CHILTERN CONSULTANCY

INDEPENDENT FINANCIAL ADVISERS

Providing for the future

The Chiltern Guide to Retirement Planning

We all know it's important to plan for retirement, but many of us are still not planning well, or early enough. Despite all the media headlines and Government initiatives, many of us still have a 'tomorrow will do' attitude.
This is worrying for one simple reason – we are going to live longer than most of us think.
Those approaching retirement today have many more opportunities and challenges than their parents ever did. There are also many more ways to fund retirement, adding to the confusion about how to best prepare for all your needs.

Live long

In 1900, life expectancy at birth in the UK was only 46 years for men and 53 years for women.
Just over a century later life expectancy at birth has increased by around 30 years.
By 2014 had reached 78.7 years for men and 82.6 years for women.
The population aged 85 years and over, often termed the 'oldest old', are now the fastest growing section of our population.
For the 1921 cohort, only 18% of men and a third of women reached the age of 85 years.
But for the 1951 birth cohort, it is expected that almost half of men and 60% of women will achieve that age*. Knowing our chances of living to our late 80s and beyond leaves us with one fundamental question – will we have enough money to enjoy the lifestyle we desire for perhaps 30 years or more after we stop work?

...and prosper?

Some of us are planning our pensions. But few of us plan for 'late retirement'.
This is a period from our mid-70s and onwards, when our expenses can rise faster than our pension income can keep up with. This can happen for various reasons. It could be because we need more help around the home or even that we require nursing care. Then there are unexpected expenses like replacing the roof, health care, or financial help for our families.
But these days, it's just as likely to be because the older generation is leading a more active life through travel, work or leisure.
And don't forget our old enemy – inflation. It continually eats away at the value of our money over time.

The true cost of retirement

Life Trust Insurance recently reported that the cost of retirement for someone who retires at 65, and lives to 100, could be as much as £1.55 million for someone currently earning £50,000 or over.
Their research shows that traditional annuity products are unlikely to be sufficient for retirees' to enjoy a decent standard of living in their 'late retirement' years. The choices for some people are likely to be stark – sell their precious assets like their home or live out their final years in poverty.

Forward planning

This problem has been at the root of much of the recent innovation in the retirement market.
Getting sound financial advice throughout the different stages of retirement will help identify which products can help you achieve the income you need.
Although it may seem a long way off, making robust financial plans now for late retirement will give you the peace of mind to enjoy your early retirement years – safe in the knowledge that you will be able to live the lifestyle you desire further down the line.

A pension is a long term investment. The fund value may fluctuate and can go down.
Your eventual income may depend on the size of the fund at retirement, future interest rates and tax legislation.

What is a Personal Pension?

Personal pensions may be suitable if you're employed and not in a company pension scheme, or as an addition to a company pension. You may also wish to set up a personal pension if you are self-employed or if you are not working but can afford to put aside money for retirement.
You pay a regular amount (usually monthly or annually), or a lump sum to the pension provider who will invest it on your behalf. Funds are usually run by financial organisations like building societies, banks, insurance companies, and unit trusts companies.
The final value of your pension fund will depend on how much you have contributed and how well the fund's investments have performed. The companies that run these pensions charge you for starting up and running your pension.
Charges are normally deducted from your fund in the form of fund management charges.

Contribution Levels and Tax Relief

The Annual Allowance for pension contributions is £40,000, transitional rules are in place for 2015/16 that enable some people to benefit from an annual allowance of £80k in total.
From 2016/17 the standard annual allowance of £40k applies (except for higher earners or those who have accessed pensions flexibly).This figure includes both employee and employer contributions.
Tax relief will continue to be at the individual's marginal rate.
From April 2016 the annual allowance is tapered down for those with adjusted income above £150k pa (to a minimum of £10k for those with adjusted income of £210k plus).
You can carry forward unused contributions from the previous three years (ie. back to 2012/2013 for 2015/16), potentially allowing contributions of up to £220k for someone able to use the full £80k for 2015/16 or up to £180k otherwise (£50k for 12/13 and £13/14, £40k for 14/15 and either £40k or £80k for 2015/16).
HMRC has confirmed that you do not need to have made a contribution to a pension scheme in a year to be able to carry forward unused allowances – you simply need to have been a member.
If you wish to carry forward unused contributions from previous tax years you will need to have used the annual allowance for the current tax year.For each pound you contribute to your scheme, the pension provider claims tax back from the government at the basic rate of 20%. In practice, this means that for every £80 you pay into your pension, you finish with £100 in your pension pot.

Higher-rate taxpayers

If you're subject to the higher tax rate of 40% (up to 45% with additional rate tax), you'll still get 40 % or 45% tax relief for any money you put into your pension.
Higher or additional rate tax relief is given to gross contributions that are fully matched by income in those bands, eg. to receive 40% relief on a £10k gross contribution the individual must have income of at least £10k in the 40% tax band.

But the way that the money is given back to you is different:
The first 20% is claimed back from HMRC by your pension scheme in the same way as for a lower rate taxpayer.
It's up to you to claim back the other 20% if you're a higher rate tax payer or 25% if you're an additional rate tax payer when you fill in your annual tax return, or by contacting your Tax Office.
If you don't have any relevant UK earnings the most you can pay is £2,880 net.
Someone could have earnings of up to £10,600 in 2015/16 and not be paying tax and they could contribute up to the level of their earnings and receive tax relief (ie. up to £10,600 potentially).
But you'll still get basic rate (20%) tax relief, meaning the government will 'top up' your contribution so that £3,600 is invested.
Your pension fund will invest the money you save (including the tax relief amount) in your pension.
Your pension fund growth is free of tax except dividend income.
Any rise in the value of the scheme's assets between what you put in, and what they're worth at the end, would include gains made and income received by the pension fund (all tax free except dividend income).

Drawing your Personal Pension

The minimum age to draw is 55 and it is now possible to withdraw the whole fund if required – subject to tax on anything above the tax free cash?
You can take a pension commencement lump sum of up to 25% of the value of your pension savings, which is currently tax free, when you retire (up to a maximum of 25% of the lifetime allowance).
The lifetime allowance for the tax year 2015/2016 tax year is £1.25 million.
You then have two main options:
Use the rest of the fund you have built up to buy an annuity (a regular income payable for life) from a life insurance company.
This does not have to be the same company that you have your pension plan with.

Take an income (taxed at your normal Income Tax rate) from the remainder of your fund while it remains invested.

Putting money into someone else's personal pension

You can put money into someone else's personal pension (eg. your spouse/partner, child etc).
They will get tax relief added at the basic rate, but this won't affect your own tax bill.
If they have no income, you can pay in up to £2,880 a year (which becomes £3,600 with tax relief).
For example, if you put £80 into a spouse or civil partner's pension scheme, the government would put in £20, so their pension pot would increase to £100.
Your tax would remain the same.

Please note: The value of units can fall as well as rise, and you may not get back all of your original investment.

How Personal Pensions work

The fundamental idea behind a personal pension plan is simple. You put money into a savings fund and it hopefully grows in value. At retirement, you convert the fund into a regular income payment, which is designed to replace some (or all) of your employment income.

These notes apply to an individual who is looking to establish a personal pension or stakeholder pension.

1. Payments In

You can typically save into a pension plan in one of two ways:

Regular instalments - The pension payment can be taken automatically each month by Direct Debit. Once you start making regular contributions in this way, and become accustomed to the regular payments going out of your account, you may find it easier to plan your monthly budget.

One-off investments - Some people prefer the flexibility of making one-off investments at a time of their choosing, rather than commit to regular monthly contributions.

Providers usually place minimum contribution amounts on single premium payments.

This method can be useful for self-employed people or those paying higher rate tax, as the amount of contribution will attract tax relief but gross contribution must be covered by income in that band.

It is your responsibility to make sure that an investment is made.

A combination of the above - This provides both the discipline of regular investments and enables one-off investments to also be made so that the best use of the available tax relief can be made.

2. Tax Considerations

Tax relief is granted on pension contributions.

Currently, the basic rate of tax is 20% and higher rate is 40%. The additional rate can take this to 45%.

For employees contributing to a personal pension or stakeholder plan, the contribution is made net of basic rate tax. If you invest £80 into a personal pension, the provider will add the remaining £20 and invest £100 on your behalf (claiming the tax relief back themselves from HMRC).

If the investor pays tax at higher rates, it is possible to claim back the marginal rate via a tax return.

In the example above, £100 is declared on the self-assessment tax return.

The tax office will then credit you with £40 of tax, less the £20 already received and invested.

Self-employed investors face a complex system for claiming back pension tax relief, based partly on what they’ve already paid, and partly on an assumption about future payments.

Care should be taken to understand the effect on self-employed tax assessments when a large single contribution is made or regular premiums are stopped.

The tax treatment is dependent on individual circumstances and may be subject to change in future.

Restrictions on payments

The amount you save each year toward a pension, from which you benefit from tax relief, is subject to an 'annual allowance'.

The annual allowance for the tax year 2015/16 is up to £80k in some cases as described earlier.

You can carry forward unused contributions from the previous three years
(ie. back to 2012/2013 for 2015/16).

You can invest up to £3,600 per year gross in a personal pension (and still receive the 20% tax credit) even if you have no earnings.

As the person making the contributions does not have to be the same as the person benefiting from the pension, this facility can be helpful in providing a pension for a non-working spouse - or for children and grandchildren as part of inheritance tax planning.

3. Investments

You will have to decide on the type of fund in which you invest your money.
Most pension providers have a wide range of funds available - some have literally hundreds.
Essentially, funds break down into two categories:

Unit Linked funds – These are pooled funds, linked to the performance of underlying investments – usually equities (ie. stocks and shares).
The money is used by the fund manager to purchase more of the fund's underlying assets.
The price goes up and down in line with the investments held. If the market falls, so does the unit price.
This can be good news for people investing with a long time to go (a new cash investment will buy more units), but bad news for people about to use their fund to provide retirement benefits.
Those approaching retirement tend to switch funds into less volatile investments to avoid this risk.

The value of units can fall as well as rise, and you may not get back all of your original investment.

With Profit funds – These also invest in stocks and shares and other assets, but the fund manager tries to smooth out the peaks and troughs of unit linked funds by holding back some of the growth as a reserve. This can provide a smooth increase in value in your investments.

A Market Value Adjustment might apply on encashment. The value of this policy depends on how much profit the company / fund makes and how they decide to distribute that profit.

4. Projections

Growth assumptions

When projecting pension fund values, certain growth assumptions are made by pension providers.
These are currently 0.5%, 2.4% and 5.5%.
A better way to predict growth is to try to link inflation in and establish ‘real growth’.
In other words, if a fund achieves 5.5% per annum growth but inflation has been 2.5% per annum, the real growth is 3.0%. This more realistic real growth assumption is now the norm.

Pension options

From 6 April 2015 new "Pensions Freedom" legislation came into effect, and consequently, at retirement, there are now many new options as to how you take your pension.

5. How Much Should I Invest?

You should invest as much as you can comfortably afford, as soon as you can.
You should not overstretch yourself and you should be sure that if you commit to a monthly investment, it will continue for a long time.
The actual amount you should invest will be different for each individual.
Once you have arrived at a figure, it is useful to try to link it to salary.
If you have decided that you can afford £100 per month and you earn £20,000, a quick calculation will show this amounts to around 6% of salary.
Try to maintain that link in future years. You may choose to calculate the level of savings necessary to achieve a certain level of income (in today’s terms) at your chosen retirement date. This target funding is then reviewed on a regular basis to account for revised objectives, investment performance and changing market conditions.

6. What About State Benefits?

State benefits will, for most of us, form a major part of our retirement income.
The introduction of the minimum income guarantee (MIG) - now the pension credit guarantee – has also complicated retirement funding.
Because it’s means-tested, it’s easily possible to end up in a position where 40% of your pension income is lost to subsidising the Pension Credit, meaning your long term savings have been poor value for money.
If you are serious about your retirement, you should get a state pension forecast.

7. What About Other Forms Of Savings?

Obviously if you are serious about retirement planning, you should not necessarily concentrate all your savings into the one area of personal pensions. However, personal pensions will certainly form part of your overall strategy.

8. Summary

If you are considering starting to save for your retirement, ask yourself:
Is the level of savings you are proposing realistic from a retirement and state pension perspective?
Do you want the discipline of a monthly investment or could you make lump sum payments from time to time (or both)?
How much would you need to live on, if you retired today?
It’s then possible to begin calculating the cost of achieving that objective.

Your Retirement Options and Pensions Freedom

On 6 April 2015 new pension rules came into force, giving you much greater flexibility over how you use your pension savings and the options you have in retirement.
These changes include the freedom to access the whole of your pension fund, more choice over how to receive the tax-free cash from your fund, changes to death benefits and changes to the contributions you can make.
Whether you have a personal pension, a group personal pension or a stakeholder pension these new rules are far-reaching, and they could have significant tax implications.
It is therefore important to take advice on the various options open to you.

Flexi-access drawdown

The first of the new options is “flexi-access drawdown” which in essence places no limit on the amount of income you can take from your pension fund, this means that it would be possible to take the whole of your pension fund in one go, however it may not be tax efficient to do so.
If you will be dependent on your pension to support you through your lifetime you may need to consider taking a lower level of income to sustain you.
You will be able to take 25% of your fund as a tax free lump sum if you have not previously used that fund for drawdown purposes with the remainder of the fund staying in your pension to provide you with an income. It is important to remember that the amount of flexi-access fund withdrawn to provide you with an income will be taxed at your marginal rate of income tax therefore if you take too much income this may move you into the next tax bracket and result in you paying a higher rate of tax.

Pension Lump Sum

A new option has been introduced by the Government which is called the Uncrystallised Funds Pension Lump Sum (UFPLS).This option is for funds not already in drawdown and allows you to take a one-off payment from your pension or a series of lump sums leaving the remainder of the fund in your pension invested, the first 25% of each UFPLS is tax free, with the balance being subject to tax. UFPLS is not available from any part of your pension that is already in drawdown.

How can I access the new pensions options?

For anyone who is in drawdown as of 6 April 2015 (capped or flexible) the new options differ depending on which one you currently have.

Capped Drawdown

Currently if you are in capped drawdown you will have a maximum level of income that you can take each year and this is reviewed every three years up until you are 75 and annually thereafter.
From 6 April 2015 you will be able to continue to take capped drawdown or you will also have the option to use the new flexi-access drawdown whereby the amount of income you can take will be unlimited and there will be no further maximum income level reviews.
It is also important to remember that if you take the decision to move from capped drawdown to flexi-access drawdown that the amount you can contribute to your pension each year will change.

Flexible Drawdown

Anyone who has taken flexible drawdown should automatically be moved into flexi-access drawdown from 6 April 2015.
This will have no effect on how you take benefits but will enable you to make tax-relieved contributions to your pension.

New Death Benefit Rules

You can nominate whoever you choose to receive your death benefits, this can be your spouse, children, grandchildren or even someone unrelated to you, you can also leave some or all of your pension fund to charity. The beneficiaries of your pension fund can elect to take the fund as a lump sum or leave the fund invested and take an income under the new flexi-access drawdown rules.
If they do choose the flexi-access option then they can take income as and when required or leave the funds invested thereby benefitting in the tax advantaged pension. What about tax on the death benefits?
The tax treatment of your death benefits will depend on two things.
Your age when you die. Whether or not the funds are designated to your beneficiary within two years.
If you die before your 75th birthday and your pension funds have been designated to your beneficiaries within two years they will be paid tax-free, if in flexi-access drawdown (a lump sum death benefit would have to be paid out within 2 years).
If you live beyond your 75th birthday or if you die earlier but your pension funds are not designated within the two year period, then the death benefits will be taxed, the taxation that would normally be applied would be at the beneficiaries’ marginal rate of income tax.

The only exception to this rule is that if they choose the lump sum option and this is paid before 6 April 2016 then it will be taxed at 45%.
If your beneficiary has not withdrawn the whole of the pension fund before their subsequent death then the pension funds can be passed on again with the tax position being based on the age at death of the most recent beneficiary.
It is possible to have unlimited successors so in essence your pension fund could be passed on for generations if it is not all withdrawn.

Annuities

You will of course still have the option of purchasing an annuity which for some people may still be the right choice to give a guarantee of an income for life paying a level income or increasing over time.
From 6 April 2015 new flexible annuities will also be available which will allow the income level to decrease as well as increase providing this is stated in the annuity when the contract is started.
The new rules are far reaching and far more flexible therefore we would be more than happy to discuss these options with you in more detail so please contact us to arrange a meeting.

Please note that whilst every effort is made to ensure that the information contained within this guide is correct, these notes are by necessity brief and of a generalised nature.
We would provide specific personalised advice prior to finalising any arrangement.
The value of units can fall as well as rise, and you may not get back all of your original investment.
It is important to note that not all personal pensions allow the facility to Self Invest and you should check the details of your existing pension if this is a requirement.

Pensions and Divorce

With pensions being most people's second-largest asset, they can become a major consideration in any divorce settlement.

1. Previous Legislation

Whilst the consideration of pension benefits within divorce settlements was an issue in the 1969 study by the Law Commission, the key legislation has been:
Matrimonial Causes Act 1973 - Ss 23-25 deal with the provision of a 'clean break' wherever possible.
Pensions Act 1995 (PA) - The PA requires courts to take pension rights into account when assessing assets on divorce. It introduced the concepts of earmarking pension benefits as well as the basis for cash equivalent transfer values (CETVs) for assessing the value of a pension on divorce.
Welfare Reform and Pensions Act 1999 - The Act brought in the option of Pension Sharing On Divorce from December 2000. The thrust of the legislation is to attempt a 'clean break' settlement for pension funds on divorce. The legislation states that pension benefits will still be taken into account in divorce settlements. Offsetting and earmarking will still be options to consider, however a new (and probably much more appropriate) option was introduced which allows the pension benefits to be shared or split between the parties at the time of the divorce.

2. Offsetting

This simply means that the pension funds are valued, and the spouse with greater benefits provides the other spouse with additional funds elsewhere in the settlement, to compensate them for the loss in pension rights. In an ideal world, this system would be by far the simplest and arguably the best solution. Unfortunately, however, many people do not have sufficient assets to enable offsetting.

3. Earmarking

Earmarking applies to all private pensions (including those in payment), but not state benefits.
For some unfunded public sector schemes this might be the only option.
It involves the court issuing an attachment order to the pension scheme.
This attachment requires the scheme's trustees to pay a proportion of the member's benefits directly to the ex-spouse, when the benefits are taken.
The court can also earmark a proportion of the member's 'death in service' lump sum, and widow(er)'s pension benefits, for the protection of their ex-spouse.
Earmarking has many problems, not least that the pension remains under the control of the member.
If he or she decides not to retire, invest riskily, or take any other action prejudicial to the ex-spouse there is nothing that they can do about it.
In addition: If the petitioner remarries, the earmarking lapses.
Earmarked benefits are all taxed at the highest rate of the pensioner, irrespective of the tax rate for the ex-spouse.
If there is the likelihood that the petitioner will remarry prior to the respondent's retirement age, then - except for some safeguard on the life cover side – this procedure is probably a costly waste of time.

4. Pension Sharing

Pension sharing applies to all pensions, apart from the state basic old age pension.
All pension benefits are valued (see CETV below). The share can be granted by way of a transfer to the petitioner's own scheme, or the petitioner may become a 'paid up' member of the respondent's company pension scheme.
This latter option is rarely used, as the retaining scheme will not wish to have the increased costs, disclosure requirements and administrative inconvenience associated with additional members (non-employees).
The rules allow schemes to insist on 'buying out' the spouse's benefits, if the scheme considers it appropriate. Most schemes insist on this route.
The exception is usually the government and Local Authority schemes, which are 'pay as you go' and therefore reluctant to pay large transfer values.
Pensions that are already in payment (eg. through an annuity) can be 'unbought', split and 'rebought' using the annuity rates for the member and petitioner at date of divorce. Indeed, if the petitioner is much younger, they can use the lump sum as a pension contribution (or many other alternatives).
The biggest problem with pension sharing is the cost. Schemes are entitled to charge for the calculations and administration involved in splitting the benefits. The recipient must also consider the cost of any required financial advice, which may make the entire process uneconomical.
At present, little consideration has been given to "co-habitant" relationships, although it is the subject of significant lobbying.

5. Cash Equivalent Transfer Value (CETV)

The CETV is the basis for valuing pension benefits held by a divorcing member.
This value can be used to calculate an 'offset' against other marriage assets, or to divide the pension between the member and the former spouse. For the purposes of this legislation the date of valuation will be the divorce date. In some cases, the CETV can be unfair to the petitioner, as it represents the minimum valuation of the member's fund. For example, with a final salary scheme, the valuation assumes the member is divorced, hence the CETV takes no account of the widow(er)'s benefits.
In the case of a money purchase scheme, it will probably be the external transfer value.
This sum frequently includes a charge against the fund for the accrued costs of the scheme between the date of transfer and the retirement date of the plan. In the case of some investment funds (eg, With Profits), the value will be after short-term market value reductions, which may not be there when the remaining member retires.

6. Summary

We expect pension sharing to be used in the vast majority of divorce cases, where offsetting is not an option. Cost will, however, be a key issue. Any transfers will have to be sufficient to warrant the large costs involved in calculating and organising the new arrangements

Income Drawdown

Income Drawdown is a more flexible alternative to the traditional annuity route, offering greater choice and control for many people.

Benefits

You can put off buying an annuity, and instead withdraw a regular income from the pension fund while the remainder of the fund stays invested. While the fund remains invested, you could benefit from growth in the market – and from ongoing advice. Anyone from the age of 55 can set up a Drawdown contract.
It could be suitable if you:

- want to vary your income over time, to reflect changes in your circumstances
- want your pension fund to continue benefitting from potential investment growth, and you're prepared to accept the risk that the value of the fund may fall
- have other sources of income
- want to maximise the benefits your family receives upon your death, and also give you choice about how they receive these benefits
- are in ill health, and would like to pass on remaining assets to your estate tax free on death before 75
- want to control the time at which you buy an annuity
- want to maintain an active interest in managing your pension fund
- have a pension fund in excess of £100,000.

Summary

Typically, Income Drawdown suits people who are not adverse to investment risk, and who have larger pension funds. However, there are no guarantees that income will be greater than if the fund was used to purchase an annuity at retirement.
There is also no guarantee that the initial income level selected will be maintained.
The costs of Income Drawdown are normally higher than for an annuity.

Income Withdrawal Plans are complex. It's a good idea to get professional advice because what you decide now will affect your pension income for the rest of your life. A pension is a long term investment.
The fund value may fluctuate and can go down. Your eventual income may depend on the size of the fund at retirement, future interest rates and tax legislation.

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V2.0 Nov17