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SPOTLIGHT ON:

Pensions for the self-employed

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WHAT YOU NEED TO KNOW

Saving for retirement can feel daunting for many self-employed people. Without the workplace schemes that salaried workers often rely on, self-employed individuals must take proactive steps to secure their financial futures. But with the right guidance, pensions can become a valuable tool for your retirement planning.

We'll walk you through why pensions are vital, your pension options as a self-employed person and some practical ways to maximise your retirement savings.

WHY PENSIONS MATTER FOR THE SELF-EMPLOYED

When you're self-employed, financial planning often revolves around the immediate needs of your business. However, looking after your future is just as important, and a pension offers a tax-efficient way to save. Research from the Department for Work and Pensions shows that only 16% of self-employed workers contribute to a pension, compared to 78% of employees. Since state pensions alone may not cover all living costs in retirement, having a personal pension plan can help secure your long-term financial stability.

Investing in a pension also comes with attractive tax benefits. As a self-employed individual, you're entitled to tax relief on contributions, meaning a portion of what you invest is effectively returned to you by the government. For basic-rate taxpayers, this is 20%, while higher-rate taxpayers can claim up to 40% and additional-rate payers, 45%.

YOUR PENSION OPTIONS AS A SELF-EMPLOYED PERSON

Without a workplace scheme in place, you have several pension options. Let's break down the most common choices available for self-employed workers.

PERSONAL PENSIONS

A personal pension is a private plan set up by an individual with a pension provider, such as a bank, insurer or investment firm. You decide the contribution level and control how your money is invested. Personal pensions invest your contributions in stocks, bonds or other assets, aiming for long-term growth. You'll receive tax relief on contributions and any investment growth, which can provide a strong foundation for retirement savings.

SELF-INVESTED PERSONAL PENSIONS (SIPPS)

A SIPP functions similarly to a personal pension but offers greater investment flexibility. You can invest in various assets, from stocks and shares to commercial property and even specific types of precious metals.

SIPPs can be ideal if you have investment experience and want greater control over your portfolio.

The drawback of a SIPP is that it requires more time and knowledge to manage. Fees can also be higher than standard personal pensions, so you'll need to balance the benefits of control against the costs and complexities involved.

STAKEHOLDER PENSIONS

Stakeholder pensions are designed to be accessible and straightforward. They have low minimum contributions, capped charges and offer the flexibility to stop and start contributions without penalties. They're generally a good option if you're looking for a simple, affordable way to save without managing investments actively. However, the range of investments may be more limited than in a SIPP or personal pension.

HOW MUCH SHOULD YOU CONTRIBUTE?

When it comes to pension contributions, there's no one-size-fits-all answer. Financial planners typically recommend saving at least 12-15% of your annual income for retirement. This may sound high, but remember that every little bit helps. Even small, regular contributions can grow significantly over time due to compounding.

For instance, according to Aviva's Pension Calculator, a 30-year-old self-employed individual who contributes £200 per month could have a pension pot of approximately £130,000 by age 68, assuming moderate investment growth. Increase that to £300 a month and the pot could rise to around £195,000. These figures underline the importance of starting early, even if your contributions are modest.

BENEFITS OF STARTING A PENSION EARLY

The earlier you start contributing to a pension, the more you stand to benefit from compound interest. When your investments generate returns, those returns are reinvested, creating an exponential growth effect over time. Small contributions in your 20s and 30s can add to a sizeable pension pot by retirement.

On the other hand, starting later in life doesn't mean it's too late; it just requires a more focused approach. You may need to contribute more or choose investments with higher growth potential. However, building a meaningful retirement fund is still possible, and you'll still receive valuable tax relief on your contributions.

TAX RELIEF: A BOOST FOR YOUR SAVINGS

Tax relief can significantly enhance the value of your pension contributions. For every £80 you put into your pension, the government adds an extra £20 in basic-rate tax relief. You can claim an additional £20 through your self-assessment tax return if you're a higher-rate taxpayer and £25 if you're an additional-rate taxpayer. This means that £100 in your pension pot costs only £60 of your post-tax income if you're in the 40% tax band.

Tax relief effectively boosts your contributions and accelerates the growth of your pension savings, making it one of the most advantageous features of contributing into a pension scheme. This tax advantage can be a crucial factor in reaching retirement goals for self-employed individuals without the benefit of employer contributions.

> *"Some pension providers offer flexible contribution options that let you vary payments depending on your income level. This flexibility can be particularly helpful if your income fluctuates throughout the year"*

BALANCING PENSION CONTRIBUTIONS WITH BUSINESS NEEDS

Balancing long-term pension savings with immediate business expenses can be challenging when you're self-employed. It may be tempting to pause or reduce contributions during lean periods, especially if cashflow is tight. However, it's often better to keep contributing a smaller amount than to stop altogether.

Some pension providers offer flexible contribution options that let you vary payments depending on your income level. This flexibility can be particularly helpful if your income fluctuates throughout the year. Remember that any modest contribution keeps your pension pot growing and ensures you're still benefiting from tax relief.

MAXIMISING PENSION GROWTH THROUGH INVESTMENTS

While your contributions are the foundation of your pension, investment performance plays a major role in determining your final retirement pot. With self-employed pensions, you are typically free to choose your investment approach, ranging from cautious to adventurous.

For example:

- **conservative investors** might prefer a portfolio with a higher proportion of bonds offering stable returns but limited growth potential
- **balanced investors** might allocate equally between stocks and bonds, offering moderate growth with reduced risk
- **growth-orientated investors** may invest mainly in equities, which have the potential for higher returns but come with increased risk.

Most pension providers offer pre-built investment portfolios tailored to different risk profiles, which can help simplify the investment decision process. Remember, your risk tolerance may evolve over time, and adjusting your investments to match your age and retirement goals is a sensible approach.

A common strategy is to invest in riskier assets, such as equities, earlier in your career to maximise growth potential, then gradually shift towards safer investments, like bonds, as you approach retirement to protect the value of your pension pot.

PLANNING FOR RETIREMENT WITHDRAWALS

When you reach 55, you can access your pension savings, with up to 25% available tax free. You can take this as a lump sum, stagger it through drawdowns or leave your money invested for further growth. It's worth thinking carefully about how you'll structure your withdrawals to ensure your savings last throughout retirement.

With life expectancy rising, retirement can now stretch 20 years or more. Many self-employed retirees opt for a phased approach, gradually withdrawing funds to supplement their income while keeping some investments in place. Planning your withdrawals thoughtfully can provide financial security without depleting your pension pot too quickly.

TAKING ADVANTAGE OF NEW PENSION RULES AND ALLOWANCES

Pension rules and tax allowances can change, and it's important to stay informed so you're making the most of available opportunities. The annual allowance for pension contributions is currently set at £60,000, but any unused allowance from the previous three years can be carried forward. This "carry forward" rule can be especially helpful for self-employed individuals with variable incomes.

In addition, the lifetime allowance, which previously limited the amount you could save tax free, was abolished as of 6 April 2024. This change allows more flexibility to build your pension pot without concerns about tax penalties.

IS A PENSION RIGHT FOR EVERYONE?

While pensions are highly beneficial for many, they may not be the only option. Some self-employed people prefer to invest in property, ISAs or their businesses as part of their retirement strategy. Each option has pros and cons, and it's wise to consider all avenues when planning your retirement.

It's worth seeking professional advice to ensure you make the best choice for your circumstances. With tax advantages, flexible contribution options and various investment choices, pensions remain among the most effective ways to secure your financial future. They offer reliable long-term growth and can complement other retirement savings efforts.

READY TO TAKE THE NEXT STEP?

Taking control of your retirement planning is empowering, and a pension offers a structured way to build a secure future. Start by researching different pension providers, comparing fees and assessing investment options that align with your risk tolerance and goals.

If you'd like more personalised advice, we're here to help. We specialise in guiding self-employed professionals through retirement planning, from selecting the right pension type to managing contributions and maximising tax relief.

Reach out to us for a consultation to discuss how we can support your journey towards financial independence in retirement.

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