

## RETIREMENT PLANNING

### INTRODUCTION

When you retire, you will still need an income to meet the lifestyle you have planned - for a long time. People are living longer and enjoying better health than their forefathers.

One way of determining how much income you need is to work out the likely expense of household bills and add to this your lifestyle choices, such as travelling, hobbies and entertainment. Another way is to determine what outgoings you will *not* have in retirement, such as travelling to work, and deduct these from your current income requirements. Either way most of us live up to our income and that is likely to form the basis of your needs in retirement.

The state makes some contribution to this in the form of a basic pension and, if you qualify, for supplementary pensions or benefits. The basic state pension is equivalent to about 19% of average earnings\*, so is well below the defined poverty line. The ratio of those in retirement to those in work is getting greater; therefore fewer people are supporting the state pension through National Insurance contributions. This means it is getting too costly for the taxpayer so state benefits are likely to reduce.

Most people therefore need to supplement the state pension to maintain a reasonable standard of living in retirement.

Saving for retirement does not have to be through pension schemes but their accompanying tax benefits make it worthwhile for pensions to be included in your financial planning. Pension schemes are available either through your company, by taking out a personal pension or both.

\*Office of National Statistics October 2008.

### WHY HAVE A PENSION?

Contributions to pensions schemes attract tax relief. For a private individual this means tax relief at the highest rate of tax they fall under at the time. For a high rate taxpayer, an investment of £1,000 will only require a net outlay of £600. That's an immediate return of 66.6%. For a basic rate taxpayer, an investment of £80 per month means £100 going into the pension fund, an immediate return of 25%. The investment fund itself also has certain tax advantages, which means that the growth of the fund might be greater than the equivalent in another type of investment fund.

As pension contributions enjoy tax benefits, the government limits how much you can put in at a time.

### PENSIONS SIMPLIFICATION

On the 6th April 2006 major changes were introduced to the structure of UK Pension schemes. The new simplified regime is largely a replacement of past pension rules as opposed to adding another layer of legislation. Many changes were introduced, some of the main ones are as follows:-

#### Introduction of a Lifetime allowance

Each member of a pension scheme has a maximum permitted tax-exempt fund at retirement. Initially this lifetime allowance is £1.65 million per person (2008/2009 tax year), but will rise year by year to £1.8million in (2010/2011 tax year)

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#### Contributions & The Annual Allowance

An individual can now contribute up to 100% of their earnings or £3,600 whichever is the greater. There is now an annual allowance limited to £235,000 (for the 2008/2009 tax year), but rising to £255,000 by 2010/2011 tax year, for all pension schemes. Tax relief is given on this annual allowance.

#### Pension Commencement Lump Sum (Tax Free Cash)

The maximum Tax Free Cash from any pension arrangement is normally 25% of the value of the pension rights, although in some circumstances a higher amount may be taken.

#### Retirement Age

The concept of a normal retirement age is less definite than it was in the past. Members of pension schemes can choose (within certain age ranges) when to take their benefits, making the process of retiring more flexible. The minimum age for drawing benefits will rise from 50 to 55 years with effect from 6th April 2010, (subject to some transitional rules)

#### Death Benefits

The maximum lump sum death benefit is equal to the lifetime allowance so initially this will be £1.65 million (2008-09).

#### **COMPANY SCHEMES**

There are two main types of company scheme (or occupational pension scheme):

- Final Salary – sometimes called defined benefits
- Money Purchase – otherwise known as defined contributions

Final Salary schemes calculate your pension from the number of years you have been in the scheme, and a fraction of your earnings in your final year of employment. For example if you earned £36,000 in your final year after 20 years of service and the fraction was 1/60<sup>th</sup> the pension would be £12,000. This would normally be on top of the state pension. Final salary pensions usually increase in line with inflation but might be limited to a maximum percentage increase each year.

A Money Purchase Scheme is where the company deducts money from your salary and this is invested in a pension on your behalf. The amount of the pension received on retirement will depend on the value of the pension fund and the cost of a lifetime annuity on retirement. An annuity is where you use capital to purchase an income. Types of money purchase schemes include

Stakeholder Pensions – see below,

Small Self-Administered Schemes – a company scheme where the members are usually all company directors or key staff. ,

Executive Pension Schemes – designed especially for directors, senior executives and people who own their own businesses.

Group Pensions – low cost personal pension plans bought by groups of employees arranged through their employer.

Your employer may make a contribution to your occupational pension scheme in addition to deducting a percentage of your salary and paying it into the scheme. You may make extra contributions to your occupational scheme to boost your pension provision up to a maximum of the annual allowance. Tax relief is available on pension contributions of up to 100% of your taxable earnings. (You may contribute more than your taxable earnings but no tax relief will be given on payments above that amount).

#### **PERSONAL PENSION PLANS**

Personal Pension Plans (PPPs) were originally designed for the millions of employed & self-employed individuals who did not have access to a company pension scheme.

Introduced in July 1988, they were part of a government push to extend pension choice & encourage those people not in company schemes to build up a retirement fund; one that could cater for their retirement needs more realistically than the state. Many financial institutions offer PPPs, though most are run by the large insurance companies and banks.

We can research the whole market on your behalf to find a suitable pension plan. These plans can be set up for non-working spouses and even children and grandchildren where up to £3600 can be invested annually.

Other types of Personal Pensions include Stakeholder and Self-Invested Pension Plans (SIPPs). SIPPs allow you to choose your own investments, with certain restrictions, rather than only having the options offered by a pension company.

A Personal Pension Plan is really just a long term savings plan that is designed to produce a fund at retirement. At retirement provision can be made to protect your pension from the eroding effects of inflation, protect your income in the event of your death and make provision for your spouse or dependants.

#### **STAKEHOLDER PENSIONS**

A Stakeholder pension is a form of low cost personal pension aimed at encouraging those people who do not currently have pension provision to save for their retirement. They became available on 6th April 2001. They are not a form of state pension. In order to reach as wide an audience as possible, Stakeholder pension schemes are intended to be flexible and easy to understand. Employers with 5 or more employees have had an obligation to provide their employees with access to a stakeholder pension scheme since 8th October 2001, although it is not compulsory to save for retirement with a Stakeholder Pension plan or any other savings related product.

Stakeholder pension plans are privately managed and funded but must operate within a standard framework laid down by the Government.

Stakeholder pensions will be replaced by personal pension accounts.

#### **AT RETIREMENT**

On reaching retirement, you use the money that has built up in your personal pension to purchase benefits. These benefits can be taken in the form of either income or income with a tax free lump sum. Alternatively, the benefits can be transferred to another type of plan which provides unsecured pension benefits. These types of plan allow additional flexibility in that pension benefits can be drawn whilst your pension fund remains invested. Benefits can currently be drawn from age 50 onwards (age 55 from 2010)

The value of your pension at retirement is mainly dependent upon:

- How much money you've paid in over the life of the plan
- How well the money has grown
- The annuity rate that the provider applies to your pension fund (if you choose to take an annuity)
- Level of tax free cash taken.

#### **DRAWING YOUR PENSION**

Retirement income is now classified under 4 main headings:-

- 1) Scheme Pensions - typically, drawing your income directly from your employer's occupational pension scheme.
- 2) Lifetime annuities - taking your income as an annuity - associated with drawing income from personal pension / Stakeholder pension type schemes
- 3) Unsecured pension - Pension Fund Withdrawal / Income Drawdown and Phased retirement
- 4) Alternatively Secured Pensions - A type of income withdrawal that is only available from age 75

#### **ANNUITIES**

Annuities are used to provide an income. The pension lump sum is exchanged for a pension income guaranteed for life. Once the annuity has been bought, the income is fixed and the contract cannot be reversed - the pension lump sum becomes the permanent property of the annuity provider.

The level of income that you will receive from an annuity depends upon several main factors:

- The level of Investment
- Age of 'annuitant'
- Health
- Sex
- The prevailing annuity rates at the point of annuity purchase

In general, the older an annuitant the higher the income which can be secured. Furthermore males usually receive a higher income than females due generally to having a shorter life expectancy.

#### **GETTING EXPERT INDEPENDENT ADVICE**

Financial planning is about balancing the needs of today with the needs of tomorrow. Your financial adviser will help you determine the best pension option and calculate the optimum contributions you can make. Likewise, the best form of pension in retirement will depend on the level of investment and your income needs. By having access to the whole of the market place for pension investments and annuities, your financial adviser is there to help you get the most from the time of your life when you should be able to relax and enjoy yourself.