Pension plan in need of a health check

Senior NHS staff sleepwalking to tax bill, warns **Maisha Frost**

The problem

DOCTORS' nest-eggs may need emergency treatment if they are to escape the taxman's scalpel. Henry J, a physician who plans to retire this year, asked Your Money for a second opinion after being told he did not have a problem. Henry, 59, is concerned the value of his pensions will breach the lifetime allowance — £1.65 million — and incur extra tax. Expert Nicola Downs re-examined his finances.

The solution

"HENRY is facing a big tax bill but it can be reduced so long as he gets cracking now, " she says. However, she warns: "In my view, there are hundreds who could be clobbered. Either they have been told wrongly there is no need to worry or think they don't have a problem."

It's one that could affect anyone with a big pension pot but those most likely to be caught out are long-serving professionals in final-salary schemes, such as doctors and dentists. "These are typically highly qualified people working for years in the NHS who were comparatively moderate earners," says Downs. "In the past their final pensions were not predicted to be enough to keep them comfortably, so they topped them up.

"However, in recent years, doctors' contracts have improved — they are earning far more now. This has changed their pension prospects but now they have to contend with the pension lifetime limit, introduced in April 2006. Many think there is no way their pensions will exceed that but they are wrong. They are locked into their lower-earning mindset," she says.

Hope for Henry and others in the same boat, lies in the protection mechanism exemption introduced with the lifetime limit. However, this ends in April. "Many professionals just don't realise what they are in for. The ones with most to lose are those coming up to retirement who have not adopted the protection mechanism," Downs adds.

The paperwork involved is complex, she says. "The guidance notes stretch to 30 pages. The calculations are fiendish but the potential losses far worse."

Anyone expecting a total pension income of £55,000 or more, and who has not taken up the protection mechanism is at risk, says Downs. This includes Henry, who made a point of topping up his pension plans.

The protection mechanism formula is calculated according to someone's pension savings as they stood on April 6, 2006, when the lifetime allowance, then £1.5 million, was introduced. To get a notional value of the final sum, which is based on all pension plans held including any already paying out, the figure is multiplied by 20 (the typical number of retirement years). This is then compared to the full-time allowance. Any excess is taxed at 55 per cent.

Downs worked out that the total value of Henry's pension plans came to £1,673, 552 on April 6, 2006. "This amounted to a value of 111.6 per cent of the £1.5 million lifetime allowance as it was at that time," she explains.

Henry can ringfence 111.6 per cent, but this must now be applied to £1.65 million — the current lifetime allowance if he retires in this tax year. This equals £1,841,400, effectively gaining him £191,400 more than if he had not registered for protection.

Henry's pension is now worth £1.9 million. Minus the £1,841,400, his personal excess amounts to £58,600. Taxed at 55 per cent he has to pay a bill of £32,230. Without protection, this excess would have been £250,000, to give a tax bill of £137,500. "He will have saved £105,270 by taking action," explains Downs. As a rough guideline, Downs suggests the cost of checking for any problem in the first instance might come to £500. Resolving Henry's issues in full cost just under £3,000. But time is running out for those who may be affected but who have not taken action, as the process can take a couple of months.

"Even if someone has been told they do not have a problem, they should get it documented, with figures, as to why that conclusion has been reached," she warns.

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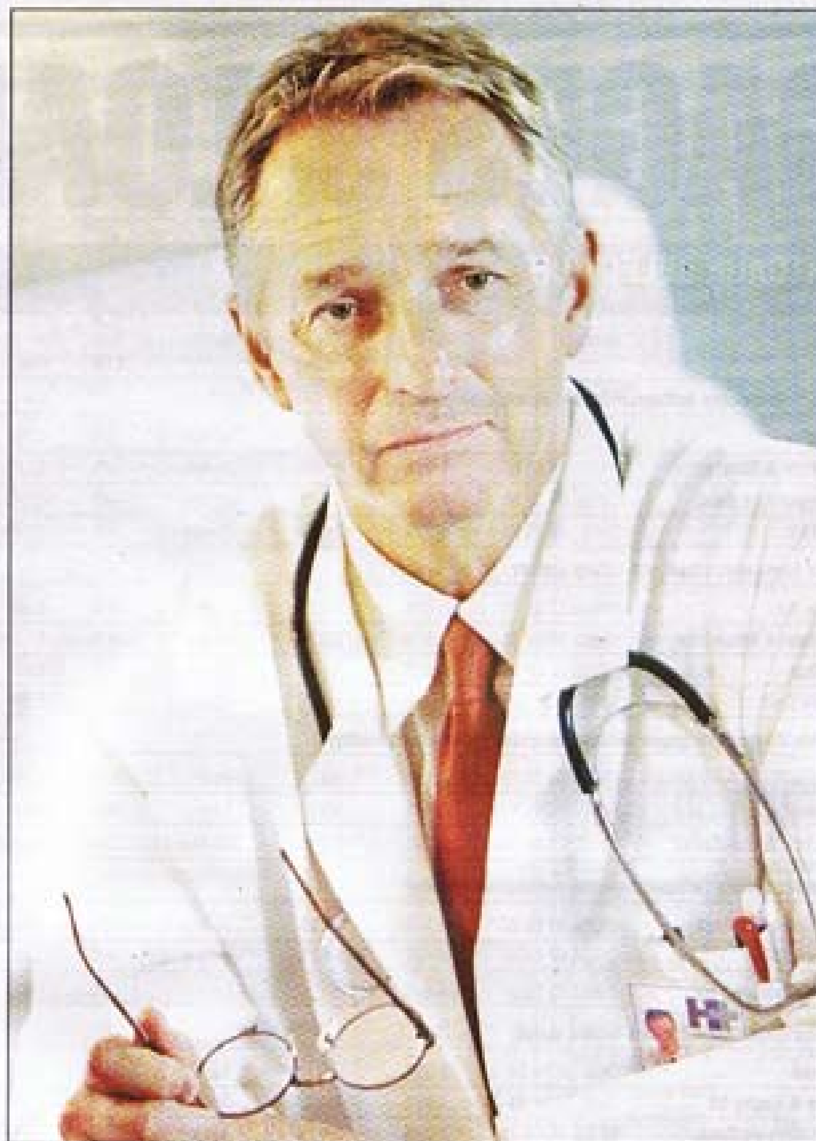

NHS doctors are prone to a lower-earning mindset, says Downs

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It's never too late to take action

The problem

BEING paid a local salary while working in Africa did no favours for David's prosperity in later life.

Now in his late 50s, he returned to the UK four years ago after working in Zimbabwe for a British-owned company. Contributions to his pensions were paid in Zimbawean dollars, which are now worthless.

In view of his loss, his company has offered to pay him a lump sum of £25,000 to cover the shortfall.

David wants to know whether he will have to pay tax on this sum and where best to invest the money. He has another small pension pot plus a basic state pension, in which he has maintained contributions while overseas.

The solution

"THE refund is of David's contributions only, not his firm's, and tax will be taken off by the fund's trustees," says adviser Nicola Downs. "But David should get the position confirmed in writing by them."

With regard to investment, Downs recommends that David opens a stakeholder pension, suggesting he look at Zurich's Defensive stakeholder scheme, or those offered by Prudential or Scottish Life.

As a basic-rate taxpayer, he could contribute the equivalent of 100 per cent of earnings each year. For every £1,000 he wants to save, he can pay £800 and the £200 tax "uplift" will boost it to £1,000. Downs advises lower risk investments such as corporate bonds, fixed interest and gilts.

He could also investigate topping up his current UK employer's pension and also consider starting a rainy-day fund, checking for the best savings-account rates on www.moneysupermarket.com.