A guide to Personal Pensions

What is a personal pension?

A personal pension is essentially a savings plan for retirement that has certain advantages over other forms of savings.

Who is eligible?

Any individual that is considered as a 'relevant UK Individual' can contribute to a personal pension providing they satisfy the following criteria.

- Are under the age of 75 (includes children)
- They have relevant UK earnings chargeable to income tax (patent Income, royalties, self-employed or employed earnings)***
- Have been resident in UK at some time during the tax year.
- Are exempt due to a double taxation agreement.
- Has been resident in the UK at some time during the previous 5 tax years and also when they became a member of that scheme (The maximum contribution for tax relief purposes is restricted to £3,600)
- The individual or their spouses has earnings in the tax year from an overseas Crown employment that is subject to UK tax.
- An individual who does not satisfy these requirements can contribute to a pension but will not receive any tax relief.

*** An individual of any age can become a member of a personal pension irrespective earnings. However, the maximum contribution is restricted to £3,600 gross per annum (£2,880 net of basic rate tax, see below). Therefore, a husband can pay a pension contribution for his wife and/or children.

How much can you pay into a pension?

Rules apply to the maximum amount that someone can contribute into a personal pension and receive tax relief, and these are as follows:

- Anyone including those with no income can contribute a maximum of £3,600 gross per annum, which is paid net of basic rate income tax. This means that even a non-taxpayer can still receive tax relief on this level of contribution.
- Basic rate tax relief is automatically given at source, and this means that if you contribute £80, the Inland Revenue will add a further £20 to that contribution. Higher rate and additional rate taxpayers can currently claim further tax relief through their self-assessment tax return.
- The maximum contribution is restricted to the lower of £60,000 gross per annum or 100% of your salary if employed, net profit if self-employed. If you are a company director, please seek advice.

When can you take your pension benefits?

Under current legislation the benefits from a personal pension can be taken at anytime between the ages of 55 and 75. Up to 25% of the fund value can be taken as a tax-free lump but the remainder must be used to provide for a retirement income. This can be in form of annuity purchase or income fund withdrawal (please see individual fact sheets). Please note that the minimum pension age is increasing so that benefits cannot be taken until age 57 effective from 06.04.28.

Taxation benefits

Pension plans have the following tax benefits.

- All growth within a pension fund is free of capital gains tax.
- The fund grows largely free of income tax.
- You currently receive tax relief at your highest marginal rate on contributions.
- A maximum of 25% of the fund can be taken tax-free.
- On death before retirement, the benefits from a personal pension are normally free from inheritance tax.

Annual Allowance

An individual can contribute a maximum of 100% of their gross earned remuneration (to a maximum of the annual allowance) and receive full tax relief on that contribution. The current annual allowance is £60,000 gross. You may also be able to carry forward unused pension contributions allowances from previous years but should seek advice before proceeding.

Lifetime Allowance

Under pension simplification, rules were introduced in April 2006, for a lifetime allowance, to cap the amount of money someone can hold within their total pension arrangements (excluding state benefits but including final salary pensions).

In the spring 2023 budget the Chancellor of the Exchequer announced the abolition of the Lifetime Allowance from April 2023.

Types of Personal Pensions

Different types of personal pension plans are available and are as follows.

- Stakeholder pension
- Personal Pension plan
- Self Invested Personal Pension (SIPP)
- Group Personal Pension

Stakeholder Pension Plan

Stakeholder pensions are required to meet a number of conditions set out in legislation, including a cap on charges, low minimum contributions, and flexibility in relation to stopping and starting contributions. The maximum charge on these schemes is 1.5% per annum for the first 10 years and then 1% per annum thereafter. There can be no penalty on exit or entrance to the scheme, and the minimum contribution is £20 per month. However, payments can be stopped at any time and a single contribution of £20 is enough to open a plan. As a result of the lower charges many providers offer a limited number of funds.

Personal Pension Plan

A personal pension plan will normally offer a greater range of investments and funds that can be used for investment purposes, as a result the charges levied by a personal pension provider maybe more than those levied by a stakeholder pension.

Self-Invested Personal Pension (SIPP)

Typically, a SIPP is the most flexible form of personal pension, it has no cap on charges and therefore will typically be more expensive than a Stakeholder pension. Depending upon the provider you will have access to a much wider range of permitted investments which can include individual listed shares, exchange traded funds, unlisted shares in companies. Some SIPPS also allow you to purchase commercial property and may be able to provide loans to your business if applicable.

Group Personal Pension Plan

Group personal pensions (GPPs) are a type of pension which some employers offer to their workers. In a sense it is just a collection of personal pensions held under the name of the sponsoring employer. Everyone has their own segregated pension, to which the employer will typically contribute, and the employee can contribute. Where an employee contributes, this is taken from their salary and paid into the fund along with any employer contribution. The employee can choose to invest in a range of funds specified by the product provider. If they leave the sponsoring employer, the pension can move with them.

Auto enrolment

Auto enrolment is a government initiative that requires each employer to put their staff into a workplace pension, the main details are as follows:

Employers must 'auto-enrol' their qualifying employees in the workplace pension. Qualifying employees are those that:

- are aged between 22 and State Pension age.
- earn more than £10,000.00 a year.
- You usually work in the UK.

Employees will contribute a set percentage of their pay into the pension. The employer, along with the government, will also contribute a set percentage to the employee's pension pot.

The current contributions are 4% from the employer, which attracts a further 1% in tax relief and 3% from the employer. Pay may be defined in several ways and you should check with your employer to see which definition they have used.

Alternative schemes such as final salary or group personal pensions can still be used by employer, providing they meet certain criteria.

If you are eligible for a workplace pension, you should consider joining this first.

Money Purchase Annual Allowance

If you have taken or decide to take flexible benefits which include income, from your **personal pensions**. This then restricts the amount you contribute to personal pensions. The maximum amount is restricted to £10,000 per year. (Income from annuities or final salary pensions are excluded). Taking tax-free cash from the fund is excluded. The money purchase annual allowance will only start to apply from the day after you have taken flexible benefits and affects no previous contributions made.

Notes

*This information is a brief guide on Pensions and in no way constitutes a recommendation or any form of advice and was correct as at 26th May 2023 and based on our current understanding of legislation. Please contact us for further details on 01372 371030. The information contained in this booklet is not to be used by any third parties without our express permission.