# Planning for retirement

When it comes to planning for retirement the earlier you start the more potential your money has to grow. Retirement planning is not simply about paying regularly into your pension and forgetting about it, instead it is essential to review your progress against your retirement goals and take account of changes that may affect your plans.

A critical aspect of retirement planning is structuring your affairs to ensure that you can meet your desired level of income when you stop working. With ever-changing pension legislation and increasing life expectancy, it makes sense to use all the tax-efficient options available to create a flexible retirement plan.

There are three key components of retirement planning:

- Accumulating savings for retirement
- Investing your retirement fund
- Using your retirement savings to provide an income

## Saving for retirement

All financial assets can contribute to your retirement planning. These might include investment funds, Individual Savings Accounts (ISAs), personal or occupational pension schemes and property investments. The most suitable retirement strategy for you will depend on many factors. Pension arrangements remain amongst the most tax-efficient means of retirement saving, although there are now restrictions on both the level of contributions and the total value of pension funds that can be accumulated.

### Pension contributions

In general, contributions in any one tax year are limited to 100% of your UK earnings, or £3,600 if you have no earnings or earn less than £3,600 a year. Contributions you make personally can be paid net of basic rate tax. The pension scheme administrator will claim the tax relief from HMRC on your behalf. If you are subject to income tax at the higher or additional rate you can claim further tax relief on your Self-Assessment tax return.

Employers can make pension contributions on behalf of employees. There is no specific limit to the level of contribution an employer can make but they do not automatically qualify for tax relief. Employer contributions are treated as a business expense and deducted from company profits before they are assessed for corporation tax.

Contributions made to registered pension arrangements are also subject to a total annual limit known as the annual allowance, which is currently set at £40,000. Both personal and employer contributions count towards the annual allowance. If your pension contributions are more than the annual allowance you will pay a tax charge on the excess amount.

If your total income is greater than £240,000 your annual allowance will be reduced. This “adjusted income” figure includes not only your earnings, but also any income from savings, rental income and both employer and employee pension contributions. The annual allowance is reduced by £1 for every additional £2 over this income limit, with a maximum possible reduction of £36,000, leaving you with an annual allowance of £4,000.

### Making up for past years

If you have not made the maximum level of contributions you may be able to carry forward any unused amount of the annual allowance for the previous three years.

To qualify to carry forward unused allowances you must have been a member of a pension scheme at some point, but you do not need to have paid any contributions during that time.

For example:

| Tax year ending | 2017/2018 | 2018/2019 | 2019/2020 |
|---|---|---|---|
| Annual allowance | £40,000 | £40,000 | £40,000 |
| LESS pension contribution already paid | £20,000 | £25,000 | £30,000 |
| Unused annual allowance | £40,000-£20,000 =£20,000 | £40,000-25,000 =£15,000 Plus £20,000 = £35,000 | £40,000-£30,000 =£10,000 Plus £35,000 = £45,000 |

If you are making the contribution yourself this is limited to 100% of your earnings in the tax year. However, if your employer is making the pension contribution this restriction will not apply.

### Lifetime allowance

There is a limit to the total value of your lifetime pension savings which applies to both company and personal pension arrangements. The lifetime allowance is currently set at £1,073,100 and will increase annually in line with consumer price inflation. Pension savings in excess of the lifetime allowance are subject to additional tax charges.

If your pension fund value is greater than the lifetime allowance you will suffer a recovery charge when you draw benefits. The tax charge is 55% of the value over the lifetime allowance if you draw out the excess amount as a lump sum. Alternatively you can choose to pay tax of 25% of the excess amount, and then pay income tax on those funds when taken as pension income.

The lifetime allowance has reduced on several occasions since it was first introduced in 2006, with some transitional protection being made available each time, most recently in 2016. If your pension funds were near to or greater than £1m at April 2016 it is worth checking if you qualify for either fixed or individual protection, which could lead to you securing a lifetime allowance of up to £1.25m.

For those that are close to or at the lifetime limit, some employers have begun to offer a cash alternative to continuing pension contributions. It is more expensive as a direct comparison because pension contributions are not subject to national insurance contributions. Therefore, to account for this, employers that provide this option will typically offer a lower percentage of salary than the pension contribution would be.

Lifetime allowance monitoring and management is key to ensuring you maximise the tax benefits offered by pension savings.

### Keeping it all together

It is possible to transfer funds from one or more UK pensions to a single plan. This could be to access different benefit options or because you want a single wealth manager to manage your pension fund alongside your other investments. It can be helpful, but it is not essential, to consolidate pension savings into a single plan prior to drawing benefits. Holding your pension assets in one arrangement can also offer greater flexibility for estate planning.

It is important to note that there are costs involved and obtaining professional advice is essential to ensure that you take the appropriate course of action for your own situation. An adviser will research your existing plans and ensure that, by transferring, you are not giving up valuable benefits that cannot be replaced.

## More choice and flexibility

Pension freedoms, one of the most significant changes to pensions, were introduced in April 2015. These changes mean that from age 55 everyone with an investment-based pension, known as a defined contribution scheme, can now access their entire pension fund flexibly. Pension freedoms do not apply to defined benefit (also known as ‘final salary’) company schemes.

Pension freedoms mean that it is up to you to ensure your savings last as long as you need them to and this could be for 30 years or longer. There is a lot to consider in deciding which of the many options available are right for you. This includes the level and frequency of income required and whether you need an additional capital sum from your pension, maybe to repay borrowing or to meet any one-off purchases such as a new car.

You will generally be entitled to take up to 25% of your pension fund as a tax-free cash sum, known as the Pension Commencement Lump Sum (PCLS). If your fund exceeds the lifetime allowance then your maximum PCLS will be restricted to 25% of the prevailing allowance. You can draw your full PCLS as one lump sum or at regular intervals as you wish.

There are two routes to flexibly accessing your pension:

### Flexi-access drawdown

Flexi-access drawdown allows you to withdraw the PCLS and income directly from your pension pot without the need to purchase an annuity. It allows you to leave your remaining pension pot invested to continue to grow tax-free. You can draw any level of income withdrawals that you wish to from any of the liquid funds or cash held within your pension.

The PCLS may be drawn all at once or in several tranches over time as required. This is often referred to as a phased retirement. Using a phased retirement strategy, each year you can decide on the level of income required from your pension. This is then provided by using part of your PCLS topped up by taxable income withdrawals, to provide the total amount you require in the most tax-efficient way.

### Uncrystallised Funds Pension Lump Sum (UFPLS)

Uncrystallised Funds Pension Lump Sum (UFPLS) is another form of drawdown that allows you to withdraw the PCLS and income directly from your pension fund. This option is more usually offered by defined contribution company pension schemes and some personal pension plans. Whilst offering the ability to drawdown directly from your pension fund, it does not provide the full flexibility of flexi-access drawdown.

When you take an UFPLS, for each amount you withdraw 25% is paid as a tax-free lump sum and 75% as taxable income. For example, if you withdrew £20,000, £5,000 would represent the tax-free lump sum and £15,000 would be taxed as income. This differs from flexi-access drawdown, where the remaining 75% of the fund can stay invested and you may draw as much or as little income as you like.

The flexi-access drawdown and UFPLS options allow you to retain control of the investment of the pension fund whilst drawing regular or ad-hoc income amounts as and when required. Whilst these options offer maximum flexibility, they do leave you at risk of eroding the capital value of your pension fund if investment returns are low or you take high levels of withdrawals. It is therefore essential to undertake regular reviews to ensure the sustainability of both your income and capital.

### Providing a guarantee for the future

Prior to pension freedoms the main option to secure a pension was to buy an annuity. Annuity purchase is still the right option for some, particularly where there is a need for a guaranteed level of income. Annuity purchase involves exchanging your pension fund for a guaranteed lifetime income. The level of income achieved will depend on a number of factors, including your age, your health and the type of income you wish to receive (e.g. level or increasing annually).

Purchasing an annuity requires you to make an irrevocable decision at the point of retirement. It is possible to secure a higher level of income payment if you are in less than perfect health. Impaired life annuities can be underwritten based on your particular circumstances and it is always worth comparing how much more income might be payable. You only have one opportunity to shop around for your annuity. Once you have committed to purchase an annuity and started to receive an income the decision cannot be reversed. It is therefore recommended to obtain professional financial advice to help you secure the best terms for your particular requirements.

### Pension as a legacy

Historically, one of the least popular aspects of pensions was that they died with you. Annuity payments might have continued for a guaranteed number of years from inception or a reduced spouse's pension could have been payable.

However, new pension freedoms provide increased flexibility as to how any unused pension fund can be used after your lifetime.

| Member's age at date of death | Options and taxation at date of death |
|---|---|
| Pre age 75 | • Tax free lump sum<br>• Tax free income via drawdown<br>• Beneficiary's annuity free of tax |
| Age over 75 | • Lump sum payment at beneficiary's marginal tax rate<br>• Drawdown taxed at beneficiary's marginal tax rate<br>• Beneficiary's annuity taxed at marginal tax rate |

If the fund remains invested, on the death of a beneficiary a new successor beneficiary can be nominated, therefore allowing the remaining pension fund to benefit further generations. The pension fund is generally outside of your estate for inheritance tax purposes and can be regarded as a key component of your estate planning. It is no longer the case that the pension should be the first port of call to source retirement income. Once again, appropriate advice is key to maximising the benefits of all the options available at retirement.