

Your guide to

TAX-EFFICIENT PENSION PLANNING

*Helping you understand and make the most of your
pension provision and tax allowances.*



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UNDERSTANDING HOW PENSIONS ARE TAXED

With the careful planning of allowances and exemptions, you could unlock your pension's potential to build up your wealth in a tax-efficient way and maximise your income at retirement.



Pensions are a very tax-efficient way in which to save money for your retirement, and in passing on wealth to future generations. One of the best features of using a pension to save for retirement is tax relief. When you pay into your pension, some of the money that would have gone to the government as tax, instead goes towards your pension and is given at the marginal rate of tax you pay.

Money you take from your pension pot comes from your provider with the tax already taken off, based on your tax code. Your provider may also take off any tax due on your State Pension through Pay As You Earn (PAYE).

On some occasions, you might pay emergency tax when you take money from your pot which you can claim back from HMRC.

However, whilst pensions offer many tax benefits, it is also important to be aware of certain allowances and thresholds in place - which we will discuss in this guide - and plan accordingly to avoid any penalties or additional charges whilst optimising your arrangements.

TAXATION ON CONTRIBUTIONS

How well do you understand how your pension contributions are taxed? There are different ways in which a pension can be taxed and there may be a more tax-efficient method than what your current pension is using.

Tax Relief

If you have income or capital available, consider contributing this into a pension to take advantage of the generous Income Tax relief available. The government will provide between 20%-45% Income Tax relief on your contributions, which can make a huge difference to your savings for retirement.

You may also have the ability to contribute via salary exchange (also known as salary sacrifice) which creates savings in National Insurance Contributions (NIC), therefore reducing the cost of paying into your pension.

Relief at Source vs Net Pay

There are two ways you can get tax relief on your pension contributions; relief at source and net pay. If you are in a Workplace Pension, your employer chooses which method is used, however, if you have a personal

pension then the relief at source method is always used. The table opposite shows a comparison between the two methods and the effect that this can have on your take-home pay.

Whilst both methods would add £6 to your pension, with net pay the full £6 is taken from your pay and you cannot claim any money back from HMRC. Whereas, with relief at source, only £4.80 is taken from your pay, and the rest of the £6 contribution is made up from tax relief.

Method of Tax Relief Used	Net Pay	Relief at Source
Weekly/Annual Income	£200 pw (£10,400 pa)	£200 pw (£10,400 pa)
Contribution into Pension	3% (£6 pw)	3% (£6 pw)
Taken from Pay	£6.00	£4.80
Amount of Tax Relief	£0.00	£1.20

Depending on the rate of tax you pay, it may be that you need to claim extra tax relief not already claimed by your pension scheme, either through self-assessment or by contacting HMRC.

There are, however, certain limits that you need to be aware of which can impact the amount of tax relief you are entitled to, which is known as the Annual Allowance. Contributions in excess of these limits could lead to a tax charge on any excess relief provided.

Company owners can also make employer-based contributions into their pension plans. This can lead to lower Corporation Tax relief within their business, but any tax relief is subject to the discretion of the Local Inspector of Taxes.

PENSION ALLOWANCES

Understanding pension allowances and planning with these in mind is important in order to optimise your financial arrangements whilst avoiding any additional tax charges or penalties.



The Annual Allowance

The Annual Allowance (AA) is the limit on how much money you can build up tax-free in your pension in any one tax year whilst still benefiting from tax relief. You can still make further contributions above this into your pension, however, you would not get tax relief on contributions over the AA.

As of 6th April 2024, the Annual Allowance has increased to £60,000 from the previous £40,000 limit, therefore allowing mid-to-high earners to increase the funding of their pensions further if they wish. However, if your earnings are lower than £60,000, you will be entitled to tax relief only up to the amount you earn. If you earn less than £3,600, you can pay in up to £2,880 and still get tax relief.

Lifetime Allowance

Previously set at £1,073,100, the Lifetime Allowance (LTA) was abolished from 6th April 2024. This removes the maximum limit that can be accumulated in pensions before an LTA tax charge is incurred on the value of pension benefits exceeding the LTA.

However, it is wise to keep in mind that the LTA could be re-introduced in future depending on the government's decisions.

TAX WHEN TAKING AN INCOME FROM YOUR PENSION

Income taken from your pension(s) is treated as salary, and is therefore subject to Income Tax. However, this is where an Independent Financial Adviser can help you structure your income effectively.

Any income you receive from your pension will be added to your salary/other earnings to create a total annual income, which may result in you falling into a higher rate Income Tax bracket (40% or 45%).

Through careful planning and the help of an Independent Financial Adviser, you may be able to reduce your tax liability by regularly reviewing the level of income you withdraw, depending on your salary/other income in a respective tax year.

Individuals can typically access 25% of their pension benefits as a tax-free cash sum. Some may be able to use this capital to supplement earnings without the need for taxable income, and possibly invest for growth to increase the value in the long-term.

Pension Commencement Lump Sum

You can take money from your pension pot as and when you need it until it runs out. 25% of your fund is available tax-free but can be taken in different ways, and the rest of the fund is added to your other income and is therefore taxable.

The remaining pension pot stays invested, meaning the value of your pension pot and future withdrawals are not guaranteed (unless you are purchasing an annuity). Keeping your pension pot invested creates the potential for growth in a tax-efficient environment, but it is important to be aware that investments can go up or down. You can also spread the money you withdraw over a number of years, helping to reduce the overall amount of tax you pay.

Money Purchase Annual Allowance

There are potential tax implications of continuing to pay into a pension if you have taken taxable income from a Defined Contribution scheme. This is known as the Money Purchase Annual Allowance (MPAA).

The MPAA limits the amount you (or any employer or third party) can pay into a pension to £4,000 per annum. Exceeding this value will create a personal tax charge.

HOW ARE PENSIONS TAXED UPON DEATH

Pension planning can not only help you build up your funds to provide more for you at retirement, but can also help to pass on savings to your loved ones in a tax-efficient manner when you pass away.



If you die before you have taken everything from your pension pot, the remaining value will usually be paid as a lump sum to your beneficiaries.

If you die before age 75 then your entire pension pot can be paid to your beneficiaries tax-free and they can choose to take it as an annuity, a lump sum or through beneficiary drawdown. Whereas, if you die aged 75 or older, your pension pot can be paid to your beneficiaries either as a lump sum or through beneficiary drawdown, or an annuity, but all payments will be subject to Income Tax at their marginal rate.

Which death benefits are paid very much depends on how these plans were set up at outset. Some annuities include a guaranteed pension period, typically 5 or 10 years. If you die before the end of the guaranteed period, the balance of any pension income (annuity) due continues for the remainder of the term.

Inheritance Tax

Inheritance Tax (IHT) can apply to any property, money and belongings you pass on, however, it does not usually apply when you pass on your pension fund. This is because, unlike other investments, your pension is not part of your taxable estate.

This means it is very tax-efficient to keep your savings in a pension fund and pass it down to future generations, should your estate be liable to IHT. However, any money you take out of your pension (such as PCLS, or income) becomes part of your estate and is subject to IHT.

HOW ARE PENSIONS TAXED UPON DEATH

There are a variety of factors that can impact what happens to your pension when you die, such as: your age when you die; the type of pension you hold; your beneficiaries; and additional rules.

Annuities

You can choose to have an annuity which has a guaranteed period, meaning payments are guaranteed until the end of that period, even if you die before then. If you bought an annuity that provides for a dependant or nominee, they will receive a dependant's annuity if they are still living after you have died, and will be paid for the rest of their life. If you die before age 75, the annuity payments will be tax-free, however, if you die after age 75 then any payments will be taxed as income at their marginal rate. In all other cases, no further payments are made after your death.

Joint Annuity

These ongoing payments continue to your spouse, for their entire lifetime after you die. When your spouse dies, the income ceases and cannot be left to continue to anyone else (such as children or grandchildren).

Capital Protected Annuity

Also known as a 'value protected' annuity. Your beneficiaries inherit a lump sum, being the value of your initial pension pot less the amount of any annuity payments you took before you died.

Flexi Access / Drawdown Plans

This is a popular and relatively new type of pension plan, introduced during the advent of 'pension freedom' legislation in April 2015. It is a way of using your pension pot to provide you with an income. There is no limit on how much income you can choose to take from your drawdown funds.

The income you get will vary, depending on the fund's performance and how much you withdraw from the pot. This means that your income is not guaranteed for life.

In the event of your death, it is possible to nominate anyone, not necessarily a dependent, to benefit and inherit the remaining pension funds.

Your nominated beneficiary then has three options:

1. Take this amount as a one-off lump sum;
2. Use the remaining pension pot to purchase an annuity, which is guaranteed income for life;
3. Keep the pension pot invested in drawdown to continue taking an income.

This Drawdown option offers a new intergenerational planning avenue where individuals can pass their remaining pension pots to not only their spouse but also grown-up children, grandchildren and in fact anyone else they wish to benefit. As the remaining funds are held within a pension wrapper the inherited pension pot remains outside the estate for IHT.

CASE STUDY: PENSIONS FOR BUSINESS OWNERS

Aside from the valuable National Insurance Contribution savings for both employee and employer, business owners may also be able to utilise pension savings further to reduce Corporation Tax.



Our client, Bryan, owns a business that has been in his family for several generations and, since taking over, he has increased profits by implementing a number of streamlining efficiencies to their processes. Whilst this offered initially attractive dividends to him as the sole shareholder, increasing income payments was actually quite costly to the business from a tax perspective.

Therefore, he came to his adviser looking for alternative solutions to increase the tax efficiency of the business using these increased profits.

Firstly, his adviser reviewed the family expenditure and income requirements which highlighted a) that he was 5 years away from his retirement goal b) his children were older and no longer required the same level of financial support and c) his mortgage had

recently been paid off. Therefore, they focused on optimising plans for his upcoming retirement goals.

Bryan had been contributing the same amount (£200 per month) into his pension for the last 10 years, regardless of any increase in business profitability. Therefore, his adviser suggested that making a large single contribution for the current tax year would help to reduce Corporation Tax for the company, as well as reducing his personal Income Tax liability - as this would also be subject to dividend taxation if it was taken as income.

Using what is known as 'carry forward', the way of looking back at the previous 3 tax years to benefit from using any unused Annual Allowance, the maximum amount to pay in could be calculated.

CASE STUDY: PENSIONS FOR BUSINESS OWNERS

Is your pension working in the most tax-efficient way? Reviewing your plans with an Independent Financial Adviser could prove beneficial to not just your income at retirement, but also your business.



Tax Year	Annual Allowance	Payments in	Unused Allowance
2020/21	£40,000	£2,400	£37,600
2021/22	£40,000	£2,400	£37,600
2022/23	£40,000	£2,400	£37,600
2023/24	£60,000	£2,400	£57,600
Total Allowance Carried Forward			£170,400

The table above shows Bryan's unused Annual Allowance, therefore he could have made a payment of £170,400 into his pension in the 2023/24 tax year (allowing for the 'wholly and exclusively' rules). If this was not used in this way, it would have been subject to Corporation Tax at 25%, and therefore this creates a further saving of £42,600.

Also, if Bryan had taken this as a dividend instead then he would have to pay a further 33.75% in Dividend Tax (as a higher rate taxpayer), totalling £57,510. This then generated a combined saving of £100,110.

By working with his trusted Independent Financial Adviser on a plan based on his individual circumstances, not only did Bryan reduce the Corporation Tax bill for the company, but by utilising unused allowances Bryan could also save more for retirement and put those profits to further use in a tax-free environment, without any Capital Gains or Income Tax (as the Lifetime Allowance tax charge was currently 0% and in the 2023/24 tax year there was not a Lifetime Allowance).

SEEKING TRUSTED ADVICE

Your pension savings play a huge part in the lifestyle you can afford to live at retirement, therefore it is important that you understand and make the best use of this to provide more for you later in life.



Pension planning is a complex area due to the taxation considerations, investment decisions and various allowances involved, therefore it is wise to seek expert advice to make informed decisions based on your individual circumstances.

Look out for our 'Managing Your Pension' guide for more information on this topic.

If you would like to discuss the tax-efficiency of your own pension arrangements or have any questions for our trusted Independent Financial Advisers, please do not hesitate to get in touch using the details opposite.

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