

Tax-saving tips for pensions

Outline

The government provides an array of generous tax incentives to encourage you to invest in your pension. This factsheet outlines the various tax benefits, as well as the key pitfalls to be aware of. A

professional financial plan that optimises pension contributions provides peace of mind, and can also save you thousands of pounds in taxes each year. Is it time to review your pensions?

Key tax breaks and pitfalls		
	Tax breaks	Potential pitfalls
Pension contributions	<ul style="list-style-type: none"> Tax relief on contributions 	<ul style="list-style-type: none"> Tapering of allowance to £10,000 (due to high earnings or taking pension income)
Inheritance tax (IHT) considerations	<ul style="list-style-type: none"> Pensions can currently be passed on to children free from IHT (until April 2027) 	<ul style="list-style-type: none"> The 25% tax-free lump sum entitlement is lost on death, as the funds are fully 'crystallised'
Other tax aspects	<ul style="list-style-type: none"> Tax-free investment growth Tax-free cash lump sum (25%) available 	<ul style="list-style-type: none"> 75% of pension withdrawals are subject to income tax

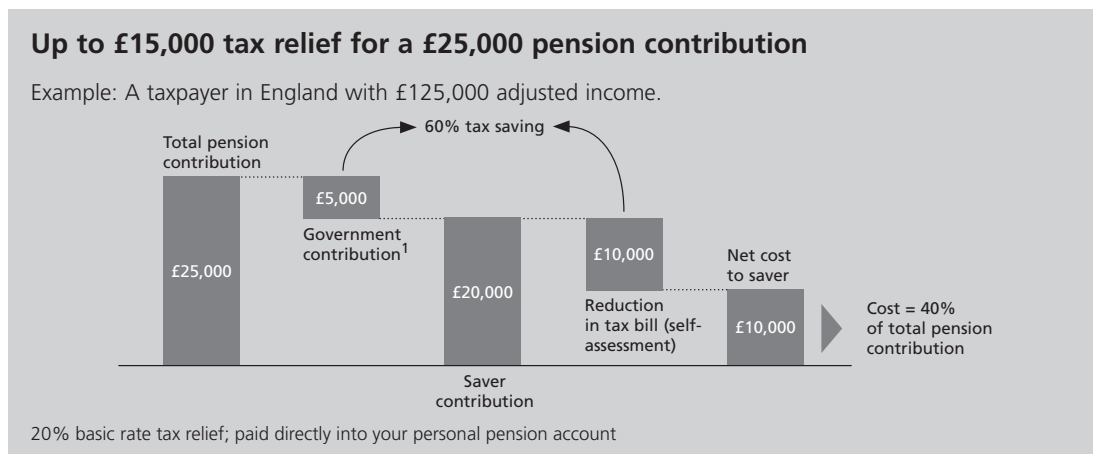
Tax relief on contributions

The contributions that 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 too. That means even those who don't pay tax still get tax breaks on contributions. Pensions for children is a good example of this.

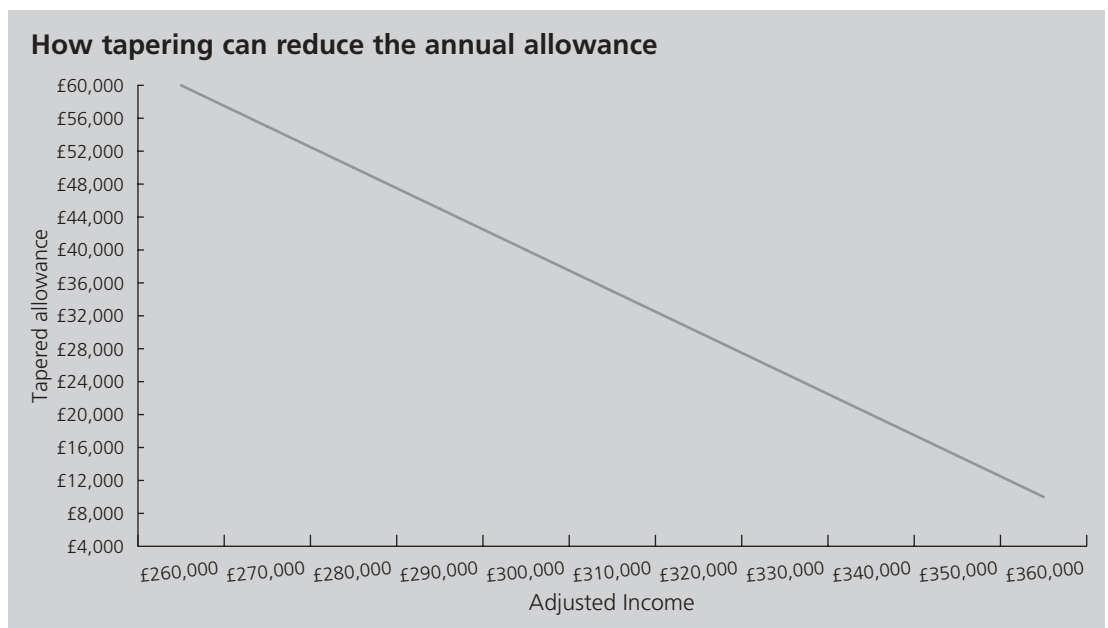
Higher and additional rate taxpayers benefit from tax relief of 40% and 45% respectively. Those in the 'personal allowance trap' who are earning between £100,000 and £125,140 receive 60% tax relief, as illustrated below.

Pension contributions from your employer are an additional benefit for employees, and are also deductible against corporation tax for employers and business owners.

A taxpayer with £125,000 adjusted income could contribute £20,000 into a pension, and the government would add £5,000 (basic rate relief), giving a total of £25,000. In addition, you can claim a further £10,000 of tax relief via self-assessment as a higher rate taxpayer. The overall saving is £15,000 (£5,000 + £10,000), so a £25,000 contribution only costs £10,000 net in this case.



Tax-free growth	The money in your pension pot is not subject to tax on interest, dividends, or capital gains. This means your money is growing tax-free for as long as it is inside your pension. This is particularly important over long periods, due to the 'snowball'	effect of compounding as your pension grows. Given many people have pensions for several decades this is a significant benefit. £10,000 compounding at 6% tax-free annually will grow to over £180,000 pounds in 50 years' time.
Tax-free cash	<p>When drawing your pension in retirement 25% can be taken tax-free. This can be done as a lump sum, or in smaller amounts over many years. For example, a £400,000 pension holder can take £100,000 as a single tax-free lump sum, or withdraw £5,000 a year tax-free over 20 years.</p> <p>The remaining 75% of your pension withdrawals are subject to income tax. Typically, tax rates are lower in retirement, with many only paying basic rate tax. The tax-free personal allowance, which is £12,570, is also still available for pension income.</p>	<p>Example A: Pension income of £16,000 a year: £4,000 (25%) is tax-free, and £12,000 (75%) is taxable. If this is your only income then it falls within your personal allowance, so no tax is due.</p> <p>Example B: Pension income of £40,000 a year: £10,000 (25%) is tax-free, and £30,000 (75%) is taxable. If this is your only income, £12,570 falls within your personal allowance, and the remaining £17,430 is subject to basic rate income tax at 20%. The total tax due is £3,486 (~9% of pension income of £40,000).</p>
Pensions and IHT	From April 2027 unused pension assets will form part of your estate for IHT purposes (unless they are left to a spouse or civil partner). The exact details of the proposed rule change are yet to be	finalised, but this change is likely to have a significant impact on retirement and estate planning for many savers. Those with handsome pension assets will need to plan accordingly.
Don't forget to claim your pension tax relief	Despite the generous tax treatment of pensions, many people miss out on the full benefits and pay more tax than they need to. This is because many higher/additional rate taxpayers need to claim tax	relief from HMRC via their tax return. You have up to four years to reclaim this tax, so it is well worth double-checking if this applies to you.
Common pitfalls: Be aware of your allowances	Because the tax treatment of pensions is so favourable, penalty charges may apply if the rules are not followed closely. Tax-privileged pension	contributions are capped by an annual allowance, which is £60,000 for most people, except some higher earners (see chart below).
Avoid the tapered annual allowance trap	Extra care is needed for certain higher earners, who may be subject to a tapered annual allowance. A tax charge would be payable if pension contributions exceed your allowance. This could be impactful if you make your pension contribu-	tions via 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).

applies to those who are earning over £360,000, and people who have taken a flexible income from their pension pot.

The annual allowance is reduced by £1 for every £2 of adjusted income over the limit of £260,000. A minimum annual allowance level of £10,000

Rules and calculations around the tapered annual allowance are complex, so advice from a professional can help to provide clarity.

Carry forward

The standard allowance for annual pension contributions is £60,000. 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.

years. Carry forward from the 2021/22 tax year must be used before 6 April 2025, or it will be lost forever.

Various eligibility rules apply. You must use the annual allowance in the current tax year first, before using carry forward from prior tax years, starting with the earliest of the available three

You will 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.

Lifetime allowance (LTA)

The lifetime allowance (LTA) of £1,073,100, the maximum amount that could be saved into pensions without incurring extra tax, has been abolished. The 25% or 55% tax charge on amounts exceeding the LTA threshold was removed from 6 April 2023. Savers with large pensions can continue, or resume, payments into their pension – and benefit from the tax relief on their contribu-

tions – without the risk of exceeding the LTA on certain occasions. The tax-free cash lump sum entitlement will remain at £268,275, which is 25% of the original lifetime allowance. However, savers who benefit from fixed protection can pay into their pension again and won't be subject to the £268,275 cap, meaning they will benefit from their higher tax-free cash entitlement.

Lumin retirement planning

There are important decisions to get right, and it is always good to plan early and help to ensure a worry-free retirement. Speak to a Lumin expert for professional, independent advice around State and private pensions, ISAs and investments, in-

heritance and tax planning, and financial protection for yourself and your loved ones. A holistic financial plan helps to provide an overall strategy to coordinate key decisions, balance your priorities, and achieve your goals.

In expert hands with Lumin

Lumin is a leading independent financial adviser headquartered in St Albans, with particular reach across London and the South East. We offer trusted and professional advice on pensions and retirement, investments, inheritance and tax planning, financial protection for individuals and businesses, and mortgages. Lumin's financial plans are geared toward growing, or protecting, wealth by optimising our

clients' income, assets, tax burden and financial security. Whatever your financial ambitions, you can count on our expertise to provide peace of mind. We are backed by VZ Group, the leading independent financial services provider in Switzerland.



Financial advice made easy: Scan the QR code to arrange a complimentary meeting over a coffee.

London | St Albans
info@luminwealth.co.uk
www.luminwealth.co.uk
03300 564 446

5 Sandridge Park
Porters Wood
St Albans
AL3 6PH

Cornwell House
21 Clerkenwell Green
London
EC1R 0DX

Heath House
51 Dane Street
Bishop's Stortford
CM23 3BT

4 Pauls Hill
Penn
High Wycombe
HP10 8NZ

This document is for general information only. It does not constitute advice or (by itself), a basis for any financial decision. You should only make such decisions based on your individual circumstances and, we recommend, with advice from a suitably qualified and regulated financial adviser. Whilst we endeavour to be accurate, Lumin Wealth does not accept responsibility for any inaccuracies in this document or for any loss that may result from reliance on it, but this disclaimer does not affect our responsibilities or your rights under the Financial Services and Markets Act 2000. Any financial projections in this document are provided for illustrative purposes only and should not be regarded as predictions. Past performance is not a guide to future returns. The value of investments may fall as well as rise and you may get back less than you invested. Tax treatment depends on your individual circumstances and rules may change. Lumin Wealth Limited is authorised and regulated by the Financial Conduct Authority, or FCA, (under registration number 775068). It is a limited company registered in England and Wales under company number 03381115. Copyright: No part of this publication may be reproduced or transmitted in any form without the prior permission of Lumin Wealth. The FCA does not regulate tax and estate planning.