

Pensions explained

Which?

Welcome



The past two years have seen unprecedented changes in the pensions system. First, in April 2015 the government introduced the pension freedom reforms, revolutionising the way in which people are able to access their money in retirement. Then, a year later, a new single-tier state pension came into force, replacing the two-tier system of basic and additional state pension for anyone reaching state pension age after 6 April 2016.

Many of these changes have the potential to leave you better off. But they have also made it more difficult to get to grips with what was already a complicated pensions landscape. Still, as we live longer and the state finds it harder to fund pension incomes for a growing population, it's crucial that we take more responsibility for planning our retirements – not least so that we can look forward to some well-deserved financial security and peace of mind in later life.

That's where this guide can help. In jargon-free language it helps to explain the significant changes to pensions, explores how to maximise retirement income and what tax bills might look like if you cash it all in. Whatever you decide to do with your savings, let Which? steer you through to a healthy financial future.

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Getting started with retirement planning

Pensions come in different shapes and sizes, and you're likely to have more than one by the time you retire



How will you save for your retired years? Given that we are spending more of our lives in retirement than ever before – the Office for National Statistics says the average 65-year-old man retiring today can expect to live for more than 18 years, rising to almost 21 years for women – it's something you need to think about very carefully.

For most people, however, there is no single answer to this question. Your income in retirement will most likely come from a mixture of different sources – and you will have saved for it in a variety of ways.

The pensions patchwork quilt

For many, pension income is likely to provide the lion's share of what you have to live on during your retirement years. But that could mean any, or all, of three things:

- **State pension income** – pension benefits provided by the state in return for tax and National Insurance contributions you make during your working life.
- **Occupational pensions** – pensions you qualify for having been a member of a workplace pension scheme; they come in many different forms.
- **Private pensions** – Any pensions you've set up on an individual basis, usually with an insurance company or investment manager; they include schemes such as personal pensions and stakeholder pensions.

It may be that you also have other retirement income – from savings and investments you've made outside of a pension plan, or because you continue to work. So you may have several sources of financial support, and it's important that you consider how they all fit together in order to plan effectively for the future.

For many people, it is worth taking independent, specialist financial advice on pension planning – you'll pay a fee for this support, but given the complexity of dealing with so many different elements during the

“The more you put into your savings, the more you'll get out when it's time to cash in on retirement”

retirement process, it can make sense to get some professional guidance.

The bottom line, however, is that the more you put into your savings, the more you'll get out when it's time to cash in on retirement – that's true of both state (where you must make a minimum amount of National Insurance contributions) and private or occupational pensions.

There are various tools available online to help you work out how much you'll have in your pension fund at retirement. For example, try the Which? pension calculator at [which.co.uk/pensions-retirement](https://www.which.co.uk/pensions-retirement).

Don't forget that you'll get some help. If you're in a pension scheme at work, your employer is now required to make contributions on your behalf. All private pension contributions (subject to certain maximum limits set down by the government) qualify for tax relief. And if you can't make National Insurance contributions for a period – because you're taking time out of work to have children, for example – you may be able to get a top-up from the state.

Still, don't be tempted to put off saving for retirement. The earlier you start, the more chance you have of achieving a good standard of financial comfort later in life.



Find out more

Check out the Which? website for detailed information on pensions, along with retirement planning – see [which.co.uk/retirement](https://www.which.co.uk/retirement).

The state pension today

The state pension is likely to provide the base for your retirement income, but the system has been through big changes

For many people, state pension benefits will provide the core of their income in retirement. But major changes to the state pension came into force in April 2016, and it's important you understand how the new system differs from what went before.

One important aim of the shake-up has been to simplify state pensions. Where there used to be both a basic state pension and an additional state pension – known as the state second pension (S2P) or the state earnings-related pension (Serps) – there is now just a single-tier pension. The full level of the new pension is £155.65 a week in 2016–17, and it applies to everyone who retires after 6 April 2016. Those who retired before that date will continue to receive the old pension.

The new system also sees the end of the 'contracting out' arrangements that used to enable some people to opt out of the additional state pension. Those who did so paid less National Insurance, and the money saved went into their workplace or private pensions.

At the same time, the rules are also becoming more demanding. It used to be that you needed to make 30 years of National Insurance contributions to qualify for a full state pension; now you will need a 35-year record.

How much state pension will I get?

Anyone reaching state pension age on or after 6 April 2016 will see their state pension

calculated on the basis of the new single-tier state pension of £155.65. But that's not the sum you'll necessarily get.

Those that have built up a certain amount of additional state pension will get a higher amount, while those that were contracted out before 6 April 2016 for a significant time will probably get less. Either way, though, the final figure will be whatever is higher – the amount you would have got under the old system, or the amount you would get had the new system been in place over the whole of your working life.

The significance of your contracted-out status:

■ **Contracted out** – If you've been contracted out, you've been making National Insurance contributions at a reduced rate or receiving a rebate into your pension pot. The new system makes a reduction in the single-tier pension in the same way as a contracted-out deduction

Get a forecast

You can get a state pension forecast from the Department for Work and Pensions (DWP) at gov.uk/check-state-pension, or by calling 0345 300 0168. The forecast gives you an estimate of what you can expect in terms of your state pension, based on your National Insurance contributions.



was made from your additional state pension under the old system. If you've been contracted out but carry on working for a number of years after 2016, your National Insurance contributions will automatically increase to the standard rate, and you can carry on building up your entitlement until you reach the full level of the new state pension.

■ **Contracted in** – No-one will lose any additional state pension that they've built

up while contracted in. The government now makes two calculations when you collect your pension: your state pension entitlement under the old rules; and the amount of state pension to which you are entitled under the new rules. Whichever of these values is the highest is called your 'starting amount'. If this is greater than the full level of the new state pension, you'll get the higher amount.

Old vs New state pension

	Qualifying years	What you get	Full rate in 2016-17	Deductions	Contracting out
OLD SYSTEM	30	Basic state pension plus additional state pension	Basic state pension £119.30 (plus additional state pension, if applicable)	Deduction for years contracted out of additional state pension (during transition period)	Yes
NEW SYSTEM	35	Single payment	New state pension £155.65	Deduction for years contracted out of additional state pension (during transition period)	No. Additional state pension no longer exists

Maximise your state pension

Make sure you're getting the best-possible deal from your state pension



Only those who meet a number of criteria are entitled to claim the full state pension: you must have reached state pension age, made National Insurance contributions for 35 years and, if you aren't in work, have paid voluntary National Insurance contributions or been credited with them from the government.

On the first of those criteria, the state pension age is changing: by 2018, it will be 65 for both men and women, and it is due to

increase to 66 in October 2020 and to 67 between 2026 and 2028. The government will review the state pension age every five years.

As for National Insurance, you build up a contributions record in one of two ways:

- If you're working and you earn at least £112 a week (£5,824 a year) in 2016/17, or are receiving working tax credit; or if you're self-employed and paying what's known as class 2 National Insurance contributions

“If you're not working, you may be entitled to National Insurance credits, which fill in any gaps in your contributions record”

- If you're not working, you may be entitled to National Insurance credits, which fill in any gaps in your contributions record. You'll receive credits if you've been out of work due to illness, unemployment or maternity leave; if you're a parent of children under age 12 for whom you're claiming child benefit; if you're a carer for someone sick or disabled, or a foster carer, or received Carer's Allowance. (You'll also receive National Insurance credits if you are in work, but don't earn enough to pay it.) If you're unlikely to qualify for a full state pension because you haven't made enough National Insurance contributions, it's possible to top up your contributions in some cases. Voluntary class 3 contributions in 2016–17 are

£14.10 a week, or £733.20 a year, and you can normally go back up to six years to fill any gaps.

Calculating the benefit of making additional National Insurance contributions is quite complex. In all cases it is worth getting a state pension forecast from the DWP (see page 6) as well as seeking guidance from the Pensions Advisory Service (pensionsadvisoryservice.org.uk) before deciding what course to follow.

Deferring your pension

You don't have to take your state pension the moment you hit retirement age. In fact, if you choose to defer taking it, you'll get a higher income once you do begin to claim. What you're entitled to will go up 5.8% for each year that you defer, or by 10.4% if you were eligible before 6 April 2016

Still, this is something of a gamble because it will be quite some time before the extra pension you're collecting each week adds up to the total amount you've missed out on by deferring. In fact, if you reach state pension age after 6 April 2016 the break-even point comes after 17 years – so it's only worth exploring this option if you're in good health.

Temporary top-up arrangements

For a limited period, the government is offering an extra top-up deal for anyone who retired before 6 April 2016, in recognition of the fact that the old, basic state pension was less generous than the single-tier rate paid today. In return for making a one-off payment, you can get an immediate top-up to your pension.

How much you'll pay for the extra state pension will depend on your age – the cost reduces the older you are. The maximum extra pension you can buy is £25 per week, or £1,300 per year, so:

- At 65, increasing your pension by £1 a week will cost £890; or £22,250 for £25 a week.

- At 70, the cost is £779 for an extra £1 a week; or £19,475 for £25 a week.
- At 75, the cost is £674 for an extra £1 a week; or £16,850 for £25 a week.
- At 80, the cost is £544 for an extra £1 a week; or £13,600 for £25 a week.

For many, this represents a very good deal since the extra pension is payable for life – although people in less good health need to consider whether they will live long enough to recoup their money. The offer is only available until April 2017. See gov.uk/state-pension-topup for details of how to apply.

Tax on state pensions

Your state pension is potentially liable for tax, just like any other income. Make sure you know where you stand

When some people draw their state pension they pay no income tax at all. Others will pay tax at a rate of 20%, 40% or even 45%. Once you understand your position, there may be ways you can legitimately reduce your tax bill.

The good news is that once you have reached the state pension age, you no longer have to pay National Insurance. However, you're still liable for income tax on any money you have coming in, including your state pension entitlement.

That said, pensioners, like everyone else in the UK, have a personal allowance – which in the tax year 2016–17 is £11,000 – so that everything earned below this level is not subject to tax. If you're living purely on the basic state pension, your income will fall below this threshold, and there's no tax to pay. If it's

just one of a number of sources, you need to check where you stand.

HM Revenue & Customs (HMRC) will take into consideration all of your sources of income, including the basic state pension, additional state pension (or single-tier pension if you've retired since April 2016), interest from any savings or investments you have, earnings from work and income from other pensions. If the combined total is over the threshold, there will be tax to pay.

The amount of tax due will depend on your level of income. In the 2016–17 tax year, people with taxable income up to £32,000 are basic-rate taxpayers and pay tax at a rate of 20%. With the personal allowance, this gives a threshold of £43,000 in 2016–17.

Those with taxable income between £43,001

Claiming extra help

If you're less well off, there is help available to boost the state pension you receive. This comes in the form of 'pension credit' and is awarded to you based on your income. The idea is to ensure you have a weekly income of at least £155.60 if you're single, or £237.55 for couples.

To qualify for pension credit, you must:

- live in the UK
- have reached the pension credit qualifying age - this is currently based on the state pension age for women, and will increase in line with the rising state pension age for men and women

- have a weekly income below £155.60 if you're single, or £237.55 if you're a couple.

If you're a carer, severely disabled or have certain housing costs, you might qualify for more credit. Contact the Pension Service on 0800 991 234 for details of how to claim.



“If you're still working after your state pension age, or you have income from other pensions, your employer or provider will deduct income tax”

and £150,000 pay tax at 40% on this money, and, if you're lucky enough to earn anything over £150,000, you'll be taxed at 45%.

How tax is collected

If you're still working after your state pension age your employer or pension provider will deduct income tax for you – including the tax due on your state pension, as it is otherwise paid to you without tax deducted. If you don't work, but get pensions from more than one pension company, HMRC will ask one of the

pension companies to take the tax off your state pension, too.

It's important to check that this is being done correctly. You should ensure that the right tax is coming off each source of income, and, if your financial situation changes, you will need to make sure that HMRC is aware of your new circumstances.

If you don't work or receive any other pension income, you'll need to complete a self-assessment tax return, so HMRC can calculate any tax due on your state pension.

Make the best of pension freedom

Pension reforms have given people far more flexibility about how they cash in their savings once they're ready to retire



“Buying an annuity will still be appealing for many. You're entitled to take up to 25% of your savings as a tax-free cash lump sum”

The pension freedom reforms that took effect in April 2015 have been hailed as the biggest shake-up of the pensions system for decades. Crucially, they give people far more freedom over how they convert their pension savings into income once they reach retirement (but note they are not aimed at people in occupational pension schemes offering final-salary benefits).

Previously, the vast majority of people used most of their pension cash, whether from an employer or from a private pension without final salary benefits, to buy an annuity – an income from an insurance company that is guaranteed for life. This was inflexible and could be poor value for money. Now, there are four main options that are covered below.

Annuity purchase

Buying an annuity will still be appealing for many. You're entitled to take up to 25% of your savings as a tax-free cash lump sum, using the rest to buy an annuity. This suits people who want a guaranteed income for the rest of their lives, and who don't want to take any investment risk with their savings. But annuities can be poor value, particularly if you don't live long into retirement.

Income drawdown

Now technically known as flexi-access drawdown, this option also allows you to take 25% of your savings as a tax-free cash lump sum. Thereafter, you can take out as much or as little of your savings whenever you want, with the money taxed as income. This is a more flexible arrangement that enables you to continue investing your pension savings in the hope of achieving further growth – although this carries risks, too. You can still buy an annuity later on.

Uncrystallised funds pension lump sum (UFPLS)

Usually, when you begin taking regular income from your pension fund, whether through an annuity or via drawdown, the fund becomes 'crystallised'. The first withdrawal of 25% or less is tax-free, but any more is taxable – as are all subsequent withdrawals. Under this option, however, you can make as many withdrawals as you like, with 25% of each one tax-free. This is a good way to spread your tax-free cash over time, and you can still buy an annuity later on.

Cash in your whole pension fund

There's nothing to stop you taking your whole pension fund in one go, with 25% tax-free and the rest taxed as income. You can even spend the lot if you want.

But think carefully about the tax bill you'll face, especially if taking a sizeable sum pushes you into a higher tax bracket. And consider what you'll live on for the rest of your life. Still, if you're in poor health, this may be a good option. Or you may have plans to invest the money elsewhere.

The end of the 'death tax'

The other important change under the pension freedom reforms was the abolition of high taxes on money left in private pension funds when the saver dies. In most cases people will now find it far easier to pass on their pension savings to their heirs - and with much less tax to pay. See page 29 for more details.

How much will I need in retirement?

Go back to basics with your pension planning, and the outcomes will be much more effective

Most of us worry about the complexities of saving for later in life, but the basic principles of pension planning are relatively simple. First, think about how much money you'll need in retirement, then assess what you'll have to save in order to generate this cash; finally, look at what you've saved so far in order to work out how much more you need to put by. Those questions aren't as difficult as you might think.

How to plan more effectively for retirement

Many people overestimate how much they'll need to live on in retirement, thinking that they'll spend the equivalent of their wages. In fact it's more likely that you'll need between half and two-thirds of your salaried income levels as a household, after tax, to maintain your lifestyle once you retire. You may well have paid off the mortgage, will no longer be bringing up children and won't face the cost of commuting.

A detailed survey from Nest – the government-backed pension provider – indicated that pensioners' overall sense of satisfaction with life is a decent 75% when their household income is £25,000–£30,000. This was for a mixture of one- and two-person

pensioner households. Which? Money's own research supports that. In September 2015 we found that our retired-member households spent a shade under £2,000 a month, or around £23,000 a year on average.

This covers all the basic areas of expenditure and some relative luxuries, such as holidays, hobbies and eating out (see table, right). Aiming for this level of income will provide a good platform for your retirement.

“You'll need between half and two-thirds of your salaried income to maintain your lifestyle once you retire”

What will I need to save to reach my target?

In the wake of the pension freedom changes, most people with predominantly defined-contribution pension provision will opt for income (or flexi-access) drawdown or an annuity, or a combination of both, when it comes to taking money out of their pension.

Typical spending in retirement for a couple (per year)



● **Essentials** We define essentials as food and drink, housing payments, transport, utilities, insurance, household goods, clothes, footwear and health products.

● **Treats and extras** These add a bit of enjoyment to our lives: travel and holidays, recreation and leisure, tobacco and alcohol, and charity donations.

● **Luxuries** Including frequent and extended holidays, health club memberships, expensive meals out and regular new car purchases.

(Source: *Which? Money* magazine, December 2015)

Even if you're getting the state pension and aiming for a comfortable post-tax income of £24,000 a year, a lifetime income via an annuity will require a pot of nearly £250,000 according to our calculations. Producing post-tax annual income of £36,000, including the state pension, would need an initial pot of £546,000.

How am I getting on towards those targets?

You can find out exactly how big a gap you still have to bridge by asking all of your pension providers – including the government (see page 6) – to provide you with forecasts of what your pension savings with them will be worth when you retire.

The combined answer will tell you how close (or not) you are to achieving the target pension pot that you've identified. You can then think about what you may need to add to your pension contributions, and how much you can afford, in order to reach your goal.

The longer you have to go to retirement, the more room for manoeuvre you have. Which? Money calculations suggest that a 25-year-old saver looking to generate a pension income of £15,000 a year should be putting by £165 a month, or £502 monthly for a £30,000 pension. At age 35, these figures rise to £215 and £654, respectively; to £322 and £981 at age 45; and to £644 and £1,962 at age 55.

If those projections sound a little daunting, remember that tax relief will provide some of the contribution – and if you're a member of a workplace pension scheme, your employer will be adding to your pension pot, too.



Find out more

Which?'s pension calculator is a useful tool to help you check on the progress you're making towards your targets. See which.co.uk/pensioncalculator.

Avoiding the tax trap



The pension freedom rules offer opportunities to make the best of your retirement savings. But don't fall foul of the tax system

Pension freedom is wonderful in many ways. It gives you the power to do what you like with the money you've saved for your retirement – with nothing forcing you to buy an annuity, and no government telling you what you can and can't do with your hard-earned cash. If you want to blow the lot on a sports car, as one former pensions minister was quoted as saying, you're more than welcome to do so.

But if you do use your pension to buy a Lamborghini, you'll pay enough tax to buy the Treasury a Porsche. The government's vow to 'completely change the tax treatment of defined contribution pensions' will earn it an expected extra £3bn in tax from 2015–19 as people cash in their pension pots and, unless you plan carefully, taking advantage of the new freedoms could see you hand a large chunk back to HMRC.

Under the new system, the first 25% you take from a pension pot is tax-free. Before the pension reforms, if you cashed in any of your pension pot above this tax-free amount, you were usually hit with a punitive 55% tax rate. Now the rate you pay depends not only on your personal circumstances and how much your pension pot is worth. It also depends on how you access your pension:

- **Via an annuity** (see page 13) – you'll pay no tax on the tax-free cash lump sum you take, up to 25% of the value of your fund; thereafter you'll pay income tax on your annuity income at your marginal rate – 20%, 40% or 45%.
- **Via income or flexi-access drawdown** (see page 13) – the first 25% of your first withdrawal is tax-free, and the remaining 75% is taxed as income at your marginal rate, as are all subsequent withdrawals. You could use this option to take all of your pension out in one

“If you want to blow the lot on a sports car, you're more than welcome to do so. But if you use your pension to buy a Lamborghini, you'll pay enough tax to buy the Treasury a Porsche”

go but, if you do, expect a large tax bill – especially if you end up moving into a higher tax bracket.

- **Via uncrystallised funds pension lump sums** (see page 13) – with this option, you get more than one chance to use the 25% tax-free cash concession. On each withdrawal you make, the first 25% is tax-free and thereafter you pay income tax at your marginal rate.

Three ways to keep your tax bill down

Consider these ways to make the most of pension freedom without paying a hefty chunk back to the taxman.

- **Stay within the 25% tax-free lump sum.** For those with a large pension pot, this might free up enough money for a short-term goal, while shifting the rest of your pension pot into drawdown, ready to provide further incremental sums.
- **Take less than the full pot in a single withdrawal.** Smaller instalments, straddled over more than one tax year, may enable you to pay less tax, while still freeing up funds. For example, you can take £11,000 tax-free in the 2016–17 tax year, provided you have no income from other sources, or if you do but you're not a higher-rate (40%) taxpayer, take an amount that keeps you paying 20% tax.
- **Withdraw more than 25%, but reduce your income from other sources** – those in receipt of state pension can defer this for as long as they like. This can save tax while earning interest during the deferral period.



Find out more

For more information about your tax liabilities in retirement and tips on how to reduce your bill, visit which.co.uk/taxinretirement.

Workplace pension schemes explained

Almost all employers now have to offer staff a workplace pension scheme and make contributions on their behalf

Under the auto-enrolment pension regime that came into effect in 2012, almost every employer in the country now has to offer staff access to a workplace pension scheme. Your employer will automatically enrol you into the scheme unless you specifically opt out. This will mean contributions are deducted from your salary, but your employer will be required to make contributions to the scheme, too, which will give your savings a boost.

In practice, workplace schemes fall into two categories. 'Defined benefit' (or 'final salary') schemes were once the most common option, but employers have increasingly been moving away from them in recent times, in favour of 'defined contribution' (or 'money purchase') schemes.

Defined contribution schemes

The contributions made by you and your employer will be invested in the stock market, with the aim of growing it over the years before you retire. You will usually have a wide range of options as to where the pension contributions are invested. Many people opt to put their money in the scheme's default fund – a fund that has a mix of different assets – but you could choose more risky investments to

maximise growth, as you may be saving for a long time until you retire.

Once you do reach your retirement date, you'll need to use your pension pot – all of your savings over the years and all the growth they've gained through investment on the stock market – to buy an income. You can buy an annuity, which is an insurance product designed to give you a guaranteed income for the rest of your life, or enter into income or flexi-access drawdown, where you leave your money invested in the stock market and draw an income from it. You can also take the lot, subject to taxation.

What you'll get from a defined contribution scheme depends on several factors:

- how much you contribute each month – you can usually choose to increase this
- how much your employer contributes
- how long you contribute for
- how well the investments perform
- how much any charges eat into your pot
- how much you take as a cash lump sum.

Defined benefit schemes

A defined benefit (or final salary) pension scheme is one that promises to pay out an



income based on how much you were earning when you retire. The amount you'll get at retirement is guaranteed, and it will be paid directly to you – you won't have to use your pension pot to decide your next move.

If you've saved into a defined benefit pension scheme during your career, it will provide you with an income for your retirement based on three key factors:

- 1 The number of years you have paid into the scheme
- 2 Your salary – this might be your final salary when you retire, or your average salary across your career
- 3 Your pension scheme's accrual rate – this is a formula that's used to calculate your final retirement income; it might be, say, 1/60 of

your final salary for each year you are a member of the scheme. So, if your final salary before retirement is £30,000 and you've worked at the company for 40 years, your annual pension would be £20,000, at a 1/60 accrual rate.



Stick or twist?

Since the pension freedom rules came into force, we've seen adverts that aim to persuade people in final salary pension schemes to switch to defined contribution plans, on which the reforms are focused. Tread very carefully here – it rarely makes sense to give up the guarantees that final salary schemes offer.

How personal pensions work

If you don't have access to a workplace pension scheme, consider an individual arrangement with a personal pension provider

If you don't have access to workplace pension arrangements – or have a good reason for not joining – you can still save privately for retirement via your own pension plan, and qualify for the same tax relief as members of occupational schemes. These plans are often known as personal pensions and are offered by providers such as insurance companies.

Personal pensions are defined contribution pensions. You choose the provider, who invests the money you pay in, and what you do with the accumulated sum on retirement – whether to buy an annuity or go for income drawdown, for example.

“You choose the provider, who invests the money you pay in, and what you do with the sum on retirement”

In practice, personal pensions come in many forms. For example, stakeholder pensions are a basic type of personal pension that must conform to certain government standards, such as low charging structures and clear terms and conditions. Self-invested personal pensions (Sipps) are personal pensions that offer access to a broader range of investments.

What you'll get from a personal pension

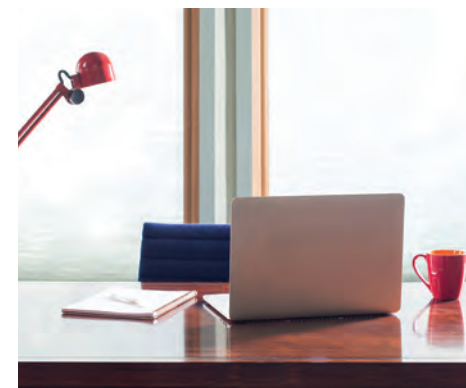
How much you get at retirement depends on the performance of the funds in which the money has been invested, less any charges to be deducted. Your pension provider will claim tax relief at the basic rate and add it to your fund. If you're a higher rate taxpayer, you'll need to claim this rebate through your tax return.

Although your total pension pot should increase each year you continue to pay into the scheme, there is no way of accurately predicting what the final total will be and how much pension income this will provide. Still, it's important to think carefully about where your money is invested. Many personal pension investors opt for the scheme's default fund, which is likely to be invested in a broad mix of assets. However, some will want to be more cautious, investing in cash funds and corporate bonds; others may prefer a more adventurous mix, prioritising stock-market investments, including overseas markets.

Your attitude to risk should change over time. As you near retirement, it's wise to alter your asset allocation into more cautious investments, such as gilts (fixed-interest, government-issued securities). This is because you want to reduce the risk of your investments performing badly and having less time to make up any losses.

Pensions for the self-employed

If you're working for yourself, you won't have access to an occupational pension scheme. But don't let that stop you saving for your retirement



Britain's almost 5m self-employed workers are far less likely to contribute to a pension than employees, according to research produced by independent analysts.

For example, in one survey conducted by the Resolution Foundation, just 31% of people in self-employment said they were currently contributing to a pension. That's particularly unfortunate given that so many self-employed people are aged 50 or over.

It is true that if you're self-employed, you won't have access to a lucrative company pension that is topped up by an employer, but you can still reap the benefits of saving into a personal pension plan. These schemes offer 20% tax relief upfront automatically, and if you're a higher-rate or additional-rate taxpayer, you can claim further relief through your tax return.

There are, in fact, several advantages of personal pensions. They tend to be more flexible and portable than company pensions, so it should be easier to vary your contributions or to move your savings as your circumstances change. You should also have more investment choice and greater control over where your money goes, particularly if you choose a self-invested personal pension (Sipp).

Some self-employed workers even use their pension plans to support their businesses. Small self-administered schemes (SSASs) are specially designed for these purposes and, subject to certain rules, can be used to invest in your company.

Finally, self-employed workers need to be careful not to neglect their state pension. It's important to consider the effect of your employment status on your National Insurance contribution record, and what that might mean for your entitlement to state pension. It's possible to make additional voluntary contributions if needs be (see pages 8–9).



Find out more

For more advice on tax regulations for the self-employed and how to fill in a tax return, visit [which.co.uk/self-employed-tax](https://www.which.co.uk/self-employed-tax).

Where to find good advice

Financial advisers can help you make the right pension choices, but free guidance is available, too



An independent financial adviser (IFA) is a professionally qualified and regulated individual who can offer personalised recommendations on how to achieve your retirement goals. IFAs will charge a fee for their time, but the best firms offer genuine expertise and can really help you move towards your objectives.

If you're interested in consulting an IFA, there are lots of ways to find one:

- The Financial Conduct Authority (FCA)'s

register ([fca.org.uk/register](https://www.fca.org.uk/register)) lets you check whether an adviser is authorised.

- The Personal Finance Society's website includes a directory of authorised advisers ([thepfs.org/yourmoney/](https://www.thepfs.org/yourmoney/)).
- The government-funded Money Advice Service also offers a directory of FCA-registered advisers ([directory.moneyadviceservice.org.uk](https://www.directory.moneyadviceservice.org.uk)).
- The Chartered Institute for Securities & Investment (CISI) – a trade body for financial advisers – provides a tool to search for

accredited financial planning firms by postcode ([financialplanning.org.uk/wayfinder](https://www.financialplanning.org.uk/wayfinder)).

- Other independent websites, such as [unbiased.co.uk](https://www.unbiased.co.uk) and [vouchedfor.co.uk](https://www.vouchedfor.co.uk), allow you to search for financial advisers near you.

However, don't just opt for the services of the first adviser you come across. It's worth talking to several advisers before deciding which one you feel most comfortable with. Ask each adviser about their experience in your particular area of need, and how they propose to charge for their services. Don't be afraid to negotiate on fees if you're not offered a deal that you think is acceptable.



Find out more

The Which? Money Helpline is available to all

Which? members, and our team of qualified experts can help you find a financial adviser or give guidance on any other financial matter. For more, see [which.co.uk/helpline](https://www.which.co.uk/helpline).

10 questions to ask a potential IFA

- 1 How will you be paid, how much and how often?
- 2 What does your fee cover, and what isn't included?
- 3 What are your professional qualifications?
- 4 Are there any areas on which you cannot advise me?
- 5 Do you work from a panel or do you have access to the entire market?
- 6 How often will I see or hear from you?
- 7 Do I have to have an ongoing service or can I opt for a transactional service? And, if I don't take ongoing advice, will the advice be different?
- 8 How will you assess if I am on target to meet my objectives?
- 9 How many clients do you personally serve, and what is their average portfolio size?
- 10 Tell me about your best and worst client experiences.

Free guidance from the government

Pension Wise is a free service introduced in April 2015 alongside the pension freedom reforms. It's delivered by independent organisations, namely The Pensions Advisory Service (TPAS) and Citizens Advice, and is available to anyone over the age of 50.

The guidance provides tailored help and highlights the options available to you - but it doesn't give specific product or provider recommendations. Citizens Advice provides face-to-face guidance while TPAS provides telephone guidance. Visit [pensionwise.gov.uk](https://www.pensionwise.gov.uk).



Dodging the pension scams

Tread carefully to avoid being taken for a ride by scammers with an eye on your pension savings

The pension freedoms that came into effect in April 2015 have created choices, allowing people to make better use of their money in retirement. But, unfortunately, fraudsters are among the beneficiaries – they see the flexibility that the system now offers as a golden opportunity to exploit people who aren't sure what to do with their pension savings. In the first year after the pension rules changed, regulators received some 10,000 reports of attempted scams.

The free pension review scam

One issue is that as people approach the age of 55, they are entitled to free guidance on how to make the most of their retirement savings. Regulators have recently warned against scammers exploiting these changes by cold calling people and offering 'free pension reviews', sometimes claiming to be from the Money Advice Service, which does provide much of the guidance available under the system.

These reviews try to persuade people to move money saved in their existing pension to a self-invested personal pension (Sipp), or

in a small self-administered scheme (a type of occupational pension with fewer than 12 members). The money is then typically invested in unregulated investments, such as overseas property developments. Not only are the returns on these unreliable, but the investments are unregulated, so victims don't have recourse to the regulator or the Financial Ombudsman Service if things go wrong.

There's a pretty good chance of things going wrong – but even if the investments these pensions fraudsters sell don't prove disastrous, they take huge charges out of people's savings when transferring their money from their existing pension arrangements. Falling victim to a pension sting of this type is likely to prove especially pernicious, since there's no time to make good your losses.

The pension liberation scam

For many people, pension savings are by far and away their most valuable asset. And there are times when it can be frustrating that cash is locked up in a pension plan that you can't access until you reach the age of 55. There is a nasty and growing group of fraudsters who

“**Fraudsters see the flexibility that the system now offers as a golden opportunity to exploit people who aren't sure what to do with their pension savings**”



know this all too well and are attempting to cash in: the Financial Conduct Authority says 'pension liberation' scams cost people £9.1m in just the period between April and August 2015.

If you receive a call or text about pension liberation, avoid it at all costs. These companies get in touch, offering to unshackle the money that's tied up in your pension before you turn 55 – the earliest age you can access it. At best, this is an extremely expensive way of getting access to your pension savings and, at worst, a major crime that could see you receiving no money at all.

If in doubt, check them out

No reputable pension adviser will cold call you and attempt to talk you into a pension review, let alone into transferring your money elsewhere. If you receive such a call, hang up the phone.

If you do have doubts about an adviser, check out their credentials with the Financial Conduct Authority (register.fca.org.uk). You could also contact your current pension provider and ask whether it has had prior dealings with such a firm – many scams have been foiled by the intervention of pension companies keen to protect their customers.

Working in retirement

If you are one of the growing number of people planning to work on into retirement, it's vital to understand how this affects your state pension and tax liabilities



More than one in ten people work past the state pension age, according to the Office for National Statistics. Almost half of them do so because they're not ready to give up work, while 17% do it to boost their retirement income. But whatever your motivation, if you work in retirement, you need to consider the impact on your state pension and also what it will mean for your tax affairs.

In very basic terms, the fact that you are working makes absolutely no difference to your state pension, because once you have reached state pension age, you will be entitled to receive a pension, regardless of any other sources of income. However, there are some strategies worth considering that could help ensure you make the most of your state pension.

Two-thirds of those who continue to work after state pension age reduce their hours in favour of part-time work. Many make up the difference with income from their state pension. For them, it makes perfect sense to work and receive the state pension alongside a salary.

For others, it's worth considering deferring the pension. While you're working, you may have enough income to cover your outgoings, and so the state pension is surplus to requirements for those years. By deferring it, you can get higher weekly payments when you eventually take your state pension (for more on deferring your pension see page 9).

Tax issues

One possible argument for deferral is tax. Once you add in your state pension, most people who work in retirement will earn over the personal allowance threshold – £11,000 in 2016–17. This means you'll pay tax at 20%. And if you earn more than £43,000 in 2016–17, you'll pay 40% on sums over the threshold (for more on your tax position see pages 10–11). The good news, however, is that there is no more National Insurance to pay once you reach state retirement age.

“For some people the state pension will make up a vital part of their income; for others it won't be essential until they stop work”

The Office for National Statistics says that more than 17% of people working past their state pension age are in professional occupations. Depending on the number of hours you're working, your salary could push you into the higher tax bracket.

If you defer your state pension, you'll get a higher amount and tax will be due on this money. However, if you've stopped working by this stage, you're likely to be on a lower income overall. This may mean a higher-rate taxpayer becomes a basic-rate taxpayer, which would mean you end up paying significantly less tax on your state pension simply by taking it later.

Of course, tax is just one consideration, and each situation is different. For some people the state pension will make up a vital part of their income; for others it won't be essential until they stop working. If you're planning to work into retirement, it is worthwhile doing your own calculations, working out whether you need the state pension income straight away, or whether deferring is a better option for you.



Find out more

For more information on working or starting a business in retirement, visit [which.co.uk/workingretirement](https://www.which.co.uk/workingretirement).

Passing on your pension benefits

Your pensions don't necessarily die with you – it's possible to pass both state and private pension savings and entitlements on to your loved ones

Unfortunately, not everyone enjoys a long retirement. But there are certain circumstances in which some of your state pension benefits can be inherited after your death.

Basic state pension

You may be able to pass on the years you have amassed in National Insurance contributions. If your spouse or civil partner has not built up enough contributions themselves to qualify for the full basic state pension, they can inherit yours. They just need to let the Pension Service know of your death and their circumstances (see [gov.uk/contact-pension-service](https://www.gov.uk/contact-pension-service)).

If your spouse or civil partner is below state pension age when you die, they will only get the extra payments when they reach state pension age. There are, however, some additional benefits they may be entitled to after you die (based on 2015–16 figures):

- They can claim bereavement benefits as a lump sum of £2,000 – if you have made enough National Insurance contributions to qualify.
- If they're looking after children, they may qualify for a widowed parent's allowance of up to £112.55 a week.
- If they are over 45 but under retirement age, they may qualify for a bereavement allowance of up to £112.55 a week.

If you pass away after reaching state pension age but have chosen to defer your pension, then your spouse will receive any

lump sum that you built up. If you don't have a spouse or civil partner, then the executors of your estate will be able to claim up to three months' worth of payments.

Additional state pension

The rules for the state earnings-related pension scheme (Serps), which ran until 2002, are different to those for the state second pension (S2P), which ran from 2002 to 2016.

Under S2P rules, you can pass on up to half of your benefits. Meanwhile, under Serps, what you can pass on depends on when you were born.

A man born on or before 5 October 1937 and a woman born on or before 5 October 1942 can pass on all of the money built up under Serps. The maximum reduces with age, until men born after 6 October 1945 and women born after 6 July 1950 can pass on 50% of their benefits.

If you reached state pension age on or after 6 October 2010, the most you can pass on is 50%. And if the person receiving the pension benefits already has their own additional state pension benefits, the amount they can inherit can't take them over a set weekly maximum amount.

The state pension rules now

If you were already getting your state pension in April 2016, and you die afterwards, the old



“If your spouse or civil partner is below state pension age when you die, they will get the extra payments when they reach state pension age”

rules will apply – even if your spouse wasn't due to receive their pension until after April 2016. For those who reached state pension age on or after 6 April 2016, and die after that date, your partner will not be able to inherit your National Insurance contributions – so their pension will be based solely on their own contributions. The only exception to this is women who previously opted to pay reduced-rate contributions – known as Reduced Rate Election or the Married Woman's Stamp – who may have their pension increased.

Passing on private pensions

The rules on private pension inheritance changed as part of the pension freedom reforms that took effect in April 2015. In most

cases, people now find it far easier to pass on their pension savings to their heirs – and with much less tax to pay.

Previously, only funds that hadn't been drawn on (uncrystallised) and were left by someone who died before age 75 escaped a 55% tax when someone died. Now, all defined contribution pension funds left by someone under 75 can be inherited tax-free. The heirs can get pension income without paying tax on it, or take the remaining pot as one or more tax-free lump sums.

Anyone who dies aged 75 or over also escapes the 55% 'death tax', but their pot is taxed at the marginal income tax rate of their heir (20%, 40% or 45%, depending on their income) if they cash it in or use it to generate an income.

Jargon buster

Don't be put off by all the confusing financial terms you sometimes hear – use our jargon buster to find out what it all means



■ Additional state pension

An extra payment made on top of the old basic state pension to those who have made sufficient National Insurance contributions and have not opted out of the system (see Contracting out).

■ Annuity

An income for life, or a set period, provided by an insurance firm in exchange for a lump sum, usually from a pension pot.

■ Basic state pension

The sum paid to all pensioners with sufficient contributions. This was replaced in April 2016 (see Single-tier state pension).

■ Contracting out

Some people with workplace defined benefit pensions paid lower levels of National Insurance, while some with personal pensions opted to have National Insurance contributions paid into private schemes. In return,

both groups gave up their entitlement to the additional state pension for the years they were contracted out.

■ Deferring your pension

Putting off taking your state pension in return for a higher weekly pension later on.

■ Defined benefit scheme

Also known as a final salary scheme, this is a plan where your pension is guaranteed to be a set proportion of your pre-retirement earnings.

■ Defined contribution scheme

Also known as a money purchase scheme, this is a pension plan run by an employer or a private provider such as an insurer whereby your savings are invested and you decide how to use the money on retirement.

■ Income drawdown

Sometimes known as flexi-access drawdown, this is a way of taking a flexible income from your pension savings. In this arrangement, you leave your pension invested in retirement, while drawing an income or lump sums as you see fit. You can take 25% of your entire pot tax-free, and any further withdrawals are subject to income tax.

■ National insurance

Automatically deducted from your salary while you are working in the UK – or you may make voluntary contributions. To qualify for a state pension you need to have been contributing for a minimum number of years.

■ National insurance credits

People who missed years of National Insurance contributions, because they were claiming certain benefits or caring for a child under 12, are entitled to credits, which

count towards their years of contributions.

■ Pension credit

Anyone earning below a set level when all their retirement income is taken into consideration (£155.60 for individuals or £237.55 for couples, in 2016) can have it topped up to this level.

■ Reduced rate election

Until April 1977, married women could choose to pay a reduced rate of National Insurance under this scheme.

■ Self-invested personal pension (Sipp)

A personal pension that offers wide investment choice before retirement and/or in drawdown.

■ Single-tier state pension

In April 2016 this replaced the old two-tier system, ensuring that everyone who has made sufficient National Insurance contributions will eventually receive the same payment.

■ Small self-administered scheme (SSAS)

An occupational pension with fewer than 12 members.

■ State earnings-related pension scheme (Serps)

The additional state pension scheme that ran between 1978 and 2002.

■ State pension age

As of 2016, this is 65 for men and is gradually rising to 65 for women. It will reach 65 for both men and women in 2018, then continue rising to 66 by 2020 and 67 by 2028.

■ State second pension (S2P)

The additional state pension scheme that replaced Serps in 2002, before coming to an end in 2016.

■ Tax-free lump sum

An amount of cash that you can take out of your pension pot at retirement, free of tax – the maximum is 25%.

■ Top-up

People who retired before April 2016 can top up their pension by up to £25 a week, in exchange for a lump sum.

■ Uncrystallised funds pension lump sum (UFPLS)

Usually, when you take regular income from your pension fund, whether through an annuity or via drawdown, the fund becomes 'crystallised'.

The first withdrawal of 25% or less is tax-free, but any more is taxable – as are all subsequent withdrawals. Under UFPLS arrangements, however, you can make as many withdrawals as you like, with 25% of each one exempt from tax.