Orchid Financial Services Ltd

Saving for your retirement

Getting into the habit early should pay off in the long run.

Saving for retirement is essential if you want the financial freedom to enjoy your later years, and getting into the savings habit early can help you achieve that.

Not only will placing money into a pension each month provide you with an idea of when you'll be able to retire, it will give you peace of mind that you'll have a financially secure retirement.

According to a study by Scottish Widows, 61% of 3,535 respondents are confident of having enough money to fund a comfortable retirement.

If you fall into the 39% minority, the easiest way to boost your retirement income is to seek expert advice early and plan your savings strategy to ensure the taxman isn't taking more than his fair share.

Where do I start?

Auto-enrolment offers a solid base to build on for most workers earning at least £10,000 a year and between 22 and state pension age, but your savings habit shouldn't end there.

Eligible workers put 3% of their salary into their workplace pension in 2018/19, while their employer contributes 2% to bring the total to 5%.

You'll also have national insurance contributions (NICs) deducted from your pay packet through PAYE.

These contribute towards your **state pension** entitlement, with 35 years of NICs needed to qualify for the full new state pension of £164.35 a week.

If you are self-employed and registered with HMRC, you can make class 2 voluntary NICs towards your state pension.

With the state pension unlikely to be enough to fund a comfortable retirement after you've stopped working, you could consider setting up a **personal pension**.

This is more applicable for the self-employed, who do not have a workplace pension or the beneficial employer contributions that go with it.

How much should I save?

You should save as much as you can afford to, within your contribution limits, and the earlier you start saving the less you will need to put in each month.

Research from Scottish Widows suggests a 25-year-old should be putting £293 a month into their pension pot to collect an annual retirement income of £23,000.

If you put off saving until you're 35, you will need to save £443 a month, while at 45 this monthly figure jumps to £724.

Someone who's left their retirement saving until they were 55 would need to contribute £1,445 a month towards their pension to achieve the same annual retirement income.

Ultimately, if you have a lower retirement income target in mind you will not need to save as much as the report suggests and if you start saving early you will pay even less towards your target.

What are tax-efficient ways to save?

Most people can contribute up to £40,000 a year into their combined pension pot without paying tax, although you will pay tax when you take an income from it in retirement.

This annual allowance combines the value of all your pensions inside your pot, such as any workplace pensions and any personal pensions.

If you exceed the threshold, or 100% of your earnings (whichever is lower), you will be liable for tax.

For higher earners – those earning more than £150,000 from all types of income plus any employer pension contributions – the allowance is tapered by £1 for every £2 above £150,000, up to a maximum reduction of £30,000.

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This means the allowance is capped at £10,000 for anyone earning more than £210,000.

Most pension providers give 20% tax relief, although it's possible to receive tax relief at your marginal rate of income tax on pension contributions in 2018/19.

This makes the cost of contributing the same amount into a pension cheaper for people in the highest tax brackets.

For instance, you put £8,000 into your pension in 2018/19 and the government adds £2,000. A higher rate (40%) taxpayer can then claim an extra £2,000 in tax relief through their tax return, making the total cost of a £10,000 contribution £6,000.

The same contribution would cost an additional rate (45%) taxpayer £5,500.

Different tax bands and rates apply to taxpayers in Scotland, which means the tax relief available will be slightly different.

The lifetime allowance, which stands at £1.03 million in 2018/19, allows you to save into a pension without triggering an excess tax charge at retirement.

Anyone who exceeds this lifetime limit will be liable for 25% tax on the excess if the money's withdrawn as income or 55% if the money's taken as a cash lump sum.

ISAs

Taking advantage of your ISA allowance (£20,000 in 2018/19) is another strategy that enables you to save using a combination of ISAs, and potentially benefit from government top-ups.

Cash ISAs, which have offered savers miserly returns due to prolonged spells of low interest rates, and stocks and shares ISAs are the two most popular options.

The Lifetime ISA enables savers to put away up to £4,000 a year, with the government contributing £1,000 so long as it is used to either buy a first home or for retirement.

Is it worth topping up missed NICs?

You can make class 3 NICs to fill in missing years in your national insurance record that will count towards how much you're entitled to receive from the state pension.

Whether or not it's worth topping up your missed contributions depends on your circumstances, and the first thing to do would be to check your NICs record at gov.uk/check-state-pension

That will tell you how many years are incomplete and inform you of how much you need to pay, while you can top up using voluntary class 3 NICs paid by cheque, online or over the phone.

However, remember you need 35 years in the new system to qualify for the full state pension.

HMRC will continue to accept top-ups, but this won't increase your state pension if you've already got enough years to qualify for the full entitlement.

Pension pitfalls

One of the biggest pension traps you could fall into is simply not saving enough for a comfortable retirement. It's easily done and saving something, no matter how small, is better than nothing.

Arguably the second biggest pension pitfall that could affect you is running out of savings if you happen to outlive the amount you've stashed away.

This has the potential to be disastrous if, for example, you end up in a nursing home where the average weekly cost of care stands at £866.

In addition, new rules allow you to withdraw your entire pension pot after the age of 55. The first 25% will be tax-free, but you will pay income tax on the rest.

For those with larger pension funds, these withdrawals, combined with your earnings, could push you into the next tax bracket and you might face a 40% or 45% tax bill.

Contact us to discuss retirement saving.

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