Pennymatters
THE MODERN APPROACH TO FINANCIAL ADVICE

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Strategies to minimise retirement tax

Many pensioners may face a lurking tax risk as the State Pension grows

Many pensioners may face a potential tax pitfall as the State Pension escalates and Income Tax bands remain fixed. Pensioners are set to see a substantial increase in their income next year. The State Pension is projected to rise by 8.5% in April 2024, following a 10.1% increase in April 2023[1].

This is due to the government's 'triple lock' mechanism, which guarantees that the benefit increases in line with wage growth, inflation or 2.5% – whichever is higher. Consequently, a full new State Pension could increase from £10,600 this tax year to slightly over £11,500 in 2024/25. However, the Prime Minister has yet to confirm if the triple lock will remain fully in place.

Many pensioners may face a lurking tax risk as the State Pension grows. The Income Tax personal allowance, which is your overall income's tax-free portion, is currently stagnant at £12,570 a year. In some situations, an individual could have a higher amount than this tax-free, for example if all income is savings income. This could mean some people might receive less tax-free income from other sources. This situation may result in a tax code change on a pension or annuity or necessitate reporting other income to HMRC for the first time.

UTILISING YOUR ALLOWANCES

When retiring it's good to be aware of certain 'allowances' that could help you earn a bit from your cash and shares without paying tax. Understanding these allowances is the first step towards paying less tax in retirement.

Take note of the personal savings allowance, for instance. This allows basic rate taxpayers to earn £1,000 of interest in 2023/24 before paying tax. The allowance is lower (£500) for higher rate taxpayers, while additional rate taxpayers don't receive any personal savings allowance.

EXTRA SAVINGS AND DIVIDEND ALLOWANCES

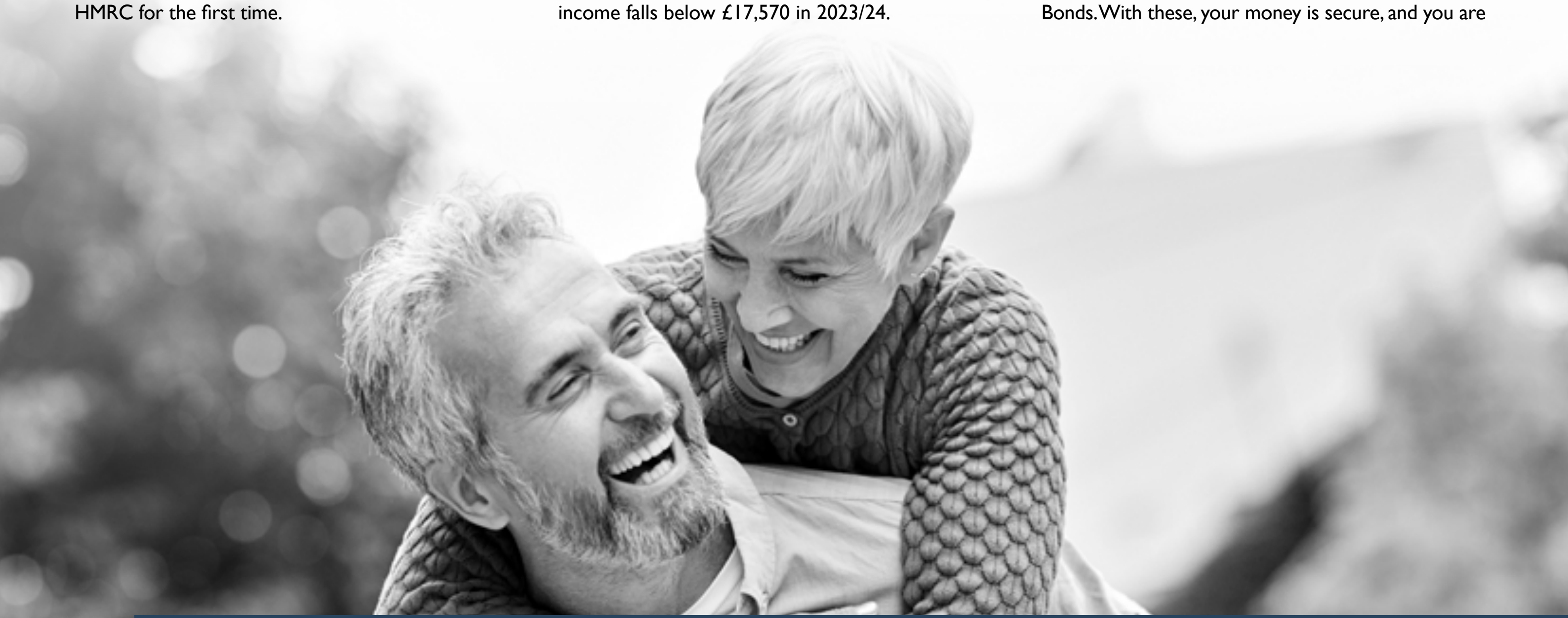
An additional 'starting rate' for savings offers a special 0% rate of Income Tax for savings income of up to £5,000 for those whose general taxable income falls below £17,570 in 2023/24.

The dividend allowance is another tool at your disposal. It allows you to receive £1,000 tax-free from shares for the 2023/24 tax year, which is reduced from £2,000 the previous tax year. Come 2024/25, the allowance will drop further to just £500.

PROTECTING YOUR SAVINGS FROM TAX

There are different ways to shelter your savings from tax. One such method is using a Cash Individual Savings Account (ISA), where any interest earned is tax-efficient. However, remember that the more you use your £20,000 a year ISA allowance for cash, the less you'll have available for investments in a Stocks & Shares ISA. This could be more useful in avoiding tax on income or gains from shares or other assets.

National Savings and Investments (NS&I) also offer certain tax-free cash savings products, like Premium Bonds. With these, your money is secure, and you are



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entered into a monthly prize draw where you can win between £25 and £1 million tax-free.

PLANNING PENSION WITHDRAWALS

Under the current rules, once you reach normal retirement age, you can usually take an invested pension pot, such as a Self-Invested Personal pension (SIPP), as cash in one go. But remember, taxes on retirement income will generally apply to 75% of this sum. It's also added to other income in the tax year it is received so it could push you into a higher Income Tax band.

Depending on the scheme options available, you can 'phase' your retirement pension income by taking the 25% tax-free lump sum and taxable income in stages. Spreading withdrawals over multiple tax years in this way may help you make the most of tax allowances and avoid paying more tax than necessary.

USING ISAS FOR TAX-EFFICIENT INCOME

Stocks & Shares ISAs are a tax-efficient way to invest your money for the long term. Unlike a pension, an ISA also offers the freedom to withdraw money easily whenever you want to without paying any tax. Proceeds are free of Income Tax and Capital Gains Tax.

These features make ISAs very useful for almost any investing need. They can be beneficial in retirement as a way to supplement income without any tax consequences. For example, they can complement pension income, which is usually taxable beyond the first 25% of the pot, or in some circumstances, help bridge a gap until you access a pension.

DEFERRING THE STATE PENSION

It's worth noting that you don't have to claim your State Pension as soon as you're entitled. By not claiming your State Pension immediately, you're giving up income in the short term, but if you're still working and know you'll experience a drop in income later on, it can make sense. You could pay less tax, plus you'll receive a larger amount when you take it.

However, you must also be confident you will live a relatively long life. The longer you live, the more valuable deferring gets, but if you live significantly shorter than the average, it is unlikely to be worth it.

EFFICIENT ASSET DISTRIBUTION

If appropriate to your situation, consider splitting income-producing assets if you're married or in a registered civil partnership. This can be done by holding them in joint names or allocating them to the partner with the lower income and tax liability. The beneficial ownership, as well as the legal ownership, would need to be transferred.

You can also think about how you arrange your asset types across different accounts. For example, it can make sense to prioritise your ISA allowances for dividend-producing investments rather than cash. However, your needs, objectives and circumstances will dictate what's best for you. ■

DO YOU REQUIRE FURTHER INFORMATION?

Many factors come into play when looking at your income and the tax you pay in retirement. But with careful planning, you can secure your financial future. Please don't feel that you have to go it alone. We're here to help you take control of your finances, giving you freedom and peace of mind. Understanding the intricacies of retirement tax can be complex. Please get in touch with us for further information.

Source data:
[1] House of Commons Library 2023 - The triple lock: How will State Pensions be uprated in future? Published Friday, 13 October, 2023