SCOTTISH WIDOWS

official pensions and investment provider

Case Study:

Maximise the power of pensions

John Daniels is 55, single and has always enjoyed the 'high life'. He doesn't have any pensions, investments or savings.

John has had a great year at work and as well as an annual gross salary of £80,000 he has received a bonus of £40,000 after tax. His long-term aim is to stop working in the next 10 years but he is aware that the Basic State Pension will not be sufficient to provide for his retirement.

He has an outstanding mortgage of £22,500 and is keen to pay this off in the next few months. John has approached his financial adviser Derek Smith to help him figure out his options.

Derek advises John that if he pays his bonus of £40,000 into a Scottish Widows Retirement Account, the plan would receive basic rate tax relief of £10,000 immediately, meaning that a gross contribution of £50,000 would be applied to the plan.

As John is a higher rate tax payer he can claim a further £10,000 tax relief through his self assessment tax return*.

Derek recommended the Scottish Widows Retirement Account as this is a self invested personal pension plan which includes both Retirement Planning and Retirement Income parts in the same policy. John can pay his bonus into the Retirement Planning part and as he is 55 he can then immediately crystallise the value and receive £12,500 tax free cash with the balance of £37,500 moving to the Retirement Income part**.

He can now use the tax free cash along with the £10,000 that he has received through his self assessment tax return to pay his outstanding mortgage of £22,500.

The following table compares this approach with using his bonus to pay his mortgage directly.

	Option 1 Re-pay mortgage directly from bonus	Option 2 Use bonus to fund a pension contribution and then re-pay mortgage**
Bonus received	£40,000	£40,000
Payment into Retirement Account	N/A	£40,000
Basic rate tax relief added	N/A	£10,000
Additional tax relief claimed through self assessment	N/A	£10,000*
Value of Retirement Account at age 55	N/A	£50,000
Tax Free Cash taken at age 55	N/A	£12,500
Amount used to pay mortgage	£22,500	£22,500 (£12,500 tax free cash and £10,000 additional tax relief)
Residual amount after mortgage paid off	£17,500 (cash in hand)	£37,500 (Retirement Income value)

* There will be a period of time before John is in receipt of higher rate tax claimed through his self assessment tax return; as such he will be unable to use this amount as immediate payment to his Retirement Account.

** These figures are for illustrative purposes only, and ignore the effects of product charges and investment performance. Any income which is taken from the Retirement Income part or by purchasing an annuity will be subject to income tax at John's highest marginal rate.

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This table shows the tax benefits of using a pension plan to help pay off his mortgage. By using his bonus to pay off the mortgage he is left with just £17,500. However, by taking advantage of the tax relief that is available under a pension plan, as well as paying off his mortgage, he now has an initial Retirement Income fund value of £37,500 which can be used to help provide an income in retirement. This represents a difference in value of 114%, although the income that the Retirement Income fund can provide will be subject to tax at John's highest marginal rate.

As John is still working, he may wish to consider making further contributions to the Retirement Planning part of his Retirement Account. These contributions will also attract tax relief and can provide further tax free cash when he decides to crystallise their value.

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