FACT SHEET
Pension, the Advantages and Disadvantages

Introduction

Whether employed or self-employed, the National Insurance Contribution we pay secures credit for the basic State Pension. If employed and contracted in to the Additional State Pension, National Insurance Contribution buys credit for the State Second Pension, formerly known as the State Earnings Related Pension, SERPS see Fact Sheet 'The State Pension – Part VI 2007 And Beyond'. It is reported our State Pension is the lowest of any developed country. Defined benefit Pension Schemes, sometimes known as Final Salary Schemes, are all but closed. Defined benefit schemes have been succeeded by defined contribution schemes to which an employer may or may not contribute. As the name suggests, the employer defines the contribution they pay but accepts no responsibility beyond this so the individual is wholly responsible for ensuring they contribute an amount sufficient to provide their target benefit and the funds in which they invest remain suitable. They are also responsible for renewing the arrangements they are making for retirement on a regular basis to ensure they remain on target.

Under regulation introduced from April 2006, defined contribution pension schemes cannot be accessed before age 50. However retrospective legislation will increase the minimum age to 55 with effect from 6 April 2010. This is the first pension regulation that has been applied retrospectively.

In summary, if you are eligible to join a Scheme sponsored by your employer to which your employer contributes almost certainly you should do so. Normally these Schemes include free Life Assurance and may include other Company paid Risk Benefits to include Adult Financial Dependant's Pension, Permanent Health and Private Medical Insurance.

To qualify, you will almost certainly be required to contribute personally but the contribution you pay will be relieved against income tax at your marginal rate. If the employer undertakes to match an Additional Voluntary Contribution, then if you can afford to, you should take advantage paying the amount necessary to secure the maximum additional employer contribution. You may then pay any additional contribution to this or to a parallel Scheme.
When planning for retirement, it is important to establish the age at which you propose retiring and the proportion of your final salary you are targeting to receive after you have stopped working. Making reasonable assumptions about wage inflation and investment return we can then determine the percentage of your salary that you need to pay over and above any employer contribution.

The four factors that determine your income post retirement are, in descending order:-

- The amount that you and your employer save
- The real rate at which your fund grows above inflation in the period to retirement
- Annuity rates prevailing at retirement
- The impact of charges in the period to retirement.

Saving for retirement by way of an exempt approved pension scheme is saving in the long term because the primary objective is to provide a replacement income after you have stopped working.

You should always retain access to monies on deposit for short term needs and emergencies. In the medium term you may consider using the tax exemptions afforded by ISA, Individual Savings Account. From 6 October those over 50 may subscribe £5,100 annually to a Cash ISA and £10,200 to a Share ISA or £5,100 to each. These limits will extend to everyone from 6 April 2010. In addition, your individual Capital Gains Tax allowance is £10,100 this fiscal year to a total of £20,200 per couple.

To conclude, saving by way of an exempt approved pension is a long term investment intended to provide a replacement income once you have stopped working. It is a deferral of income tax because the contributions we pay are relieved against income tax at our marginal rate but under current regulation, the income we receive whether by way of annuity or if drawn directly from the fund will be subject to income tax in retirement. 25% of the fund may however be drawn free of tax under current regulation. Formerly this was known as the tax free lump sum but post 6 April 2006 is now known as the Pension Commencement Lump Sum. A cynic may suspect that the change of name has paved the way for the Government imposing a tax on this lump sum.

The advantages of saving for retirement by way of pension are:-

- In this tax year you are allowed to make a gross contribution to a Personal Pension Plan of the lower of your taxable earnings or £ with an overall lifetime allowance rising to £1.8 million for 2010/11 by 5 April 2011*.
- Contribution within revenue limits are relieved against income tax at your marginal rate.
- Regardless of whether you have relevant earnings, you can contribute £3,600 withholding income tax at 20%.
- You can draw your pension between the ages of 50 (55 from 6 April 2010) and 75.
- The contributions are invested in a fund that accumulates free of UK tax on investment income and Capital Gains, although it is no longer possible for pension funds to claim the tax credits on dividends from UK Equities.
- The pension when it becomes payable is taxed as earned income.
- Part of the pension can be taken as a completely tax free sum not exceeding 25% of the total fund, excluding any protected rights.

The disadvantages of saving for retirement by way of pension:-

- When you draw out benefit it is possible you will pay income tax at a lower rate than you were paying when you were employed. However, we have no control over the rates of income tax future Governments may impose.
- For the first time the Government introduced legislation that impacted retrospectively. Since April 2010 you cannot access your pension fund before age 55, previously you could draw benefit from age 50. With effect from 199 Gordon Brown changed the regulation so that dividend tax credit could no longer be reclaimed. It is estimated this costs pension funds in excess of £5 billion annually reducing the potential returns on all pension funds.
- Once you have contributed to a pension you cannot change your mind and cannot access benefit before age 55.