Factsheet – Personal Pensions

A personal pension is a savings scheme designed to pay you an income when you retire. Broadly speaking, there are three types of personal pension: stakeholder, standard and self-invested personal pensions (SIPPs).

Whichever type of pension you choose, you can make regular or lump sum contributions into the scheme until you choose to retire. The money will be invested on your behalf, and your savings will grow in line with the performance of the underlying fund(s).

Contributions and Tax relief

- Contributions to Personal Pensions should generate direct tax savings. Contributions are usually made net of basic rate tax relief, which means that you will only actually contribute £80 net for every £100 of contributions paid. Higher and additional rate taxpayers likewise make contributions net of basic rate tax and can then claim additional relief via their Inspector of Taxes/Self Assessment return. Contributions made after the age of 75 will not attract any tax relief under current legislation.

- A 40% taxpayer therefore physically contributes £80 for every £100 of contributions they make. However they are able to claim a further £20 relief through their tax return. Creating an effective cost of the £100 contribution at £60. Additional rate taxpayers will claim a further £25 relief, £100 contribution therefore effectively costing £55. . These figures assume basic rate tax of 20%, higher rate tax at 40% and additional rate tax at 45% (2019-20).

- An employer is able to contribute, and receive corporation tax relief on any amount that their local Inspector of Taxes is satisfied meets the "wholly and exclusively" rule for the purpose of the business test.

- Your pension contributions once made will be invested in funds where there is no liability to tax on capital gains and where all forms of investment income (except dividends) are also tax free. Your money may therefore grow faster in a Pension than in most other forms of investment.

- Given the many tax advantages that are available with regard to funding a personal pension there are limits to the contributions that can be paid. Employees are able to make contributions of up to the greater of £3,600 gross or 100% of their annual earnings to all of their pensions each tax year. If you are not earning, you can still pay into a pension but your contributions are limited to £3,600 gross a year, but which will still attract tax relief (even where no tax is paid), creating a cost of £2,880.

<u>Annual Allowance</u>

- However, where the total gross contributions paid from all sources (member / employer / 3rd party) exceeds the Annual Allowance a tax charge will apply. Depending on your taxable income the excess pension savings can be charged to tax in whole or in part at 45%, 40% or 20%.

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- It should be noted that all savings within pensions will count towards the Annual Allowance i.e. personal / employer / third party contributions.
- For the 2019-20 tax year the Annual Allowance has been set at £40,000, reducing to £4,000 for those who take income 'flexibly' from a money purchase pension (known as the Money Purchase Annual Allowance).
- However, it is possible to allow unused Annual Allowances from the 3 previous tax years to be brought forward and added to the current year's Annual Allowance in order to make contributions in excess of the current year's Annual Allowance. This facility is not available for those who are subject to the MPAA.
- The annual allowance may also be reduced by a maximum of £30k under the tapering rules for high earners. Where both Threshold Income is over £110k and Adjusted Income is over £150k, the Annual Allowance is reduced by £1 for every £2 of Adjusted Income over £150k.

Taking benefits

- The earliest age upon which you can take benefits is age 55.

- At retirement you have the option to take up to 25% of the fund as a tax free cash lump sum. There is no upper age limit by which retirement benefits must be taken. It is also possible to stagger the payment of your pension commencement lump sum (PCLS) and benefits, i.e. you do not have to draw all of the benefits at once.

- The requirement to purchase an annuity was removed some time ago and there are now effectively 3 main options available for individuals taking benefits for the first time from a personal pension arrangement. The options can be used in isolation or combined. They are:

    - Flexi-Access Drawdown – This allows you to decide how much of your pension you wish to draw benefits from, 25% will be paid tax free. The balance will be available as taxable income to be drawn at whatever level is required with no limits (other than the fund value). The income can be drawn as a lump sum or on a regular basis.
    - Taking a single or series of lump sums from uncrystallised funds – these will be known as Uncrystallised Funds Pension Lump Sums (UFPLS). Each payment will consist of 25% tax free, with the balance as a taxable lump sum.
    - Purchasing a lifetime annuity – Again 25% will be tax free, with the balance used to purchase an income guaranteed for life. Any income you take is taxed as income under PAYE.
    - It should be noted however that not all schemes offer all options and in some cases there may be more restrictive options.

- Each time you draw benefits (crystallise funds), the value of the benefits crystallised will be tested against the lifetime allowance (LTA) and you will use a % of the allowance available to you. Should you crystallise funds with no remaining LTA, then the excess of the allowance is taxed at either 55% if taken as a lump sum or 25% if taken as income (with income also being subject to income tax). The LTA for the current tax year is £1,030,000 (2018/2019), set to rise to £1,055,000 from 6th April 2019. Individuals who have a form of LTA protection will have a different allowance.

Death Benefits Uncrystallised Funds

Please refer to alternative fact sheets relevant to Drawdown / Annuities for information on death benefits where funds have been drawn.

Before April 2015, what benefits could be paid depended upon whether the funds were crystallised or not. Since April 2015 it is the age of the person who dies, at the date of their death, that affects the tax treatment of the benefits, there is no differentiation between crystallised and uncrystallised funds.

However, a lifetime allowance (LTA) check applies to uncrystallised funds. If the value of the death benefits takes the member over their remaining lifetime allowance then the beneficiary will need to pay the appropriate lifetime allowance charge. If there is more than one beneficiary the charge is apportioned across the fund they each receive, so one beneficiary isn't burdened with the whole charge.

Pre 75 benefit options – death of the member

The value of the pension fund at the date of death is usually payable to the nominated beneficiaries or dependents, and this is free of income tax provided they are designated within two years of the member's death. If the designation is made after 2 years any income or lump sum paid will be subject to income tax at the beneficiary's marginal rate.

The beneficiaries can choose how they wish to take the benefits, including a lump sum from the scheme, as a form of pension, although not all schemes offer all choices.

Post 75 benefit options – death of the member

The value of the pension fund at the date of death is payable to the nominated beneficiaries. Again, the beneficiaries can choose how they wish to take the benefits, if at all.

However, unlike death benefits before the age of 75 which will be paid tax free, any benefits drawn where death occurred after age 75 will be taxed at the recipient's marginal rate of income tax.

Inheritance Tax

Pension death benefits will not normally be subject to inheritance tax (IHT) regardless of the age of the scheme member at death. However, if pension benefits have been paid from the scheme by way of a lump sum to the member's beneficiaries those funds form part of the recipient's estate for IHT purposes. If the beneficiary chooses to opt for flexi-access drawdown any funds not yet paid out to the beneficiary will remain part of the pension scheme and still outside their estate on their death.

HM Revenue & Customs reserve the right to subject a pension fund to an IHT charge if they feel it has been used for tax avoidance purposes.

Death benefit nomination forms

When a pension scheme member dies, the scheme administrator has to pay the death benefits to someone. The recipient(s) of death benefits are usually chosen at the discretion of the pension scheme trustees or administrator. However, a member / pension holder can nominate whom they wish to receive the benefits, by completing a nomination of beneficiaries form (sometimes called an "expression of wish") and the trustees will usually take this into account, although this is not a binding request.

It is essential that death benefit nomination forms are reviewed frequently and new forms are completed on the death of a member, dependant, nominee or successor to ensure there is always a valid form on file. Should there be no indication of who the scheme administrator should pay the benefits to, this will restrict the options available to any beneficiary who is not deemed to be a dependant of the member.

Another key point is that the nominations of the original member have no bearing or influence on those of the dependent / nominee or successor pensions that may follow.

Types of Personal Pension Arrangements

Stakeholder Pensions

These are the simplest form of personal pension and are designed for people seeking a no-fuss retirement savings vehicle. The investment choice may be more limited than alternatives.

Stakeholder schemes have caps on the annual costs and provide easy access for savers. The rules state that providers must accept payments of just £20, and the maximum they can charge for the scheme is 1.5% a year for the first 10 years, reducing to 1% thereafter.

The provider cannot charge members for transferring money into or out of a stakeholder scheme.

Standard Personal Pensions

These are likely to offer more investment choice than stakeholder plans, with funds available from a range of investment managers.

Many personal pension providers have now brought their plans in line with the stakeholder model, capping charges at 1.5% a year for the first 10 years and 1% thereafter. However, there is no upper cap on charges and providers charge additional for external funds – these can be as little as 0.15% to over 1% per annum.

Otherwise, most standard personal pensions are flexible – usually there are no penalties for stopping or restarting contributions or for transferring out to another provider. They are likely to offer all retirement options however, this is not always the case.

Retirement Annuities / Selection 226 or s620 Plans

These are personal pensions that pre date the Personal Pension as we know it today and were available up until 1st April 1988.

Whilst they are deemed to be personal pensions, care needs to be taken as they still follow historic legislation. They may:

- Fall under the Inheritance Tax regime
- Only offer a refund of contributions on death before retirement
- Offer guaranteed annuity rates or retirement values, combination thereof
- Only offer annuity purchase as a retirement option

There are many variations in the terms of each contract and as such should be formally reviewed.

Self Invested Personal Pensions (SIPPs)

A SIPP is a personal pension that usually offers a much wider choice of investments. There are few restrictions and, dependent upon the SIPP provider used, could allow access to all investments permitted by HMRC rules such as shares, unit trusts, OEICs, gilts and bonds, ETFs, cash deposits, future / options and commercial property.

Contributions into a SIPP attract the same tax relief as standard personal pensions.

The cost of SIPPs vary between providers and potentially the investment range chosen however, it is fair to say they are now competitively priced, although do not have the caps imposed on Stakeholder pensions.