FINANCE UPDATES

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HampshireHill
Independent Financial Advisers

PENSION CARRY FORWARD

How to make the most of your annual allowance.

The coronavirus pandemic appears to have thrown some of the nation's retirement plans into jeopardy, with recent figures commissioned by the Institute for Fiscal Studies (IFS) revealing that 13% of older workers have already changed their planned retirement age as a direct result of COVID-19.

The study, which looked at responses from 10,000 people aged 50 and over, found that 8% of those people were planning to retire later than they had previously intended, while 5% were planning to retire earlier.

Almost three in ten (29%) older workers reported that their financial situation has worsened as a result of the crisis, while 37% said their household income was lower than it was in February 2020.

Heidi Karjalainen, research economist at the IFS, said:

"The personal finances of many older adults are being hit by the fallout from the coronavirus pandemic.

"While many have wealth to help them smooth income shocks, this is by no means true of all.

"Older adults are also more exposed to financial hits to their pension saving, because being closer to retirement there is less time for fund values to recover before they might want to start drawing on their wealth."

Last month, the age at which people start to receive the state pension also increased to 66 for both men and women, meaning many will now have longer to wait before they start receiving state benefits.

People born between 6 October 1954 and 5 April 1960 will start to receive their state pension on their 66th birthday, but for people born after those dates, the age is set to increase further – to 67 in 2028, and 68 in 2037.

With that in mind, it's more important than ever to have a savings plan in place, and give yourself the best chance of reaching your retirement goals.

Even if you're unable to save as much as you'd like to this year, you can still make use of your tax-free allowance in the years to come, by using the 'carry forward' rule.

ABOUT THE ANNUAL ALLOWANCE

Before we go into the details on carry forward, it's important to understand how your pensions annual allowance works.

The annual allowance is the maximum amount of money you can contribute to a pension scheme in a single tax year, which you are entitled to receive tax relief on.

The annual allowance applies across all of the schemes you belong to, including contributions you make into your pension pot, your employer or any third party, and any tax relief received.

It's capped at £40,000 in 2020/21, although a lower limit of £4,000 may apply if you have already started accessing one of your pensions from the age of 55.

Higher earners may also be affected by the tapered annual allowance, which we'll explain in more detail later.

If you exceed the annual allowance limit, you will not receive tax relief on your contributions and will need to pay an annual allowance charge, which will be added to the rest of your taxable income for the year.

If your charge is more than £2,000, you can ask for your pension scheme to pay the charges from your benefits.

HOW CARRY FORWARD WORKS

Pension carry forward allows you to carry forward unused amounts of money from the past three previous three tax years and still receive tax relief on your contributions.

To carry over allowances from previous tax years, you are required to use up the limit for the current tax year before using your allowances for the last three years, starting with the earliest one.

For example, let's say you've used up your allowance for the 2020/21 tax year and are not subject to the tapered allowance in any of the preceding three years.

You're then entitled to go back to 2017/18 and use up any remaining annual allowance from that year, before moving on to the next tax year's allowance.

The table below illustrates how this would work if you'd made £20,000 in contributions in 2017/18, £10,000 in 2018/19, then £40,000 in both 2019/20 and 2020/21.

Tax year	Annual allowance	Contributions	Unused
2020/21	£40,000	£40,000	£0
2019/20	£40,000	£40,000	£0
2018/19	£40,000	£10,000	£30,000
2017/18	£40,000	£20,000	£20,000
Total allowance to carry forward in 2018/19:			£50,000

Be aware, though, when using carry forward that you can't receive any tax relief on contributions you make in excess of your earnings in the current year. This excludes the contributions your employer makes.

After the three years, any unused annual allowance is lost.

WHY USE CARRY FORWARD?

Being able to use up any unused allowance can come in especially handy if you are self-employed and your earnings change significantly each year.

This might mean that you want to make a particularly large pension contribution one year.

The carry forward rule means you don't need to miss out on tax relief when you contribute in a lump sum.

Another reason to use carry forward is if you're a high earner and you're affected by the tapered annual allowance.

This applies to people with a threshold income of £200,000 or more and an adjusted income over £240,000 in 2020/21. For every £2 of adjusted income over £240,000, the annual allowance reduces by £1, down to a minimum of £4,000.

That can make it much more likely that your pension contributions will exceed your annual allowance – but using carry forward means you may be able to contribute in larger amounts and still receive tax relief.

MONEY PURCHASE ANNUAL ALLOWANCE

If you decide to start taking money flexibly from a defined contribution pension scheme, your annual allowance will be replaced by the money purchase annual allowance (MPAA).

The MPAA, which stands at £4,000 in the 2020/21 tax year, was introduced as an anti-avoidance measure to prevent abuse of pension freedoms.

It's designed to discourage people from diverting their pay into their pension, receiving tax relief, then withdrawing money with 25% tax-free.

If you're subject to the MPAA, you won't be able to use carry forward to increase your tax-free limit.

We can help with your pension planning strategy.

IMPORTANT INFORMATION

The way in which tax charges (or tax relief, as appropriate) are applied depends on individual circumstances and may be subject to future change. Pensions eligibility depends on individual circumstances and pension benefits cannot normally be taken before age 55.

This document is solely for information purposes and nothing in it is intended to constitute advice or a recommendation. You should not make any pension decisions based on its content.

While considerable care has been taken to ensure the information in this document is accurate and up-to-date, no warranty is given as to the accuracy or completeness of any information.