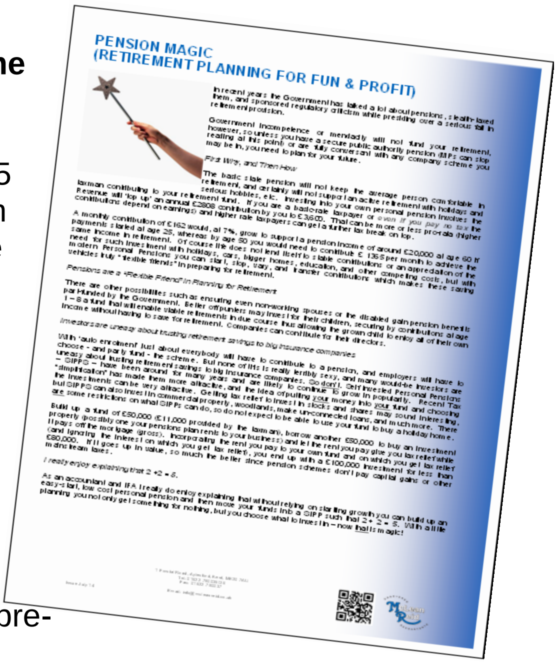
TIP OF THE MONTH - NEW PENSION CHANGES, SAME OLD RETIREMENT

The government has announced subject to consultation radical pension changes, effective from April 2015, whereby investors will have unprecedented freedom over how they take money from their pensions.

Flexible access to pensions from age 55 (income tax 'perks' from age 1)



PENSION MAGIC
(RETIREMENT PLANNING FOR FUN & PROFIT)

In recent years the Government has talked a lot about pensions, stealth-taxed them, and sponsored regulatory criticism while presiding over a serious fall in retirement provision.

Government incompetence or mendacity will not fund your retirement, however, so unless you have a secure public authority pension (MPs can stop reading at this point) or are fully conversant with any company scheme you may be in, you need to plan for your future.

First Why, and Then How

The basic state pension will not keep the average person comfortable in retirement, and certainly will not support an active retirement with holidays and serious hobbies, etc. Investing into your own personal pension involves the taxman contributing to your retirement fund. If you are a basic-rate taxpayer or *even if you pay no tax* the Revenue will 'top up' an annual £2808 contribution by you to £3,600. That can be more or less pro-rata (higher contributions depend on earnings) and higher rate taxpayers can get a further tax break on top.

A monthly contribution of £162 would, at 7%, grow to support a pension income of around £20,000 at age 60 if payments started at age 25, whereas by age 50 you would need to contribute £ 1365 per month to achieve the same income in retirement. Of course life does not lend itself to stable contributions or an appreciation of the need for such investment with holidays, cars, bigger homes, education, and other competing costs, but with modern Personal Pensions you can start, stop, vary, and transfer contributions which makes these saving vehicles truly "flexible friends" in preparing for retirement.

Pensions are a "Flexible Friend" in Planning for Retirement

There are other possibilities such as ensuring even non-working spouses or the disabled gain pension benefits part-funded by the Government. Better off punters may invest for their children, securing by contributions at age 1 – 8 a fund that will enable viable retirements in due course thus allowing the grown child to enjoy all of their own income without having to save for retirement. Companies can contribute for their directors.

Investors are uneasy about trusting retirement savings to big insurance companies

With 'auto enrolment' just about everybody will have to contribute to a pension, and employers will have to choose - and part fund - the scheme. But none of this is really terribly sexy, and many would-be investors are uneasy about trusting retirement savings to big insurance companies. So don't. Self Invested Personal Pensions – SIPPS – have been around for many years and are likely to continue to grow in popularity. Recent Tax "simplification" has made them more attractive, and the idea of pulling your money into your fund and choosing the investments can be very attractive. Getting tax relief to invest in stocks and shares may sound interesting, but SIPPS can also invest in commercial property, woodlands, make unconnected loans, and much more. There are some restrictions on what SIPPs can do, so do not expect to be able to use your fund to buy a holiday home.

Build up a fund of £50,000 (£11,000 provided by the taxman), borrow another £50,000 to buy an investment property (possibly one your pensions plan rents to your business) and let the rent you pay give you tax relief while it pays off the mortgage (gross). Incorporating the rent you pay to your own fund and on which you get tax relief (and ignoring the interest on which you get tax relief), you end up with a £100,000 investment for less than £80,000. If it goes up in value, so much the better since pension schemes don't pay capital gains or other mainstream taxes.

I really enjoy explaining that 2 +2 = 5.

As an accountant and IFA I really do enjoy explaining that without relying on starting growth you can build up an easy-start, low cost personal pension and then move your funds into a SIPP such that 2 + 2 = 5. With a little planning you not only get something for nothing, but you choose what to invest in – now that is magic!

From April 2015 pension investors aged at least 55 will have more freedom over how they take an income from their pension. They could take all the fund as a lump sum if they so wish. They will then be able to spend, invest or save it as they choose.

The first 25% will be tax free. The rest will be subject to income tax at their highest marginal rate. So for a basic rate (20%) taxpayer, any income they draw from their pension will be added to any other income they receive (e.g. salary) and this could push them into the higher (40%) or even top-rate (45%) income tax bracket. So careful pre-retirement planning is essential.

It will also be possible to choose to take the pension out in stages, rather than in one go, which could help them manage their tax liability. It should be possible to take the tax-free cash straightaway and the taxable income at a later date. These two useful strategies are not new, we've used them for some time.

The position set out in our flyer (available on request) is the case at present, and the logic of turning 80p into a £1, taking out 25p and using the remaining 75p to generate retirement income still makes the same sense it always has except from next April you can also get back the 75p! For detailed advice please consult Champion Financial Advisors Ltd where I am the sole IFA, but in accounting terms:

80p = £1 unless of course you pay tax at higher rate, when 80p = £1.20.

What are you earning at the bank?