

Beat the bite of inflation

The latest inflation figures are causing headaches in the Bank of England, as well as for savers. Recent figures put the consumer price index, the official measure of inflation, at 3.7% – the highest in 17 months. Earlier this year, the retail price index, which is commonly used by employers, banks and building societies, jumped from 4.4% to 5.3% – its biggest monthly leap since 1991.

The rise in inflation is a blow to the ambitions of savers, particularly when coupled with the low interest rates on savings accounts. Put simply, inflation can erode the value of your savings and reduce the buying power of your income. Basic and higher rate taxpayers need to find accounts paying at least 4.63% and 6.17% respectively to beat the effects of consumer price index inflation.

Inflation and retirement planning

So what does all this mean if you are saving for retirement? Hospital doctors working in the NHS are fortunate to enjoy inflation-proofed pensions, generally linked to final salary at retirement age, and increased each year in retirement in line with the retail price index. This is a valuable benefit.

If you had to save for retirement through a personal pension, you might be surprised at how much you would need to cover inflationary rises in prices after retirement. A man aged 65 years retiring in June 2010 with £100 000 in a pension fund could buy a non-increasing annuity income of around £6432 a year for the rest of his life, or one of around £5532 for a woman aged 60 years. If they wanted to inflation proof this income and receive a pension linked to the retail price index, the same £100 000 might provide an annual income of just £3948 for the man or £2928 a year for the woman.

As things currently stand, most public sector employees, including NHS workers,

benefit from index-linked pensions, which are ‘protected’ from inflation. However, the cost of providing this benefit is forcing many private sector employers, and the government, to review expensive pension arrangements and in some cases to discontinue schemes and replace them with cheaper alternatives.

The key issue to consider is whether your NHS pension alone will be sufficient to provide the standard of living you want when you retire. If it won't, then you should top up your NHS pension or supplement it. There are a number of options to consider and which you choose really depends on your circumstances. Two popular choices include personal pensions and individual savings accounts (ISAs). These are looked at in a bit more detail below.

Individual savings accounts

Younger doctors who may need their savings long before they reach retirement age – to buy a home, move house or educate children – might prefer saving in ISAs because money can be withdrawn at any time. They also offer significant tax breaks. The annual ISA allowance rose by almost one third earlier this year to £10 200 and you can put all of this money into a stocks and shares ISA. Alternatively you can put up to £5100 into a cash ISA, with the remainder available for stocks and shares.

ISAs benefit from growth free of capital gains tax, and no further tax is paid on any income produced by the ISA investments. If you want to save more than ISA limits allow, you could consider investments such as unit trusts.

Pension plans

The NHS pension scheme offers the opportunity to purchase extra retirement income through what is known as additional pension. Other pension options include the NHS additional voluntary contributions scheme and setting up your own personal or stakeholder pension plan.

The tax regime for pensions is currently in a very uncertain state with restrictions already in place for individuals with high income (£150 000 plus) as well as further changes planned for April 2011. While these changes have cast uncertainty on

prospects for pension savers, there are still good reasons to use pensions for retirement planning.

Personal pensions are in essence ‘money purchase arrangements’, meaning you make regular contributions to the policy and the money you save is put into investments for you. When you retire, you use the accumulated fund to provide pension benefits.

Like ISAs, pension funds offer a tax-efficient home for your retirement funds because you do not have to pay any further tax on income or capital gains.

With the exception of high income individuals, whenever you make contributions into a personal pension plan, you are generally entitled to tax relief at your highest marginal rate on these contributions. This means that for each pound you contribute to your pension policy, your pension provider claims tax back from the government at the basic rate of 20% and invests this in your plan. Higher and additional rate taxpayers can claim any further tax relief via their self-assessment tax return.

For anyone who is currently a higher rate taxpayer but is likely to become a basic rate taxpayer in retirement, the advantage of 40% tax relief on pension contributions now, with only basic rate tax deducted from the eventual income, can be very attractive.

Another attractive feature of personal pensions is the option to take a tax-free lump sum of up to 25% from the pension fund when you retire. If you don't really need the lump sum, you could consider using it to provide a regular income via a ‘purchased life annuity’ product, which can be a tax-efficient way of providing an income. Any residual fund not taken as a lump sum must generally be used to provide a taxable income.

However you choose to save it would be wise to seek advice from a specialist financial adviser who has a detailed understanding of the NHS pension scheme and can help you plan for the retirement you have worked for. **BJHM**

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The above information does not constitute financial advice. For further information please speak to your financial adviser.