PENSIONS:ACCUMULATION

Hawsons Wealth Management

The Accumulation Phase…

Pensions have been around since the seventeenth century with the first organised pension scheme being established for Royal Navy Workers in the 1670's. Nowadays, they are a minefield to many, not least because of the numerous acts of parliament which have introduced complex changes to the legislation behind them.

Rest assured though, with the right advice you can definitely take full advantage of what is still one of the most tax efficient investments available.

If you are still building up your pension pot, either by regular contributions or one off payments you are known as being in the accumulation phase.

Broadly there are 2 types of pension scheme, Defined Benefit (Final Salary) and Defined contribution (Money Purchase/Personal Pension). Today, Defined Benefit pensions are not as widely held therefore this article focuses mainly on the legislation around Defined Contribution pension schemes/Personal Pensions.

So, what are the main attractions…?

1. Tax relief – when you save into a pension you receive tax relief from HM Revenue & customs (HMRC). If you pay into a personal pension out of earned income, this income has already been taxed. For every £80 you pay in, the taxman adds a further £20 to your pension (basic rate relief). That is an immediate 25% gain!

If you pay tax above the basic rate band, you can claim the additional relief via your self-assessment at the end of the year.

If you are a director/key employee and your company is making contributions to your pension, whilst you won't personally get tax relief, the company will benefit from a corporation tax saving.

2. Death Benefits – contrary to popular belief, pensions don't die with you. In fact, they don't have to die with the next generation either! Any personal pension you hold can be left to whoever you choose, this doesn't have to be a direct spouse or dependent child it can even be your next door neighbour if you like.

The tax treatment of the pension fund in the recipient's hand depends on the age of the person who has died. If you die before age 75 the recipient would receive the whole value of the pension fund tax free for life. If you die after 75 then the pension fund is taxable at the marginal rate of the recipient.

(Please note that tax treatment on payments made to trusts may differ and you must ensure that the funds are passed on within 2 years of death).

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3. Inheritance Tax – Pensions currently fall outside of your estate for inheritance tax purposes. This could be a good way of passing your pension savings to future generations if you don't spend it all.

4. Investment choice – Cash held within your pension can be invested in assets such as stocks and shares, fixed interest, government gilts, commodities etc. This gives you access to greater growth potential than the returns available in cash deposits. Certain types of pension scheme can also hold direct commercial property (not residential though, such as buy to let).

Too good to be true…
what can catch you out…?

1. The Annual Allowance – There is a limit to how much you can put into your pension each year and obtain tax relief. This is currently £40,000 (for higher earners this could be reduced to as low as £10,000). Make sure you are within the annual allowance limit(s). Failure to do this could mean you end up with a tax charge at the end of the year – your financial adviser can assist you with this.

2. Lifetime Allowance – over your lifetime there is a total amount you are allowed to hold in pension benefits. This is currently £1 million pounds. If you go over this, at certain times a tax charge can be made on the excess. Again, with the right advice you can plan for this efficiently.

3. Nomination to beneficiaries – Make sure that you nominate your beneficiaries with the pension trustees. This is usually a straight forward form. By doing this, in the event of your death it is clear what your wishes are, rather than the trustees having to make that decision!

4. Moving your pensions – always ensure that if you are moving your pensions from one provider to another you don't lose any valuable benefits.

5. Age – Currently you can access the money within your private pensions from the age of 55 (this will become age 57 in 2028). Doing it earlier could result in severe tax and unauthorised payment charges.

Pensions have many benefits, but to get the best out of them advice is crucial. Your financial adviser will be more than happy to help you.

The information contained within this is based on our current understanding of the legislation. Past performance is no guide to the future and investments can go down as well as up.

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