Emerald ACCOUNTANCY SERVICES

Save tax by making pension contributions

There are generous tax benefits available if you pay into a private pension fund. You can claim tax relief for contributions made subject to the overriding limits listed below and benefit from tax relief at the highest rate of Income Tax you pay. This makes building a pension pot a very tax-efficient way to save for your retirement.

- A basic rate taxpayer receives 20% pension tax relief, usually deducted by your pension provider from the contributions you make.
- A higher rate taxpayer can claim a 20% top-up and benefit from 40% pension tax relief.
- An additional rate taxpayer can claim a 25% top-up and benefit from 45% pension tax relief.

Claims for higher rate and additional rate top-ups are usually made on an annual tax return.

As Income Tax rates in Scotland are different to those levied in the rest of the UK, the benefits will be different to those listed above.

How your pension fund will grow

Due to the present, generous tax status of pension contributions, your pension fund will grow by more than the actual cash you pay into your fund. For example:

- Basic rate taxpayers paying £80 into their fund will receive a £20 tax top-up, total invested £100.
- Higher rate tax payers paying £80 into their fund will receive the initial £20 top-up plus a further £20 reduction in their tax bill. This means they have effectively paid out a net £60 but will still benefit by a £100 invested in their pension fund.
- Additional rate tax payers paying in £80 into their fund will receive the initial £20 top-up plus a further £25 reduction in their tax bill. This means they have effectively paid out a net £55 but will still benefit by a £100 invested in their pension fund.

Again, these benefits will vary in Scotland where different rates of Income Tax apply.

You can elect to make regular pension contributions (usually monthly) or make one-off contributions (usually annually).

It should be remembered that pension contributions are invested and neither the capital invested, nor any income generated is guaranteed. Most pension funds offer a range of different investments with different risk profiles.

Limits on contributions you can make

The Annual Allowance
At present, the most you can pay into your pension pot in a single tax year and qualify for tax relief is £60,000 (2023-24: £60,000). Any contributions made over this limit will not attract Income Tax relief and you may also have to pay HMRC an annual tax charge.

HMRC will not penalise taxpayers for exceeding their annual allowance if they retired and accessed their pension pots because of serious ill health or if they died.

The annual allowance is reduced for taxpayers whose income exceeds £260,000 (2023-24: £260,000). Accordingly, anyone with income below £260,000 will not be subject to the tapered annual allowance rules. Those earning over £260,000 will have their £60,000 annual allowance tapered. For every complete £2 income exceeds £260,000 the annual allowance is reduced by £1.

The minimum level to which the annual allowance can be reduced is £10,000 (2023-24: £10,000).

The annual allowance can also be reduced if the taxpayer flexibly accessed their pension pot. This lower allowance is known as the Money Purchase Annual Allowance (MPAA). Presently, the MPAA limit is £10,000 (2023-24: £10,000) and this restricts the amount of tax relieved contributions that can be made by an individual.

Accessing unused relief from previous years
There is also a carry forward rule that allows you to carry forward previous years unclaimed annual allowances for up to three years. You do not need to report this to HMRC.

If you have unused annual allowances for more than one year, you need to use the allowance from the earliest year first. Any remaining balances can be used in future tax years, subject to the usual time limits. The calculation of the amount of unused annual allowance that can be carried forward can be complicated, especially if you are subject to the tapered annual allowance.

Lifetime limit

The lifetime allowance was the maximum amount of pension and/or lump sum that benefited from tax relief.

In the Spring Budget 2023, the Chancellor made the unexpected announcement that the lifetime allowance was to be removed from 6 April 2023. The lifetime allowance has now been abolished.

This measure ensures that no-one will face a lifetime allowance charge after April 2023.

The maximum amount that most individuals can claim as a pension commencement lump sum (PCLS) was based on 25% of the available lifetime allowance. Although the lifetime allowance has been removed, there remains a PCLS upper monetary cap of £268,275 (based on 25% of the 2022-23 lifetime allowance). Any individuals who already have a protected right to take a higher PCLS will continue be able to do so.

Benefits from pension contributions if you don't pay UK tax

UK residents (including children) can make payments into a personal pension scheme, even if they have no income, of up to £2,880 per year. The contributions will benefit from basic rate tax relief meaning that the pension contribution will be topped up to £3,600. Contributions can be made by another person e.g., by a parent on behalf of their child. The contributor's own contributions and allowances are not affected by this strategy. Higher contributions can be made but no additional tax relief is available.

Options at retirement

People aged 55 and over can take advantage of various options when accessing their pension savings. This age limit will increase to 57 from 2028.

There are three main withdrawal options available:

- a lifetime annuity,
- flexi-access drawdown and
- a lump sum payment.

These options can be used on their own or in combination. The first 25% of withdrawals are usually tax-free and the remainder is taxed at the individual's marginal, Income Tax rate. The timing of withdrawals from a pension pot is also important as amounts taken can count as part of your income for the relevant tax year. For example, taxpayers may lose all or part of their personal tax allowance if the pension withdrawal is added to their taxable income.

Pensions Advice Allowance

This allows those nearing retirement to take up to £500 out of their pension pots tax-free to part-fund the cost of financial advice. The advice provided can relate directly to their pension as well as to other financial products that help build retirement income such as multiple pension pots and other assets like ISA savings.

The allowance is limited to £500 per use and the £500 will not be taxed on withdrawal regardless of the individual's income. The allowance can be used no more than once in a tax year, and up to a maximum of 3 times in total.

Summary action list

- If you are close to or have exceeded the annual allowance take advice now to consider your options.
- We would recommend speaking to a regulated independent financial adviser to help with your pension decisions.
- If you are nearing retirement age, now is a good time to review progress with your pension planning.

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