PENSION CHANGES - the inside track

HM Revenue & Customs is arguably generous with tax perks when it comes to pensions. You'll get the basic rate of tax at 20% paid by HMRC, and those who pay income tax at a higher or additional rate can claim additional relief on a self-assessment tax return to bring the total relief to either 40% or 45%.

Money invested in a pension also grows free of capital gains tax and income tax, which means your money can grow much faster.

However, there are certain limits imposed so these tax breaks can't be overused. The Spring Budget contained a few surprise tweaks to those limits that took effect in April.

Here we explore those changes in detail and how they could affect retirement planning.

Annual Allowance

There is a limit set on how much individuals can contribute to a pension each year - without incurring a tax penalty.

In April the annual allowance was raised from £40,000 to £60,000. The allowance includes the employee and employer's contributions into a pension, and the tax relief itself.

One exception is that you can't pay in more than you earn.

For higher earners, different rules apply. The allowance reduces by £1 for every £2 earned over £260,000, which was increased from £240,000 in April.

The allowance can't drop to zero – it can only drop down to £10,000, up from £4,000 in April.

The annual allowance of £60,000 doesn't apply to those who have started taking a taxable income from their pensions, however. There is a separate allowance known as the money purchase annual allowance (MPAA) – see section below.

If the annual allowance is exceeded, you can "carry forward" unused annual allowance from the previous three tax years. The amount you carry forward is reduced by your annual allowance usage during those years.

Money Purchase Annual Allowance (MPAA)

When you start taking a taxable income from a defined contribution pension, the standard annual allowance is no longer applicable. Instead, you'll get the money purchase annual allowance.

In April the allowance was increased from £4,000 to £10,000.

The idea behind this separate allowance is to stop money withdrawn from money purchase pensions to then fund further pension contributions on which you'd receive more tax relief.

Lifetime Allowance (LTA)

HMRC has typically limited the amount you can hold in your pension pots combined.

The limit, known as the Lifetime Allowance (LTA), was most recently set at £1,073,100. Any excess was taxed at a maximum of 55% but this will no longer be the case.

From 6 April 2023, the LTA charge that applied to funds over £1,073,100 will be removed, with the lifetime allowance set to be removed from legislation from April 2024.

The removal of the lifetime allowance means that you can save into your pensions without the concern of an LTA tax charge should you breach the limit.

While there is no longer a limit on how much you can save in a pension for tax purposes, the tax-free lump sum you can take at retirement remains capped at £268,275 – 25% of the final LTA of £1,073,100.

In previous years, the LTA was higher. When the allowance was reduced, those with pensions exceeding the new lower allowance were able to apply for an official protection that would mean the higher allowance would be honoured, as long as no more was paid into the pension after a certain date.

HMRC has confirmed that those with LTA protections will be able to accrue new pension benefits, join new arrangements or transfer without losing these protections – including the higher tax-free cash amounts - if they were applied for before 15 March 2023.

The carry forward options on the annual allowance has become even more valuable now the lifetime allowance is no longer a concern, because if you have funds to set aside, you can add to your pension with no overall limit.

The scrapping of the LTA charges means that more money could be passed on to next generations.

Need help?

Pensions are an important tool for tax planning so it's a must to use the tax breaks to your maximum advantage. An adviser can help wade through the complexities – of which there are many – and work out the right path to retirement planning.

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[1]https://investingreviews.co.uk/blog/uk-has-2000-isa-millionaires/

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