Avoiding a pension headache

Simplifying the ins and outs of your NHS pension plan

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Is your NHS pension giving you a headache?

Are you stressed out by your lifetime allowance?

Or anxious of a retirement tax bill?

This short guide could help.

Pension planning doesn't have to be painful

While life after the waiting room should be an exciting prospect, preparing for it can be daunting.

Navigating the minefield of pension planning isn't always easy, no matter what your industry. 43% of the working population don't actually know how much they'll need to retire comfortably with.[1]

But for healthcare professionals, recent changes in NHS pension legislation make it all the more tricky.

Just recently, the NHS Business Services Authority paid out an eye-watering £35m in tax bills to cover its 3,949 members who breached their annual allowance in 2017.[2] Some healthcare professionals are even opting out of their pension schemes altogether in order to avoid a tax bill on retirement — a decision that could leave them even worse off.

But if giving up the lucrative benefits afforded by the NHS pension plan could be a costly mistake, and so could flying blind when it comes to your annual contributions, what's a healthcare professional to do?

That's where this guide's designed to help. In it, we'll try to tackle some of the big questions you might have about your NHS pension, so that you're better placed to enjoy your retirement and stay on the right side of the taxman.

Of course, none of it should be taken as financial advice. We'd always recommend speaking to a qualified adviser or financial planner before making any decision about your retirement or pension plan. After all, some things are too important to DIY...

1 Finder.com, 'Pension statistics', October 2018
2 FT Adviser, 'NHS scheme lends savers £35m for allowance breaches', February 2019

Which pension scheme am I on?

As of 1 April 2015, when new regulations came into force, there are currently 3 types of NHS pension plans offered to healthcare professionals in the UK.[3]

1995 Section

2008 Section

2015 Section

All three pension schemes are 'defined benefit' pensions. In other words, they pay a pre-agreed amount based on your income and years of service – unlike 'defined contribution' pensions, where the size of the pension is determined by how much you and your employer pay into it.

But the way that pre-agreed amount is calculated isn't the same across all three. The 1995 and 2008 sections are 'final salary' pensions, paying a proportion of the salary you're on at the point you retire. The 2015 section, on the other hand, pays workers an average of their earnings over the course of their entire career (including at the start, when they're earnings would've been considerably lower).

As it's deemed to be less generous than the 1995 and 2008 final salary scheme, the 2015 section has caused a bit of a stir among NHS pension plan members since its inception.

If you aren't sure what pension scheme you're on, it's worth finding out...

What's more, when the new 2015 scheme came into effect, many workers on the 1995 and 2008 sections were automatically transferred to the new plan for their future contributions, subsequently affecting their projected pension benefits upon retirement.

Only healthcare professionals who were within 10 years of retirement in April 2012 were left unaffected.

If you aren't sure which of these sections applies to you, it's time to find out – head to the NHS Business Services Authority for more info.

Your scheme may have changed over the years in line with legislation updates, so it's always worth double checking the finer details of your own plan. You could even be on more than one scheme.

3 See NHS Business Services 'Pensions Scheme Identifier' for more info

When can I retire?

For healthcare professionals, the Normal Pension Age is determined by which scheme you're on:

1995 Section	60 years old
2008 Section	65 years old
2015 Section	State Pension Age (currently 65 for both men and women, but expected to increase imminently)

If working until you're 65 (or older) doesn't excite you very much, you can still retire with a secured pension before the legally defined date. You can either take early retirement and face a deduction for doing so, or become a deferred member, stopping all payments until you reach Normal Pension Age.

What's my annual allowance?

A question it's well worth knowing the answer to. More and more healthcare professionals are facing large tax bills when they retire because they either don't know how much they're legally allowed to pay into their pension, or how much they're actually contributing. Or indeed both.

The current annual allowance for most individuals on the NHS pension plan is £40,000 in any given year (gross of tax). This is the most you and your employer can pay into your pension in a single year, without incurring a tax charge.

For higher earners, however, Tapered Annual Allowance was introduced in April 2016, which means that earners with a taxable income of over £150,000 will have their annual pension input reduced by £1 for every £2 over the threshold — with a minimum cap of £10,000 per year.

Straightforward, right? Well, perhaps in theory.

Many healthcare professionals may find it difficult to know exactly what their total taxable income is each year. That's because it's not just your salary that's assessed, but all sources of income — including any savings interest, investments, rental income, or other revenues.

If you aren't sure how to calculate your true taxable income, a financial planner can help you make an accurate assessment of your situation, so you aren't left to face any nasty surprises.

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What happens if I do exceed my annual allowance?

Whether done knowingly or not, any amount contributed to your pension over the annual allowance will be subject to a tax charge. And it could be a substantial one.

The NHS Pension Authority will typically write to you to let you know of the breach in accordance with your salaried income. But because they won't be aware of your other earnings, you may not get any warning at all — making it all the more vital that you work out a true picture of your finances sooner rather than later.

What's my lifetime allowance?

The lifetime allowance (LTA) for your NHS pension plan is the maximum benefit you can draw from your pensions after retirement without incurring any tax liability.

Currently, the lifetime allowance for any working professional in the UK is £1,030,000 per person (2018-2019). From 6 April 2019, the standard lifetime allowance for any working professional in the UK will be £1,055,000 per person.

Exceeding your allowance

Calculating your lifetime allowance and the benefits you have built up can be as confusing as it is daunting, especially for those who may be on more than one scheme. And the tax penalties aren't too attractive either: any excess benefits you may receive will be subject to a tax charge of 25% if taken as income (over the income tax rate which applies to you), and 55% if taken as a lump sum.

As the annual allowance has continued to fall over the last decade (2011/12's LTA was £1.8m), more and more professionals have found themselves on the wrong side of the tax threshold. And so it's perhaps not surprising that many NHS pension plan members are opting to retire early or leave the scheme altogether, rather than face a sizeable bill from HMRC.

In fact, The Health Service Journal has estimated that 16% of active members have left the NHS pension scheme in the past 3 years — that's around 245,561 healthcare professionals.[4]

But it could pay to stay. A key point to bear in mind with any company pension scheme is that, if you choose to leave it, it's not just your own contributions you're forgoing, but your employer's, too — contributions that make your pension more valuable at no immediate expense on your part.

Having a secure but taxable benefit could ultimately be more advantageous than having no benefit at all...

Is there any way to protect my pension from the lifetime allowance tax charge?

You may be eligible for a protection plan that will minimise how much you have to dip into your pension to cover tax charges.

Individual Protection 2016 will allow anyone to extend their lifetime allowance to the total value of their pension savings as they stood on 5 April 2016, provided that the amount was greater £1m.

Fixed Protection 2016 also provides similar protection, but its eligibility requirements are a little more complex to navigate.

A financial planner will be able to guide you in the right direction when it comes to protecting your pension, and help you work around the legal hurdles you might encounter as you do so.

4 Health Service Journal, ' Exclusive: A quarter of a million staff opt out of NHS pension' (October, 2018)

How can I reduce my lifetime allowance tax bill?

If you think you could be on track to reach your lifetime allowance sooner than anticipated, or if you already have, there are several things you could do to avoid a pension headache.

Early retirement

Deciding to take early retirement before the Normal Pension Age means your pension pot will be hit with a penalty deduction; a predetermined amount according to the scheme you're on.

This is where a little number crunching comes into play. Because although you're guaranteed to have your pension benefits reduced for retiring early, it's your reduced amount that will be assessed against the lifetime allowance (not the total you've built up), meaning you may avoid incurring any tax fees at all.

Give some of it up for a tax-free lump sum

When you retire at the Normal Pension Age, you have the option to exchange some of your pension benefits for a tax-free lump sum. This is a capped amount and will depend on your personal plan.

The general rule is that you can receive a tax-free cash payment of roughly £12 for every £1 of your annual pension income that you sacrifice upon retirement. And when you do so, you're ultimately reducing the total value of your benefits that will be assessed against the lifetime allowance.

Let's take an example. Say you're due to receive a guaranteed income of £20,000 per year. You could reduce that annual income to £12,857, and receive a tax-free lump sum of £85,714 for doing so.

As with early retirement, you'll need to weigh up whether it's financially beneficial to opt for a lump sum in place of tax charges — you may end up sacrificing more of your benefits just to avoid the consequences of breaching your lifetime allowance.

Become a 'deferred member'

Anyone on the NHS pension plan can choose to become a deferred member and stop contributing to their pension plan if they're nearing their lifetime allowance.

This might seem like the logical answer in order to mitigate charges. However, problems arise when people leave on a whim for fear of incurring any sort of tax charge, only to realise that they don't have enough income from other sources to tide themselves over until they reach their pension age.

Have your scheme pay the charge for you

If you exceed your allowance, you can also apply for what's called 'Scheme Pays'. As the name might suggest, this involves the NHS pension scheme itself paying your tax charges directly to HMRC on your behalf.

It's essentially a loan which you'll pay back with interest once you reach retirement age, or when you opt out of your pension plan.

Summing it up: your retirement checklist

- Find out what scheme your on
- Check your normal pension age
- See how you're tracking against your annual and lifetime allowances
- Get the rest of your house in order! Why not head to octopuswealth.com to use our free, quick and easy-to-use financial health check tool?

Do I need financial advice?

Many people tend to bury their heads in the sand when it comes to their retirement. Planning their pension is a task that's too easily shelved away for another day, and is rarely given the full attention it deserves.

But while it's never too early to get your retirement plans on track, it can be too late. And for healthcare professionals, the raft of changes to the NHS pension scheme mean it's never been more important to get on top of your later life planning.

That's where a financial planner can come in handy. While it might be tempting to take a DIY approach to your finances, monitoring the ever-changing landscape for updates and changes can be a full-time job in itself. So why not let someone else do the hard work for you?

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Want more info?

Head to the pensions section of the NHS Business Services Authority site **nhsbsa.nhs.uk**, and check out the Gov.uk website for more information relating to your annual and lifetime allowance.

June 2019

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