The Premier Partnership Limited

Your Family Office

Well, we live in interesting times! When I look back over the last 5 years, three words spring to mind: Brexit, Covid and Ukraine. It could not have been a more difficult time for global investment markets, but still a steel resilience of recovery is managing to run through the economy, and to a large extent markets remain relatively calm. Long may it continue.

In this Spring Newsletter we shall be looking at pertinent topics for you, to provide clarity of information on the issues that are arising from our regular client meetings, and we hope one or two of the articles may resonate with you and assist. As always, if you would like further information on any of the topics covered, please do not hesitate to call us.

NewsLETTER

Taxation of Drawdown Pensions

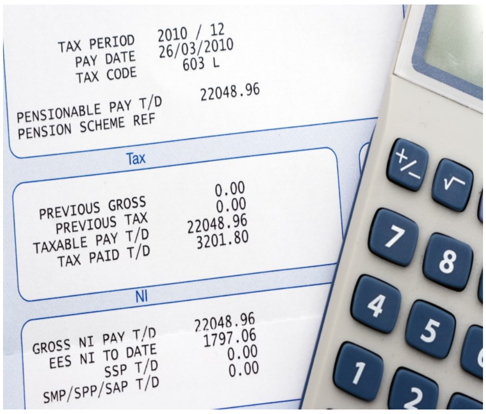
This is a subject of much gnashing of teeth by investors as they try to understand the workings of HMRC's collective minds, when taxing drawdown income from pensions.

When the pension freedom rules were introduced on 6 April 2015, there was much rejoicing over the increased flexibility of access to pensions, and the release from the need to purchase an annuity at retirement. However, there is an increasing blind spot that keeps popping up in planning discussions, and that is the taxation of income drawn from pension schemes. For clients who prefer to withdraw a single lump sum, instead of staggering payments throughout the year, there may be what was previously known as emergency tax - or over taxation initially - to contend with. This can be particularly frustrating when advisers and clients are planning to keep income within tax bands or personal allowances.

The problem is the system!

Usually, where a pension provider holds a P45 form for the member for the current tax year (usually because they have just stopped working), the provider will be able to deduct the correct amount of tax at source, as payments are made. Similarly, when the provider holds a correct tax code, created from previous withdrawals from the scheme, nasty tax surprises are usually avoided.

However, if this information is not held by the provider, they are required by law to deduct tax at a level known as the emergency tax rate. This is also known as month one basis. The amount being withdrawn is treated as a monthly payment - even if it is a one off withdrawal. You can see from the example below the effect of the month one basis taxation.



In the below example a fund of £80,000 has been crystallised. £20,000 has been paid as PCLS (Tax Free) and the member is making a one-off income withdrawal of £60,000. The amount they receive under the emergency tax code is £54,253, with the tax calculation below:

	Annual Tax Band	Month 1	Tax Rate	Tax Due
Personal allowance	Up to £12,570	£1,047.50	0%	0%
The remaining income of £58,952.50 (£60,000 - £1,047.50) is then taxed:				
Basic Rate	£37,700	£3,141.67	20%	£628.33
Higher Rate	£37,700 - £150,000	£9,358.33	40%	£3,743.33
Additional Rate	Over £150,000	£47,500	45%	£21,375.00
		Total Tax Due		£25,746.66
		From Total Taxable		£60,000.00
		Net income		£34,253.34
Source: AJ Bell		**Add PCLS**		£20,000.00
		Total		£54,253.34

Compare this with the expected tax treatment of 12 equal monthly income payments assuming the same circumstances:

	Annual Tax Band	Tax Rate	Tax Due
Personal allowance	Up to £12,570	0%	0%
Basic Rate	£37,700	20%	£7,540
Higher Rate	£37,700 - £150,000	40%	£3,892.00
Additional Rate	Over £150,000	45%	£0.00
		Total Tax Due	£11,432.00
		From Total Taxable	£60,000.00
		Net income	£48,568.00
Source: AJ Bell		**Add PCLS**	£20,000.00
		Total	£68,568.00

On a fund of £80,000 the difference between the emergency tax calculation and the correct tax calculation is over £14,000 which is clearly significant.

So that is the bad news, and something to be aware of. The good news is that HMRC are aware of this problem, and have put in place options to reclaim over paid tax.

Option One:

Complete a Tax Return at the due time and await HMRC reconciling your account. Useful - but not very timely, as this could take over 12 months to resolve.

Option Two:

There are three forms available from HMRC to expediate a quicker repayment, dependant upon client circumstances:

P50Z - For when the pension scheme has been fully encashed and the member has no additional income during the relevant tax year.

P53Z - For when the member has fully encashed a pension scheme and has additional income during the tax year from an alternative source.

P55 - For when the member has made a partial withdrawal and does not intend to make additional withdrawals during the relevant tax year.

Providing everything is submitted correctly, these are much quicker sources of reclaim than the completion of a Tax Return.

In the final quarter of 2021, HMRC figures show that £42 Million was refunded from over taxation at an average payment of £3,107.

Summary

So two things are apparent.

One - be prepared for taxation on your pension income. Some do not expect this to be the case. HMRC have a simple rule here in that they give you tax relief in the form of additional contributions when you are accumulating pension contributions into your scheme, so they consider that reliefs should come back in the form of taxation on income when benefits are taken in retirement. The key here is to get 40% tax relief on contributions if you can - but only pay 20% tax on income in retirement. Planning is everything.

Two - be prepared for the paperwork and the timing issues of reclaiming tax, for whilst it is largely efficient and quick to reclaim overpayments, it's not instant. So allow a couple of months.

If you are considering making withdrawals from your pensions, discuss planning with us first, as this always helps.

Pensions:
The Lifetime Allowance Test at Age 75

As well as nice flexible pension rules, the 2015 pension legislation brought in an altogether more unwanted rule regarding potential taxation of pensions. This is known as the Lifetime Allowance Test, and takes place on a member's 75th Birthday. This is largely a passive process and is usually overlooked by clients of this age.

Each individual has a Lifetime Taxation Allowance for their pension scheme, which for the tax year 2022/23 is £1,073,100. If the value of your pensions is at or likely to be at this figure or higher at retirement, you need to know about the taxation position. Where a member's fund value exceeds the Lifetime Allowance, the excess fund - known as the chargeable amount - will be subject to a Lifetime Allowance charge of 25%, or 55% where the funds are drawn as a lump sum. Where values are below the Lifetime Allowance, the test will still be undertaken, but no charge would be applicable.

In terms of pensions in payment, lifetime annuities or defined benefit scheme pensions, are not tested or revisited in anyway.

Planning

Whilst there are no ways to dodge the LTA test, as it is beholden upon providers to perform this task, there are a couple of points to consider if you are in this position.

If you have uncrystallised funds, and it is assumed you will be over the LTA at age 75, consider taking benefits from the scheme prior to that age. For example you could drawdown the value of the chargeable amount prior to age 75 as a lump sum, as you would not have this option at age 75. This would still be a taxable event at 55%, but it may work out that this is a better option, dependant upon circumstances. Or, take income payments before age 75, and pay the relevant rate applicable to your income at that time, reducing the overall scheme value to below the Lifetime Allowance limits.

As we have stated, you cannot avoid the test, but you may be able to plan your way through, with the least tax possible paid.

Income In Retirement

The UK Replacement Ratio

What is the 'UK Replacement Ratio'?

Well it is a rule of thumb that estimates what percentage of a person's pre-retirement income will be needed to maintain their lifestyle at retirement. On average these ratios range from 50-80% of pre-retirement income.

The process we use for this piece of planning begins with the client's data for annual expenditure, then factors in taxes and charges regarding their savings pots. The replacement ratio is then the total amount of income required in retirement, expressed as a percentage of pre-retirement income.

The replacement ratio is a key part of planning income in retirement and is needed to create a plan.

If you wish to calculate your replacement ratio, try this simple equation:

Gross Income - Taxes - Savings = Spending

Taxes on Savings & Pensions = Replacement

Divide by Gross Income for the ratio.

Simples!

This is not a measure of what is possible, merely an asset in guiding requirements, and should help investors make informed decisions in retirement. The replacement ratio can be a valuable retirement planning tool that can drive considerations such as the ideal savings rate needed, and the potential level of investment risk one might target for reasonable growth in values over time.

Financial Education

Risks Associated with Savings

We are indebted to our Lords and Masters at the FCA for the results of their latest financial lives survey, which explored the extent to which consumers understand the risks and potential returns associated with different forms of investing/ saving.

For example, the survey asked correspondents to assess the probabilities associated with investment into a deposit account, buying a rental property and investment into the FTSE 100 Index.

The results indicated that 38% of consumers were able to assign probabilities to future outcomes and showed a high degree of financial sophistication. 29% were able to show a moderate degree of financial sophistication and were able to assign probabilities of returns, and the remaining 33% are not able to assign potential return probabilities and showed a low degree of financial sophistication.

The assessment of financial sophistication covered seven levels of understanding: three relating to past events; and four to future expectations. These included assessment of awareness that stock markets, house prices and other investable assets such as crypto currencies can go up as well as down.

I am so pleased to see that our horrendously high regulatory fees are being used so well by our regulators.

House Prices

According to the latest Nationwide House Price Index, the pace of annual house price growth accelerated to 14.3% in March 2022, up from the 12.6% per annum growth figure recorded in February. This was the 8th consecutive monthly increase.

The average price of a UK house has now risen to £263,312, which is a new record high, up over £33,000 in the last year. Prices are now 21% higher than when the pandemic struck in March 2020. A combination of robust demand, cheap mortgages, and a limited stock of houses on the market all contributed to the price rises.

As a comment we would not expect this demand to continue and we feel the housing market will have peaked for the time being. The effects of rising interest rates on mortgages will be an effective drag on the market.

Salary Sacrifice

Salary sacrifice is an agreement between an employee and their employer, where the employee agrees to exchange part of their gross (before tax) salary, in return for a non-cash benefit, such as a pension contribution. Reducing salary results in a saving in individual income tax and employer and employee National Insurance contributions. This is even more pertinent now, given the rise in NI contributions for the 2022/23 tax year. As a result of the savings, when compared with the employee making personal pension contributions, salary sacrifice can produce the same pension contribution at a lower net cost, or a higher pension contribution at the same net cost. There are a number of planning opportunities around salary sacrifice, which can produce efficient savings gains.

5 Pebble Close · Amington · Tamworth · Staffordshire · B77 4RD
T 01283 711222 F 01283 711444 E enquiries@premierpartnership.co.uk W www.premierpartnership.co.uk
Registered Office: 5 Pebble Close · Amington · Tamworth · Staffordshire · B77 4RD