who reached state pension age after April 2016) is expected to rise to £230.25 a week.

The full, old Basic State Pension, for those who reached state pension age before April 2016, is anticipated to rise to £176.45 each week.

WHAT TAX RELIEF DO I GET ON MY PENSION CONTRIBUTIONS?

Whatever type of pension plan you hold, you get tax relief at the highest rate of Income Tax you pay on all contributions you make, subject to annual and lifetime allowances. This effectively means that some of your earnings which would have gone to the government as tax are diverted to boost your pension pot instead.

You can receive tax relief via either the 'relief at source' or the 'net pay' method. The 'net pay' method deducts the pension contribution direct from the pre-taxed income. So, for instance, if you're a basic-rate taxpayer investing £800 of your take-home pay into your pension, the tax relief would amount to £200; effectively the taxman tops up your £800 contribution to £1,000.

If you don't earn enough to pay Income Tax at all, you still qualify for tax relief up to a certain amount. The maximum annual contribution you can currently make is £2,880 which, along with tax relief, would amount to £3,600 a year being paid into your pension scheme. This only applies to the 'relief at source' method and doesn't apply if the workplace pension is operating the 'net-pay' method of tax relief.

IS THERE A LIMIT ON HOW MUCH I CAN PAY INTO A PENSION SCHEME?

You can contribute as much as you like into your pension, but there is a limit on the amount of tax relief you will receive each year. The Annual Allowance is currently £60,000. An individual can't use the full Annual Allowance where 'relevant UK earnings' are less than £60,000, although your employer still could. You may be able to, however, carry forward unused allowances from the past three years, provided you were a pension scheme member during those years.

The Threshold Adjusted Income limit is £200,000 and the Adjusted Income Limit is £260,000. If your income plus pension contributions exceeds the Adjusted Income Limit, your Annual Allowance is reduced by £1 of every £2 you are over the Adjusted Income Limit.

Retirement planning is never a case of 'one size fits all'; so it's vital you obtain sound financial advice tailored to your individual needs

The Lifetime Allowance (LTA) on pensions, previously £1,073,100 for the 2023/24 tax year, was removed completely from 6 April 2024. Since the abolition of the LTA charge the previous April, pension benefits are now subject to Income Tax at the individual's marginal rate.

With the abolition of the LTA came the introduction of two new allowances which limit tax-free lump sums paid from registered pension schemes – the lump sum allowance (LSA) and the lump sum and death benefit allowance (LSDBA):

LSA – a fixed cumulative limit of £268,275 (25% of the 2023/24 LTA) on the tax-free cash that can be paid as pension commencement lump sums (PCLS) and on the tax-free part of uncrystallised funds pension lump sums (UFPLS).

LSDBA – a fixed cumulative limit of £1,073,100 (the 2023/24 LTA) on the total amount of the tax-free part of lump sums and lump sum death benefits payable to and in respect of a member. In addition to the PCLS and tax-free elements of UFPLS, tax free elements of serious ill health lump sums and lump sum death benefits use up this allowance.

For both allowances, those with old-style Lifetime Allowance protections will have higher allowances (noting that the window for new applications for Individual Protection 2016 and Fixed Protection 2016 will close from 5 April 2025).

WHEN CAN I ACCESS MY PENSION?

The pension freedoms introduced in 2015 allow you to access your pension once you turn 55 (age 57 from April 2028); from that point you're free to take as much or as little as you like from your pension pot, whenever you like. While this has certainly introduced greater flexibility, it has also heightened the necessity to carefully consider your options. It's therefore imperative to seek professional financial advice before accessing your pension to minimise potential tax implications and maximise the benefit you ultimately receive from your pension funds.

PENSIONS SUBJECT TO IHT FROM 2027

During the Autumn Budget 2024, the Chancellor announced that unused pension funds will be subject to IHT from 6 April 2027.

When you die the value of your pensions will be added up with your other assets to calculate whether your estate will pay IHT. If the value of your estate is above £325,000 (or £500,000 if you're leaving your home to a direct descendant), any pension funds above that threshold will be liable for IHT at 40%. If you're passing on your pension to your spouse or civil partner, this can be inherited tax-free, as with any other assets left to a spouse or civil partner.

Past performance is not a reliable indicator of future performance. A pension is a long term investment the fund value may fluctuate and can go down. Your eventual income may depend upon the size of the fund at retirement, future interest rates and tax legislation.

WE'RE HERE TO HELP
We're only a phone call away, so if you have any questions or would like to discuss the best pension options for your individual circumstances, please do get in touch

Top Tips

IT'S NEVER TOO EARLY TO START SAVING INTO A PENSION…

You should start saving for retirement as early as possible as the sooner you begin the longer your savings have to grow. While other financial challenges can make this difficult, investing regular amounts in a pension throughout your working life gives you the best chance of enjoying a prosperous retirement.

…BUT BETTER LATE THAN NEVER

Never think it's too late to start saving for your retirement. The favourable tax treatment pensions enjoy and their potential for investment growth means any contributions you make later in life can still make a huge difference to your standard of living in retirement.

RETIREMENT PLANNING IS VITAL FOR THE SELF-EMPLOYED

As the self-employed are inevitably responsible for their own pension provision, it's particularly important that this section of society takes full control of their retirement planning. So if you belong to the growing band of self-employed workers make sure you don't delay saving for your retirement.

KEEP TRACK OF HOW YOUR PENSIONS ARE DOING

It's good to regularly review your pension arrangements to ensure they continue to meet your retirement objectives. Your pension provider(s) will send out annual benefit statements detailing your entitlements and you can also request a State Pension forecast. This information will allow you to assess your provision and decide whether you need to take further action, for instance, increasing contributions or setting up an additional pension. Many people only review their pensions when they're about to retire, by which time it's too late – don't fall into this trap.

PLAN YOUR INHERITANCE

It's important to plan what will happen to your pension benefits if you die. It's therefore essential that you keep your beneficiary nomination forms up to date as your providers will use this information when deciding who will inherit your pension savings.

TAKE CONTROL OF YOUR RETIREMENT

When you reach 55 (57 from 2028), it's important to carefully consider what you can do with your pension pot. For instance, you could: keep your savings invested; take a cash lump sum; draw a flexible income (drawdown); buy a fixed income (an annuity), or do a combination of these things. While this flexibility may enable you to retire earlier or semi-retire, it's vital you take full control of your retirement options at this stage. This should include seeking advice and discussing the pros and cons of the different avenues available to you.

GET GOOD ADVICE

Retirement planning is never a case of 'one size fits all'; so it's vital you obtain sound financial advice tailored to your individual needs. We offer advice and help with all aspects of pensions and retirement planning, whether you're just starting out and want help choosing the most appropriate pension products, or you're approaching the stage of life when you need to utilise your pension pot and want to know the most efficient way to access your funds. Remember: we're here to help.
