

More pension or more cash?

With new NHS pension scheme rules in place, there are now different options available when it comes to how you receive your money when you retire. Ray Prince explains

In the past, when it came to how the NHS paid your pension, it was very simple. You had a pension based on the number of years' service in the scheme, your income, and whether you had purchased added years. You also received a tax-free lump sum of three times that pension (although GPs have their pension entitlement calculated on a slightly different basis).

No thought was required when you reached retirement age. You simply signed the form to say you were retiring and waited for the pension payments to reach your bank account. However, since April 2008, the NHS has given you new options:

1. Just take pension only
2. Take more in tax-free cash and less pension
5. Take the maximum in tax-free cash and even less pension

To calculate how much pension you would receive if you choose option two, you need to apply a ratio. The ratio is 12 to 1, and does not change whether you retire at age 60 or 65. For every £1 of pension you give up, you receive £12 in tax-free cash. The limit in the amount of tax-free cash is 25 per cent of the capital value of your pension fund. The remaining 75 per cent provides your pension.

Having had two recent cases of clients coming up to retirement, these new rules give some interesting options. Let's look at an example, and in the interests of keeping things simple, the figures are approximate.

What's the best option?

A principal dentist with an NHS practice is retiring aged 60 in April. With all debt paid off, the children in their 30s and working, he is really looking forward to spending more time in his boat and brushing up on his golf.

He has amassed the equivalent of 36 years' NHS service and his latest pensionable income is a little over £111,000 pa. His entitlement is actually based on the notional pension pot that he has accrued with the NHS Pension Scheme.

The next step was to visit the NHS Pensions website calculator and look at the most obvious options re points 1 and 2 above.

These are the figures:

1. £50,000 pa pension plus tax-free lump sum of £150,000
2. £40,000 pa pension plus tax-free lump sum of £270,000

So, as a married man in good health with a spouse four years younger than himself, what is his best option?

Making a choice

The first thing to take into account is that he needs £2,600 after tax income per month to pay the bills and run a car etc. This is

equivalent to about £37,500 gross pa. Any extra spending would be on holidays (and he and his wife certainly intend to have quite a few over the next 10 years). So

they would need an extra £10,000 pa for this.

around £41,000 pa is taxed at the higher rate of 40 per cent. So, in

Next, it is important to note that any income received above

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effect, the real difference between options 1 and 2 is £500 per month inflation-proofed income on the one hand, and £120,000 cash on the other.

Looking at it like this, it would appear that it would take approximately 20 years for the pension option to catch up. Of course, we do not know what effect inflation will have over the

next 20 to 30 years, nor what return he will get on his cash, depending on the risks he is prepared to take.

Important factors

As you will know, we live in interesting times at the moment and interest rates are low on deposit accounts. It is reasonable to assume that he could get two to three per cent pa (gross) in a deposit account over the next 20 years, and pay



less tax by putting the money in his wife's name as she is a lower rate tax payer. But what would happen if he died soon after retiring?

With the cash option, it is 'in the bank'. But with the higher-pension option you would assume that his wife would be slightly better off, as the benefits are based on 50 per cent of the pension. The good news is that this is waived by the NHS in the event of his death, and the 50

per cent is always based on the higher pension regardless of whether he took the maximum tax free cash or not.

Another factor here is that he will receive a state pension of circa £5,000 pa at age 65 in 2014, and his wife will also benefit with her state pension for a similar amount starting in 2015 at age 62. Even if he takes the maximum NHS tax-free cash, the income he is receiving from his pensions (by age 65) will mean he will be paying Higher-rate tax.

All this information was entered into his retirement cash-flow forecast, and he could then make an informed choice confident that all factors had been covered. So, bearing all this in mind, he is choosing to go for the maximum tax-free cash, and lower pension. Visit <http://tinyurl.com/bqwkqy>, to see a calculator.

The key point

Deciding whether to opt for more cash or more pension is a one-off decision. Therefore, make sure you do your homework before you decide!

Take action

If you are approaching retirement, write down all your assets on the one hand, and your anticipated expenditure on the other. Have your adviser build you your own cash-flow forecast to show the overall picture and the effects of inflation etc. This 'Sat Nav' will give you the context to make one of the most important financial decisions you will ever make – more pension or more cash?

More information

To learn more about your retirement planning options, you can request a free copy of one of Rutherford Wilkinson's audio CDs: 'How To Avoid The Three Most Common Retirement Planning Mistakes'. Just call Catherine Lowes on 0191 217 3340 and a copy will be posted to you (please quote ref: DT). [DT](#)

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