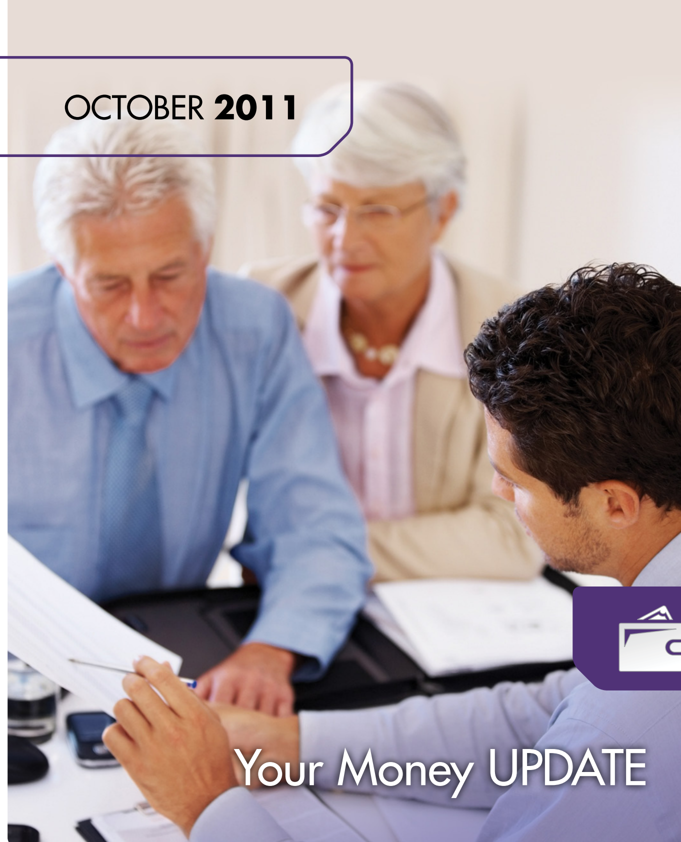

Successful Retirement Planning

Many people spend time thinking about what retirement might look like financially, and this is particularly important now, especially given the current state of the markets, the economy and interest rates. Pension funds have been depleted by higher tax charges, reduced capital values, diminished rates of return and increased longevity. It is important to look at how much you need to save to secure your desired income and how your saving can be optimised for tax purposes. Time for a review? The applicable laws and tax regime change over time, as do economic circumstances and market-based solutions. Retirement plans should be reviewed periodically to check their adequacy.

"Taking into account the impact of the recent financial crisis, no one's retirement planning looks the same as it did a few years ago."

Will the state pension suffice?

Even if it is not currently top of your agenda, being able to retire when and how you would like, is sooner or later likely to be one of your most important financial objectives. But achieving this goal takes planning and perseverance. You could spend a third of your life in retirement. Will you find those years the golden times we all dream of, or a constant struggle to pay the bills?

Your state pension is worth about £5,300 at current rates, assuming you have a full national insurance record. For those reaching state retirement age from 6 April 2010, this requires 30 years' contributions. If you have not yet retired, we can help you check your record and see if any gaps can be filled. A review of your state pension entitlement will also indicate what you may expect to receive as state second pension, SERPS and graduated pension.

The state retirement age is also changing with the state retirement age for women rising in stages from 60 to 66 between 2010 and 2020. This will not affect women born on or before 5 April 1950, who can still claim their state pension at 60. Women born after 5 March 1954 will have a state pension age of 66.

The state retirement age for men is changing between 6 March 2019 and 6 March 2020. This will not affect men born before 6 December 1953 who can still claim their state pension at 65. Men born after 5 March 1954 will have a state pension age of 66.

The state pension age may be further increased after 2020 based on life expectancy.

In 2010, the new coalition government announced that the state pension will in future increase by the highest of price inflation, earnings inflation and 2.5 per cent.

According to Government estimates, the gap between how much people are saving and how much they need to save to ensure a comfortable retirement is over £57 billion. It believes that 13 million people - nearly half the working population - are not saving enough for their retirement.

If you would like us to evaluate your retirement planning please contact us.

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Pensions

Large contributions

There has been a significant change in the rules relating to large donations to pension funds. The new rule imposes an annual contribution limit of £50,000 to a pension fund with effect from 6 April 2011. This is a massive reduction from the previous rate of £255,000.

In occupational schemes, the limit applies to both the employer's and employee's contributions. For final salary or defined benefit schemes, the contribution limit applies to the increase in the value of the member's pension entitlement value during the year. In such an employment, a significant pay rise can result in a significant increase in such entitlement value which could be caught by these new provisions.

If you make a contribution above £50,000 or otherwise have your pension entitlement value increase by this amount, it may be possible to claim further relief under a transitional provision or by using an unused deemed allowance from one of the three previous years.

If you do make a pension contribution above the limit, you will still get tax relief on the whole contribution at your highest rate of income tax. But you will also incur a tax charge on the amount of the excess.

This large reduction in the annual limit replaces the previously announced provisions of restricting tax relief for those who earn more than £130,000. That provision has now been abandoned.

Salary sacrifice

Salary sacrifice has been much in the press these last few years, but this remains a tax-efficient way of providing for your future. This approach saves both the employer and employee money through reducing national insurance contributions. This can save the employee income tax too. Even so, taking a reduction in take-home salary now in exchange for a longer-term benefit is not everyone's first choice and should only be used in conjunction with proper financial planning. This technique may not be effective for high income individuals.

Self-Invested Personal Pensions (SIPPS)

SIPPS allow the freedom to select the allocation of your pension fund investments. This pension vehicle is regarded as attractive to many as a result of this investment flexibility. Subject to approval by the SIPP provider, SIPP investors can choose what assets are bought, leased and sold, and when those assets are acquired or disposed (although certain items, like classic cars and residential property are inadvisable because they are subject to heavy tax penalties). The investor may also enjoy ownership of the assets via an individual trust, so long as the provider or administrator is listed as a co-trustee. Potentially, SIPPS can even borrow 50 per cent of the net value of the pension fund to invest in further assets. We are happy to discuss this option with you.

The capping of the lifetime allowance

The lifetime allowance of pension contributions is now capped at £1.8 million until 5 April 2012 when it reduces to £1.5 million. (The government had previously announced that the lifetime allowance would remain at £1.8 million until 2016.)

This reduction in the lifetime allowance does not affect the upper limit of trivial pension. Before 6 April 2011, the trivial pension limit was 1% of the lifetime allowance. From 6 April 2011, it is fixed at £18,000.

Retirement investing alternatives?

For those who want an alternative to pensions, or not to rely on them entirely, the alternatives are almost unlimited. Common savings and investment vehicles include ISAs, equities, bonds, insurance policies, property portfolios and fine art or other valuables. However innovative or unusual your retirement planning, it should stand the 'reality and adequacy test'. Each of these alternatives have differing tax treatments so taking tax into account is an important aspect.

Top-slice relief and the Investment Bond

Investment bonds remain much underused in retirement planning, despite having been around since the early 1970s. Some see them as complex, but they offer unique opportunities to aspiring retirees. Because they are offered by life assurance companies, the investment bond is considered a life policy and is not subject to capital gains tax, instead, a tax liability arises on a chargeable event, such as the death of the owner or maturity. You can take a 5 per cent tax-free withdrawal every year, and excepting the events just mentioned, this can be carried forward for up to 20 years.

It should be noted that this arrangement is a deferment of tax, not an exemption from tax. There is a tax advantage if you reasonably believe that you will be paying income tax at a lower rate at the end of the 20-year period.

A higher-rate taxpayer would pay 20 per cent of the total gain (or 20 per cent on withdrawals above 5 per cent) with an additional rate taxpayer bearing 30 per cent instead, but there is no further tax liability over and above this. With foresight, a taxpayer bearing either 40 per cent or 50 per cent tax on income could enjoy 5 per cent tax-free withdrawals while working, and then on retirement, if in a lower tax bracket, use top-slicing relief to withdraw large sums without incurring a tax liability.

Further, a policyholder in a higher tax bracket can transfer ownership of the bond to a lower tax-paying spouse. Because this transfer is made by deed of assignment, it is not a chargeable event. Sound advice is key to long-term Investment Bond planning.

How much capital will your business realise?

Many expect their business to provide a substantial injection of capital into their retirement pot. However, before you bank the proceeds from sale there may well be capital gains tax to consider. Entrepreneurs' relief reduces some or all of the business gain so that the net tax payable is only 10 per cent of the chargeable gain. Entrepreneurs' relief provides a reduction in capital gains tax on the disposal of an interest in a business or business asset(s) up to a maximum of £1,800,000. Advantageously for some, it has no minimum age requirement, and the business need only meet the qualifying conditions for one year. It replaced indexation allowance and taper relief, and now has a maximum lifetime allowance for gains of £10 million.

If your retirement will coincide with the disposal of business assets and your planning has not yet taken into account the tax impact, please discuss this relief and your tax planning with us.