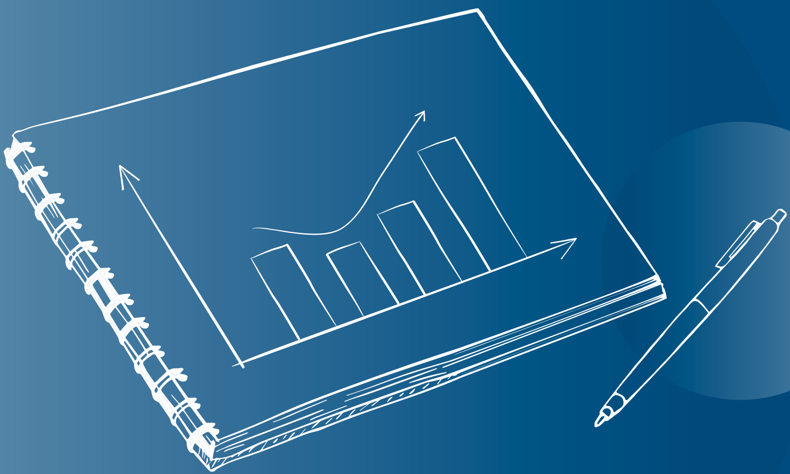


HARNESSING THE POWER OF PENSIONS

An introduction for the self-employed

Important note
Throughout this guide we often talk about tax. It is important to remember that tax treatment depends on individual circumstances and is subject to change.

Looking out for your future

Just over 13% of the UK workforce is self-employed[1]. That's a lot of people with the guts and dedication to do it themselves and make it work. On top of that, there is another thing you need to do for yourself: setting foundations for your financial future.

Most employees are automatically enrolled in a workplace pension and receive employer contributions. You don't have that benefit. And when so much time and energy is spent running your business, planning for the future often takes a back seat. Here are three key things to consider.

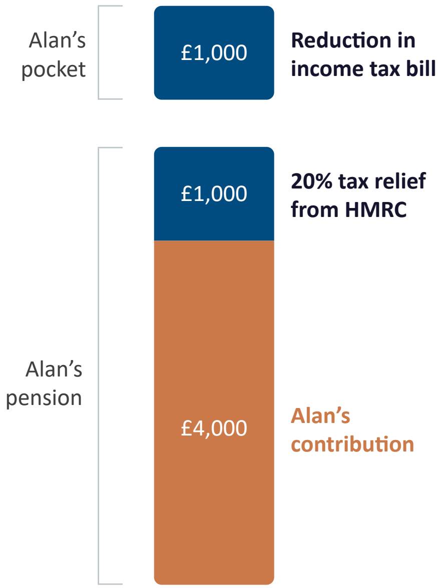
1. Reduce your tax bill

You can use the power of tax relief on pension contributions to reduce your tax bill. Let's consider Alan, who is 54 and a higher rate taxpayer with a gross annual income of £56,000.

He decides to boost his pension by £5,000. To achieve this, he adds just £4,000 to his pot, with HMRC automatically adding £1,000 to cover basic rate tax relief.

As a higher rate taxpayer, Alan can also claim an extra 20% tax relief for this contribution on his self-assessment form. This reduces his overall income tax bill for the year by £1,000.

This is effectively an extra £1,000 in Alan's pocket.



This example is for illustrative purposes only.

[1] statista.com/statistics/318457/self-employment-by-region-uk

2. Check your pension

As you plan for the next phase of your life, one of the first things to do is to get your private pensions in order. Generally, there are three things you want to check.

Charges

Admin, management and platform charges are applied to almost all private pensions. If these are too high, less of the money you have saved remains invested with the potential to grow.

Performance

How and where your pension savings are invested matters a lot. If your investments are performing poorly each year, the size of your pot when you need it will be smaller.

Investment strategy

Another thing to consider is the balance of your investments in line with how long until you plan to retire. A sudden drop in the value of your investments could leave you with less money in retirement.

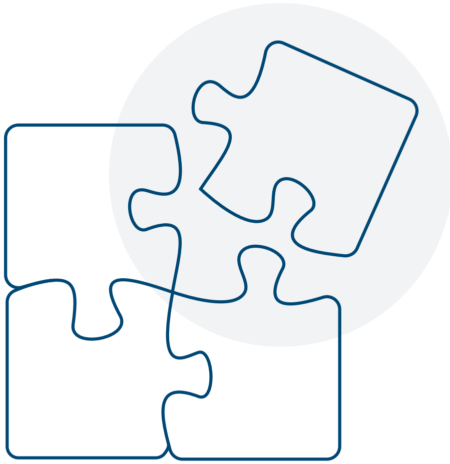
3. Funding your retirement

If you are thinking about selling your business to fund your retirement, you need to remember that you are probably its most valuable asset. So, how much will you get if you are not part of the package?

Financial planning for the future often boils down to one thing: income. How much money will you have or need to do the things you want to do? In this guide we look at:

- Some of the key things to consider when planning for the future
- An introduction to the three main types of pensions and some of the options you have

The planning puzzle



Planning for the week ahead can be tricky enough, let alone thinking about five, ten or even twenty years down the line. There are so many pieces of the puzzle to work out, and they keep changing shape.

Yet, having a plan is really important because after years of putting work and family first, many of us in our fifties and sixties want more time and space to grab life by the horns.

Your plan doesn't need to be set in stone for ever. Life is far too unpredictable for that. Instead, it is about bringing aspirations into focus, working out what is achievable, and then putting in place some realistic and practical steps to getting there.

When thinking about your plan, there are three main elements to consider, all linked to your finances.

01 Work

It is no longer unusual for people to carry on working past State Pension age, often for the social and physical benefits. And many people need or want to make changes to their work routine well before then.

That could mean cutting down hours or switching to a more satisfying but lower-paid job. What's right for you will depend on how much income you will need to either maintain your living standards or fund the lifestyle changes you want to make.

02 Health

Declining health in our older years will begin to restrict what we can do. And whilst it is a difficult subject, the cost of care at some point in the future should be considered.

Planning should take all this into account, with an emphasis on making the most of life while we can without compromising our future standards of living.

03 Family

People in their fifties and early sixties are sometimes called the sandwich generation because both children and parents often need financial support. If you are planning with a partner, there is the added complexity of managing different goals and circumstances. Then there is the question of passing on your estate, which might include some of your pension savings, when you die.

04 Your finances

Central to your plans are likely to be the goals you want to achieve and the people you love; the things that bring living to life. Yet, like it or not, the money we have and how we manage it are also vital aspects of the plan.

So, in the next section we look at the different types of pensions you may have as you plan for and enter retirement. These will play a big part in how much income and therefore how much financial flexibility you might have.

Living the dreams

On average, retirees' total household spending per person remains relatively constant in real terms through retirement, increasing slightly up to around age 80[1].

[1] ifs.org.uk/publications/how-does-spending-change-through-retirement-0

The power of pensions

Broadly speaking, there are three main types of pensions. Let's look at each one in turn, including some of the decisions you will face as you plan for and head into retirement.

The State Pension Q&A

How does it work?

This is a benefit provided by the state and funded by current workers' National Insurance contributions. The income you receive is based on decisions that are made by government, not by contributions you have made and investment performance.

Am I eligible?

You will need 10 qualifying years on your National Insurance record to receive any State Pension. In most cases, you will need 35 qualifying years to receive the full State Pension.

Can I defer my State Pension?

Generally, you can, provided you defer for at least nine weeks. Currently, for each year you defer, your weekly income will increase by just under 5.8%. You will need to do some sums to make sure this is in your best interests.

What will I get and when will I get it?

Currently, men and women in the UK can start claiming their State Pension from the age of 66. This is due to rise to 67 between 2026 and 2028, and then 68 between 2044 and 2046. This could change, though.

Currently, the full State Pension is worth £221.20 per week. If you have fewer than 35 qualifying years, this weekly amount will reduce accordingly.

Can I buy additional qualifying years?

In many cases, you can buy additional qualifying years if you are below the minimum required to receive the full State Pension and have any qualifying years missing in the last six years. Each additional year is worth 1/35th of the full State Pension. You will need to crunch the numbers to make sure it makes financial sense for you.

For all the information you need, visit: **gov.uk/new-state-pension**

Defined benefit pensions

Also known as a final salary scheme, a defined benefit pension will pay you a guaranteed income for life from a set age. The amount of income you receive usually depends on how long you worked for the company and your salary.

All benefit, less risk

If you are lucky enough to have one of these schemes, you are almost certainly better off to hold on to it and plan around it, just like the State Pension.

There are no investment choices for you to make along the way. Generally, you will have fewer decisions around when and how to take your pension benefits. And the income you receive is guaranteed, regardless of how the underlying investments have performed.

Defined contribution pensions

Most private and modern workplace pensions are defined contribution (DC) schemes. The value of your pot depends on:

- How much money you contribute
- The type and mix of investments bought with that money
- How those investments perform over time

As you head past 50 and towards whatever you want your retirement to look like, you have a number of options and decisions to make when it comes to your DC schemes.

Managing contributions

When making pension contributions, you will want to make the most of tax relief, especially if you are in the higher or additional income tax brackets. You also need to make sure contributions are going to the right pot. For example, it makes sense to add any extra money to a workplace scheme first if your employer will also increase their contribution.

Taking money from your pension

The main aim of a pension is to provide you with an income when you retire. Generally, there are two main ways to do this using a DC scheme.

Annuity: more security
When you buy an annuity, you are selling part or all your DC pension pot to an insurance company in return for a guaranteed income, either for life or a fixed term.

Pension drawdown: more flexibility
With pension drawdown, you take an income from your pot whilst keeping the rest of your savings invested so they have the potential to grow.

Let's look at how these two options compare.

	Annuity	Pension drawdown
Income guarantees	You receive a set guaranteed income for the duration of your annuity; this could be for life or a fixed term.	Your income is not guaranteed. Depending on investment performance and how much you take, you could run out of money.
Flexibility	You cannot change the terms of your annuity, which means the income you receive and when you receive it are fixed. The amount of income you get will rise if you choose an annuity that increases in line with inflation.	You can increase or decrease your income as needed. You can also withdraw ad-hoc lump sums as and when you like.
Ease of use	Once you have set up your annuity, there is nothing else you need to do.	You need to regularly check and manage your income to make sure you do not run out of money.
Investment risk	Your money is not invested, so investment risk is not a concern.	Your money is invested in different assets, which means your income will almost certainly be affected by periods of poor investment returns.
Inheritance	An annuity cannot be inherited. Although, you can choose to buy an annuity that continues to pay a reduced income to your spouse when you die.	You can pass on remaining funds in a drawdown pension to one or more beneficiaries when you die. Any remaining funds are free from inheritance tax, although, this will almost certainly change in 2027.

Taking money from your pension

The mix and match route

You could use part of your DC pot to buy an annuity that gives you enough secure income to cover the essentials. The rest of your pension would remain invested, giving you the flexibility to top up your income as and when you need to.

Tax-free focus

The first 25% of your DC pension is generally tax free. You can take this in one go, take smaller tax-free amounts or make withdrawals where 25% of each lump sum is tax free and the remaining 75% is taxed at your marginal rate.

If you decide to buy an annuity, you could withdraw your tax-free allowance before doing so. Or you could use your whole pension pot to generate an income of which 25% would be tax free.

Sustainable and efficient

You will need an income for the rest of your life. So, pension withdrawals need to be made with that in mind, taking into account any other income sources, such as the State Pension.

If you really need to access some of your pension before retiring, you can do so from the age of 55 (57 from April 2028). However, this will leave you worse off in retirement and could mean you run out of money. In most cases, the sensible decision is to only start taking an income when you need to.

You also want to be as tax efficient as possible. Let's say, in any given year, your retirement income receives a one-off boost. However, this means your regular DC pension income will be taxed at 40% or 45% because you have been pushed into a higher tax bracket. If you do not need the extra money, it makes sense to adjust your DC income for that year to avoid paying unnecessary tax.

Managing risk and investments, now and in the future

Generally, pensions are invested in a mix of lower risk assets, such as bonds, and higher risk assets, such as shares. The more risk you take, the greater the potential reward. However, this approach does make you more vulnerable to investment losses over the shorter term.

A riskier strategy can be ok if you have 15 or more years until you plan to retire because history shows us that stock markets have generally recovered their losses and continued to grow over the longer term. Although, history also shows us that what has happened in the past is not necessarily a good indicator of what will happen in the future.

As you approach and enter retirement, you probably won't have enough time to recover any significant investment losses. So, the sensible strategy is to take less risk with your investments. But you still want to aim for returns that will counter inflation and charges associated with your pension.

Financial advice could be an option

Retirement means different things to different people. You might want to quit the career of 30-plus years to do something you love. Perhaps you want to carry on working a couple of days a week for the social side and extra income. Or maybe you want to stop working for good.

Whatever you end up doing, money coming in will play a big part in how you live your life. And you should have a good idea of how much this will be, year on year, if you have access to the State Pension, a defined benefit scheme or an annuity.

Yet, when it comes to defined contribution pensions, there are generally many more decisions for you to make. If it gets confusing or you want to spend less time on financial planning, it might be worth speaking with a financial adviser who can help you make the right decisions.

pension access

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