

Maximising pension contributions

Outline

Most employees pay in regularly to a workplace pension plan, with minimum contribution levels by the employer and employees prescribed by auto-enrolment rules. Pension contributions attract tax relief at your marginal rate of income

tax, up to certain limits. As well as offering tax savings, topping up your pension can significantly enhance your retirement provision. This factsheet covers key considerations, as well as potential pitfalls.

Tax relief on pension contributions

The contributions you make into your pension are deductible against income tax. Basic rate taxpayers save 20% tax on their contributions, and this also extends to non-taxpayers, such as children. Higher and additional rate taxpayers receive tax relief of 40% and 45% respectively. Those in the ‘personal allowance trap’ who earn between £100,000 and £125,140 receive 60% tax relief, as illustrated by the example below.

The effective tax rate is 60% on earnings between £100,000 and £125,140. By making a pension contribution you can regain some, or all, of your £12,570 personal allowance and reduce your income tax bill. For example, as the table below il-

lustrates, a taxpayer could opt to contribute £25,000 via salary exchange (also known as salary sacrifice) into their pension and achieve £15,000 tax savings. Through a salary exchange arrangement, your employer pays this directly into your pension before you pay income tax or National Insurance on the contribution. You can also make personal pension contributions – outside workplace pension schemes – but you only receive basic rate tax relief automatically (£5,000 in the below example). Higher and additional rate taxpayers must claim the remaining tax relief through self-assessment, which is often overlooked.

Pension contributions can cut your tax bill

Example: UK taxpayer with £125,000 adjusted net income prior to extra pension contributions; figures rounded.

	Present	With pension contribution
Net income	£125,000	£125,000
Pension contribution	- ¹	-£25,000 ²
Adjusted net income	£125,000	£100,000
Personal allowance	0	£12,570
Income tax liability	£42,400	£27,400

- 1 Existing pension contributions need to be included
2 Gross pension contribution, including basic rate relief

–£15,000

Tax relief for business owners

Business owners/controlling directors can choose to pay pension contributions through their business. Employers are usually eligible for tax relief against corporation tax (if the employer is a limited company) or income tax (if the employer is a sole trader or a partner). Various rules apply regarding allowable deductions, in particular for controlling directors or related parties.

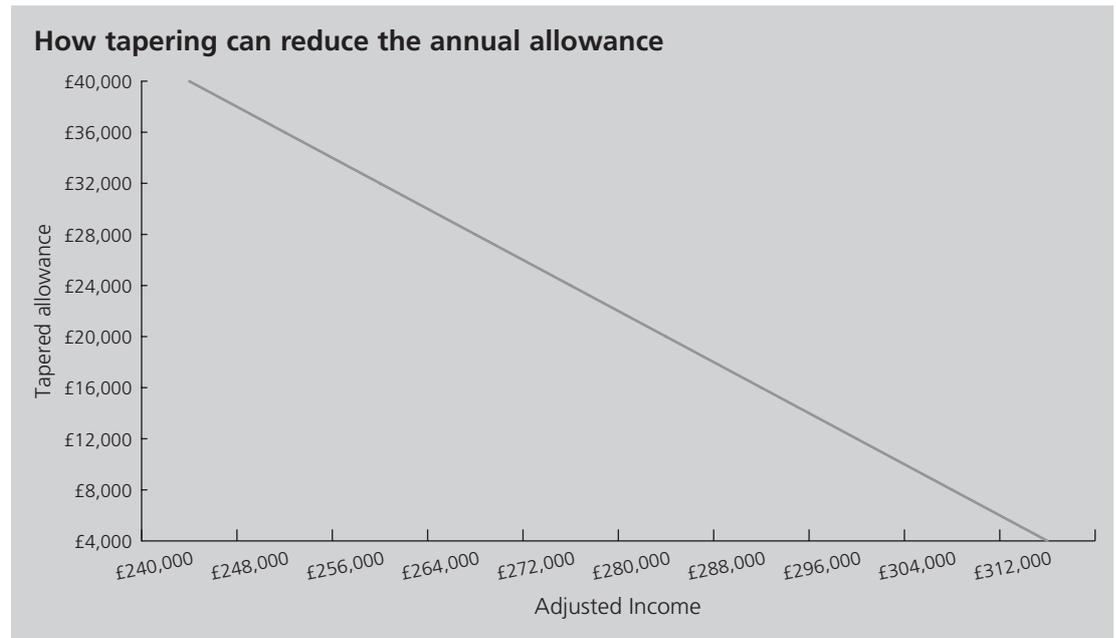
It is usually accepted that employer pension contributions are paid ‘wholly and exclusively’ for

business purposes if the remuneration package is comparable to unconnected employers performing similar duties. The remuneration package includes employer pension contributions, salary, bonus, and benefits in kind. Dividends are not included. The tax relief on large employer contributions may be spread over more than one accounting period.

Avoid the tapered annual allowance trap

Extra care is needed for certain high earners, who may be subject to a tapered annual allowance. An annual allowance charge would be payable if your pension contributions exceed your allowance. This could be impactful if you make your pension contributions through salary sacrifice and then have to pay tax out of your remaining disposable income. To assess whether your annual allowance is subject to tapering it's necessary to calculate your threshold income (broadly speaking 'net income' excluding pension contributions) and adjusted income (adding all pension contributions, including employer contributions).

The annual allowance is reduced by £1 for every £2 of adjusted income over the limit of £240,000. A minimum annual allowance level of £4,000 applies to those who are earning over £312,000, and people who have taken a flexible income from their pension pot. When considering potential carry forward from the 2018/19 or 2019/20 tax years the relevant threshold and adjusted income levels (£110,000 and £150,000 respectively) need to be taken into account. Rules and calculations around the tapered annual allowance are complex, so advice from a professional can help to provide clarity.



Carry forward

Certain taxpayers may be eligible to make increased pension contributions in a tax year by carrying forward any unused annual allowances from the three previous tax years. You must use the annual allowance in the current tax year first, before using carry forward from prior years. Carry forward from 2018/19 must be used in the

2021/22 tax year, or it will be lost forever. The table below illustrates how carry forward works in practice. In this example, the pension saver could make a lump sum contribution of £60,000 in total (£15,000 from the current year, plus £45,000 carry forward from unused annual allowances in the 2018/19 and 2020/21 tax years). You will

Make substantial tax savings with carry forward

Example: Taxpayer in England; £10,000 annual pension contribution by employer.

	Earnings	Tapered annual allowance	Pension contributions made ¹	Annual allowance remaining
2018/19	£120,000	No ²	£15,000	£25,000
2019/20	£160,000	Yes	£30,000	None
2020/21	£140,000	No	£20,000	£20,000
2021/22	£150,000	No	£25,000	£15,000
				Total £60,000

¹ Employee and employer contributions
² Assuming adjusted income was below £150,000

only be eligible to take advantage of carry forward if you have been a member of a registered pension scheme in a given tax year. Carry forward is not

available if you have already started taking pension benefits.

Boost your retirement provision and returns

Topping up your pension can significantly enhance your funds in retirement, as the below example illustrates. Available tax relief often enhances the return of additional pension contributions. Your pension does not form part of your

estate, so it is not subject to inheritance tax of 40%. Defined contribution pots can also be passed on to your beneficiaries in line with your wishes. No income tax is due in the event of death before age 75.

Enhance your retirement provision

Example: 50-year-old higher rate taxpayer with a £400,000 pension fund; £150,000 annual earnings; 8% total contributions per year (employee and employer).

	Without lump sum contribution	With lump sum contribution
Pension assets at age 50	£400,000	£400,000
Lump sum contribution		£60,000
Tax savings through lump sum contribution		£29,000
Net cost (after tax savings)		£31,000
Pension assets at age 65	£1,010,000	£1,120,000
Tax-free cash (25%)		£27,500
Pension income net of tax (40% tax rate assumed)		£49,500
Net increase thanks to pension top-up		£77,000
Annual return ¹		6.3%

¹ Assumption: No lifetime allowance excess charge

Tailored pension investments

Many people often have multiple pensions featuring investments that haven't been managed or updated to reflect their risk profile. Others are invested in default funds chosen for them by the pension scheme, but these rarely match their personal circumstances, retirement plans, investment horizon and risk tolerance. Lifestyle or 'target

date' retirement funds, another popular investment vehicle, typically transition from growth to defensive assets as your stated retirement date approaches. However, this may not necessarily be consistent with your personal circumstances (circumstances can change) and how you intend to use your pension assets.

Checklist

- How much can you pay into your pension? Are you eligible to make use of carry forward?
- Can you reduce your tax bill through pension contributions?
- How does a pension compare against other investments/tax wrappers?
- Do your pension investments reflect your risk profile and retirement provision goals?
- Are you considering lifetime allowance implications?
- Are you subject to a tapered annual allowance?
- Are you making use of tax relief if you're a business owner?

Lumin pension planning

Retirement planning sets you up for the next stages of your life. There are important decisions to get right, and it is always good to plan early.

Speak to a Lumin expert for professional and independent advice about your pension contributions and boosting your retirement provision.

In expert hands
with Lumin

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