Chiene + Tait
CHARTERED ACCOUNTANTS

# Comment on...

## Planning for retirement

**A sunny or a rainy day?**

The tax system provides some generous incentives to provide for retirement. Investing in a pension enjoys tax relief at your marginal rate of tax. You can pay in up to £3,600 or your current earnings, whichever is higher, up to £40,000 a year – although if your income is £150,000 or more, your annual pension allowance is reduced (see key planning points below). Most contributions are paid net of a 20% tax rebate which is put into the fund by HMRC.

If you have been a member of a registered pension scheme in previous years and you have not used the full annual allowance you can bring forward the unused amounts from the last three years to justify a larger current contribution.

Employer contributions to an employee’s pension are exempt from tax within the same limits. There are special rules to cover final salary pension schemes, where a formula is applied to any increase in the employee’s benefits during the year, producing a ‘pension input amount’ to compare to the £40,000 figure.

The marginal rate tax relief means that £40,000 in your fund costs you £32,000, £24,000 or £22,000, depending on whether you pay at 20%, 40% or 45%. Once your money is in a pension scheme, income and gains are free of tax until you choose to take benefits. That should make the fund grow much faster than it would do in your own hands.

There is a limit on the total that can be saved tax-free in this way – for most people who take benefits in 2018/19, it is £1,030,000m. This limit may be breached if you made large contributions in earlier years when the £40,000 annual limit did not apply. Anyone with a fund approaching this level should take advice without delay. There are tax charges on funds which are in excess of these figures when the pensioner starts to draw benefits from them.

Those aged 55 or over can now draw any amount from their defined contribution pension funds as required. In general, the first 25% of the accumulated fund is tax free (with different rules for final salary schemes), but the balance of the fund will be taxed at their marginal tax rate as they withdraw it. It is essential to take qualified pensions advice before starting to draw from a pension fund, as the decision can't be reversed. A lower annual allowance of £10,000 applies to people who have started to draw taxable income from a defined contribution pension scheme.

It's also possible to save for your retirement in other ways that don't have the same 25% limit on withdrawing a lump sum – for example, using ISAs, or investing in property. However, the tax relief on paying money into a pension fund, and the higher annual limit compared to ISAs, means that a fund can be built up more quickly.

## Key planning questions

- What is your current provision for retirement – pension funds, state pension entitlement, assets saved up which could provide an income or a capital sum?
- When do you intend to retire?
- What do you foresee as your required income at that time?
- Do you require a certain amount of tax-free lump sum, for example, to pay off the capital of an interest-only mortgage?
- What is the shortfall between your current provision and your requirements, and how can that shortfall be made up before your intended retirement date?

## Key planning points

If your adjusted income is £150,000 or more, including any pension contributions made for you by your employer, you will have your annual allowance reduced by £1 for every £2 over £150,000 to a minimum of £10,000. For example, a taxpayer on a salary of £160,000 plus employer contributions of £20,000, will only be able to contribute £25,000 (£40,000 - £15,000) with tax relief in 2018/19.

Although pension contributions are measured against earnings, they do not have to be paid out of earnings. If you receive a legacy or sell an investment, you can top up your pension contributions and enjoy Income Tax relief, even though the source of the money is not subject to Income Tax.

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