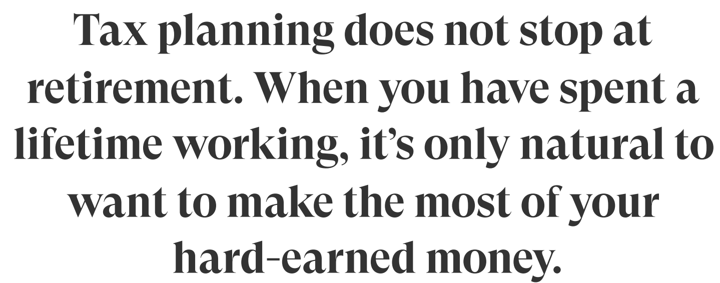
A Short Guide to Reducing Taxes in Retirement



Tax planning does not stop at retirement. When you have spent a lifetime working, it's only natural to want to make the most of your hard-earned money.

There are several options for reducing tax in retirement. By taking a combination of approaches, you may be able to save several thousands in tax over a period of years. While you should never base investment decisions solely on tax-efficiency, a good financial plan will aim to structure your investments (and your income) in the most effective way. This can bring you closer to your own goals and help to preserve a legacy for the next generation.

PENSIONS

Your pension is probably the foundation of your retirement plan. At retirement, your pension is treated in the following way for tax purposes:

- You can draw a tax-free lump sum. This is normally 25% of the fund value, although it may be calculated differently for certain occupational schemes.
- The remaining fund can provide you with an income which is taxed at your marginal rate.
- Funds invested within a pension benefit from tax-free growth, interest, and dividends.

You have a great deal of flexibility in how you draw your pension income. Here are some suggestions for making your pension more tax-efficient:

- Phase your tax-free lump sum over a number of years rather than drawing it all at once. This keeps more of your money within the tax efficient pension wrapper for longer. With investment growth, it's likely that the total amount of tax-free cash will be higher.
- Draw an income from your pension up to the value of the personal tax-free allowance. This means that you won't pay any tax on your pension income. This option works best if you have cash and investments that can be used to top up your income.
- Alternatively it may make more sense to defer drawing on your pension for as long as possible, for example if you have other income that already uses up your allowances. This allows your pension fund to benefit from tax-free growth for longer. Additionally, pension funds are not subject to Inheritance Tax. The funds can be passed on free of tax on death before age 75, or taxed at the beneficiary's marginal rate after age 75.

If you have a defined benefit pension, you will not have the same level of flexibility, however, there are still a few options:

- You may be able to commute some of your income in exchange for a higher tax-free lump sum. However, it is usually only worth doing this if you have a purpose in mind for the money, as the income (even taxed) is normally worth more than the lump sum over the longer term.
- If you plan to work beyond your normal retirement date, you can take your income later. This avoids generating additional taxable income. Your income will normally be enhanced for each year of deferral.
- You can use your pension income to make further pension contributions, building up a flexible pot to be used later in life, or passed on to the next generation. This will be subject to certain limits, and advice is recommended.

ISAs

ISAs are another important component in retirement planning. Unlike pensions, they do not offer tax relief on contributions, but they are considerably more flexible.

The main features of an ISA are:

- You can invest up to £20,000 per year, either in cash, stocks and shares, or a combination of both.
- Growth, interest, and dividends are all free of tax.
- You can withdraw money without restriction, tax, or penalty. Any money withdrawn can be replaced in the same tax year without using up any of your ISA allowance.
- ISAs can be passed between spouses on death, preserving the tax-efficient treatment.

ISAs can be used in the following ways to reduce tax in retirement:

- To top up your income, particularly if your pension already exceeds your tax-free allowance.
- To give you flexibility to fund larger, one-off expenditure items. High withdrawals from pension or investment accounts can result in significant tax.
- To make your portfolio more efficient over time, e.g. by gradually moving your taxable funds into ISAs.

INVESTMENT ACCOUNTS

Investment accounts are a basic and flexible investment wrapper. They can hold funds, shares, investment trusts and anything else deemed acceptable by the provider.

The tax treatment is as follows:

- Interest and dividends are taxable at your marginal rate.
- Disposals of assets can incur capital gains tax if your profit (net of charges) exceeds your annual exemption.

Any of the following options can help to reduce tax:

- Gradually phase your taxable investment accounts into ISAs.
- Make use of your capital gains exemption each year to avoid large gains rolling up later on.
- Structure your investments depending on the type of income they generate. You can receive dividends of up to £2,000 per year without paying tax. It can be beneficial to hold dividend producing assets in a taxable portfolio, while holding interest bearing assets in an ISA.
- Allocate more of your investments to a spouse if they have a lower income, as this can use up both personal allowances.
- Hold assets jointly before selling to make use of both capital gains exemptions. Transfers between spouses are ignored for CGT purposes and there is no minimum holding period.

OTHER INVESTMENTS

Depending on your circumstances, there are a number of other tax-efficient investments that may be suitable for you. For example:

- UK investment bonds
- Offshore investment bonds
- Enterprise Investment Schemes
- Venture Capital Trusts
- Alternative Investment Market stocks

These investments are not appropriate for everyone, but can form part of a comprehensive tax strategy in the right circumstances.

> A nancial plan can help you structure your income, reducing your tax in retirement and helping you to achieve your goals.

STRUCTURING YOUR INCOME

The most efficient retirement income strategy has the following features:

- It is planned well in advance
- Allowances and exemptions are used to their fullest extent
- Married couples plan jointly to ensure that income and assets are allocated effectively
- In terms of capital withdrawals, cash is used first, followed by taxable investments, ISAs and finally pensions.

A financial plan can help you structure your income, reducing your tax in retirement and helping you to achieve your goals.

Please do not hesitate to contact a member of the team to find out more about your retirement options.

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