

Big changes to pension planning

As a hospital doctor you are likely to be affected by the forthcoming changes to the way in which pensions are taxed by the government. It is important that you understand the implications of these changes so that you can take appropriate action to minimize your tax bills.

What are the changes?

From 6 April 2011, the amount of money which you can save into your pension with tax relief each year will be reduced from £255 000 to just £50 000. This is known as your annual allowance.

There will also be an increase in the way that pension savings are calculated in final salary pension schemes, such as the NHS Pension Scheme, which means an increased likelihood of exceeding the annual allowance and incurring tax charges. Any pension savings above your annual allowance will be taxed at your highest marginal rate of tax.

In addition, from 6 April 2012, the standard lifetime allowance, the total amount of pension savings you can build up tax free over your life will reduce from £1.8 million to £1.5 million.

Why are hospital doctors most likely to be affected?

As a hospital doctor, there is a real danger that you will exceed your annual allowance as the NHS Pension Scheme is such a good one. If you also contribute to a private pension plan or pay additional voluntary contributions, this will further increase the likelihood. On top of this, any clinical excellence awards that you earn will form part of your pensionable income and will also contribute towards hitting your annual allowance.

Research by Wesleyan Medical Sickness shows that hospital doctors in their 40s could be particularly affected and find themselves with tax bills they were not expecting as result of exceeding their annual allowance. For example, a hospital

doctor in this age group, earning over £90 000 per annum with pensionable salary increases of £6000 a year is very likely to hit his/her annual allowance (*see example below*).

Do I need to take any action if I am still a long way off retirement?

Younger doctors should also start thinking about pension planning now as the new rules make it a more complicated process. Careful planning now and making the right strategic decisions could help to avoid unnecessary tax charges in the future and give you more flexibility in retirement.

Also, the government has no plans to review the cap on these allowances until 2016 and even then there is no guarantee they will be raised. So over time, taking into account increases in inflation and pay rises, many more doctors could be hit by the rules.

What happens if I exceed my allowances?

If you exceed the annual allowance, you may be able to offset part or all of the excess against any unused allowance from the previous 3 years.

If you exceed the lifetime allowance you will incur a special tax charge (55%, if taken as cash) on the excess amount. You can register for a new form of protection to retain a lifetime allowance of £1.8 million (rather than £1.5 million)

Example

Dr Smith is a hospital consultant in his mid-40s, and a member of the 1995 section of the NHS Pension Scheme. His pensionable pay increases from £104 000 to £110 000 during the tax year ending in April 2012, when he will have completed 21 years of pensionable service.

Assuming a rise in the consumer price index of 3%, this represents an increase of nearly £40 000 in the value of his benefits.

He will not be faced with additional tax charges as this increase in his benefits is below the annual allowance of £50 000. However, if Dr Smith wants to make any additional form of retirement savings, he should consider other forms of long-term savings, as his eventual NHS pension benefits are quite likely to exceed the lifetime allowance at retirement.

but this protection will only be available to those people who agree to accrue no further pension benefits from 6 April 2012 and will therefore be unsuitable for most doctors.

How can I avoid paying higher taxes on my pension?

The key thing is not to make any knee-jerk decisions if you are worried that you are about to hit the annual allowance limit. This is a complex area and everyone's situation is different so you should seek specialist financial advice from a provider who has a detailed understanding of the NHS Pension Scheme.

It is likely that many doctors will want to look at alternative forms of long-term saving to work alongside their pension plans. While the pension allowances are falling, the amount you can save into an individual savings account (ISA) is increasing annually in-line with inflation. So for 2011 you can save up to £10 680 free of income tax and capital gains tax. All of this amount can be placed in a stocks and shares ISA. Historically equities have tended to outperform cash investments over long periods of time and so have offered better returns for long-term savers. ISAs can also be more flexible than pension savings as you can access your money whenever you want.

You could also consider other long-term savings products such as life assurance-based savings plans which are often tax free if the saver keeps to certain criteria, referred to as qualifying rules. There are a range of other products available that will help you save flexibly and tax efficiently.

As a busy doctor you may not have time to get to grips with all of these complicated changes. However, it is important not to bury your head in the sand and ignore the new limits which will affect your long-term pension planning. Seek professional financial advice and put in place plans that will allow you to maximize your retirement income, so that you can enjoy the lifestyle you are working so hard to achieve. **BJHM**

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

Wesleyan Medical Sickness provides specialist financial advice for doctors
Telephone: 0808 100 1884
Website www.wesleyanmedicalsickness.co.uk