WHIreland®
WEALTH MANAGEMENT

Case Study

Pension vs ISA for Retirement Income

Clients might decide to save into a pension, knowing that they will have funds available when they retire, or they might decide they prefer the flexibility of an ISA. Alternatively, they could use a combination of the two.

The example below gives an idea of how things might work out depending on the decision they make and their personal circumstances.

James is 42 and earns £60,000 a year. He is married with two children who are still at school. He has received a net bonus payment this year of £15,000. He has no pension plan at all and he needs to decide what to do with the money. His financial adviser talks him through his options, including a pension and an ISA.

At the outset

Pension

£15,000

James decides to invest £15,000 into a pension

+£3,750

With basic rate tax relief, James receives an additional £3,750 into his pension, making a total contribution of £18,750. (As a higher-rate taxpayer, he also claims an additional £3,750 relief through his tax return).

James' pension fund is worth £18,750

ISA

£15,000

James decides to invest £15,000 into a stocks and shares ISA.

+£0

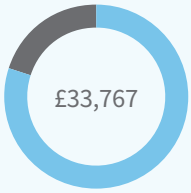
James does not receive any tax-relief on his payment into the ISA.

James' ISA is worth £15,000

What happens after 15 years?

We assume that the pension and the ISA grow by 4% a year, after charges, for 15 years. James is now aged 57 and can take 25% of his pension fund as a tax-free lump sum, plus unlimited income, taxed at his marginal rate, if he chooses to. He can take any amount out of his ISA whenever he wants without having to pay any tax on this.

Pension



James' pension fund is now worth £33,767.

£8,441

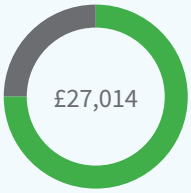
TAX FREE

James takes £8,441 tax-free cash from his pension fund to pay off his mortgage.

£25,326

James' pension fund is now worth £25,326, and is in income drawdown (Retirement Income) but he is not taking any income.

ISA



James' ISA is now worth £27,014.

£8,441

TAX FREE

James takes £8,441 out of his ISA to pay off his mortgage.

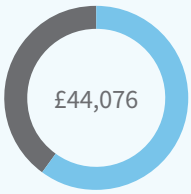
£18,573

James' ISA is now worth £18,573.

James then decides he wants to make a lump-sum payment to boost his retirement fund. He pays £15,000 into either his pension or his ISA.

£15,000 + £3,750

James pays £15,000 into his pension and £3,750 tax relief is added. (As a higher rate taxpayer, he also claims another £3,750 additional tax relief through his tax return). (Since James has not taken any income from his pension, he is not subject to the lower £40,000 annual allowance.)



James' pension fund is worth £44,076 of which £25,326 is in Retirement Income, though he takes no income at this stage.

Retirement Planning Retirement Income

+£15,000

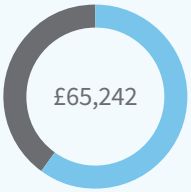
James pays £15,000 into his ISA

James' ISA is worth £33,573.

What happens after 25 years?

James is now age 67 and decides to retire. We assume both pension and ISA funds grew at 4% each year after charges and James takes 25% of his remaining pension fund as tax-free cash.

Pension



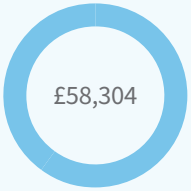
Retirement Planning Retirement Income

James' pension is now worth £65,242
with £37,488 in Retirement Income

£6,938
TAX FREE

James takes another £6,938 tax-free cash and moves the balance of his fund £20,816 into the Retirement Income part of his pension as he is ready to start taking an income.
His income will be subject to tax.

His pension is now worth -



There is no limit on the income James can take, and he settles on £625 a month gross. This will be taxed at his marginal rate – if this is 20% his net income is £500 a month. (James is now a basic rate tax payer as his income has dropped – he is now working part-time as he approaches retirement, and is earning £20,000 a year. As he is taking an income, he is now subject to the lower £40,000 annual allowance if he wishes to continue making pension contributions.)

£625 = **£500**
LESS 20% TAX A MONTH

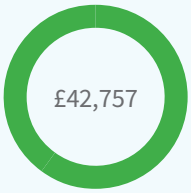
ISA

James' ISA is now worth £49,695

£6,938
TAX FREE

James can take any amount of money out of his ISA whenever he wants, tax-free. He decides to take £6,938 immediately.

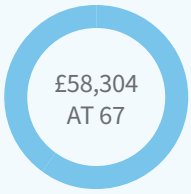
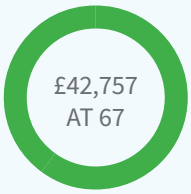
His ISA is now worth -



James draws £500 a month out of his ISA for his income.

£500
A MONTH TAX FREE

What James had at age 67 for his original investments?

Pension	ISA
40%	**0%**
40% tax relief paid by the Government £15,000.	No tax relief.
(Half of this was added to his pension and is included in the figures below- the remainder was claimed back through his tax return.)	
£15,379 TAX FREE	**£15,379** TAX FREE
Tax-free cash of £8,441 at age 57 and £6,938 at age 67.	£8,441 withdrawn tax free at age 57 and £6,938 tax free at age 67.
	
A fund value of £65,242 at age 67 giving tax-free cash of £6,938 and an income of £500 a month after 20% tax.	A final fund value of £49,695 at age 67, giving a lump sum of £6,938 and tax-free income of £500 a month.
£625 LESS 20% TAX = **£500** A MONTH	**£500** A MONTH TAX FREE

The income that might be taken from a pension or ISA is not limited, but if investment returns are not what was anticipated, the client might run out of money sooner than they think.

The income withdrawn from the pension will be taxed at the customer's marginal rate so will be eroded more quickly than the ISA where any withdrawals are tax free.

It is important to remember that one method of saving for retirement is not always better than another – it depends on the client's individual circumstances. An ISA can offer additional flexibility as it can be accessed at any time, whereas a pension can normally only be accessed from age 55. In 2028, this is expected to rise to 57 and thereafter it can only be accessed within 10 years of your state pension age.

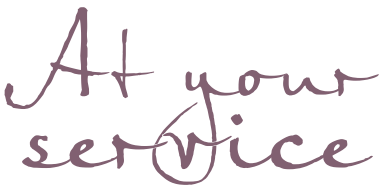
The value of the tax benefits of a pension or ISA depend on a client's individual circumstances. The client's circumstances and tax rules may change in the future.

Pensions are a long term investment. The retirement benefits a client may receive from a pension plan will depend on a number of factors including the value of the plan when they decide to take their benefits which is not guaranteed, and can go down as well as up. The value of the plan could fall below the amount(s) paid in.

If any income and the charges deducted from the pension plan are more than any investment growth, the value of the pension will go down. This could reduce the amount of income that can be taken in future and the income from any annuity bought later.

The value of an ISA is not guaranteed and can go down as well as up. If the amount withdrawn and the charges deducted are more than any investment growth, the value of the ISA will go down. The value of the plan could fall below the amount paid in.

Information is based on current understanding of taxation legislation and regulations. Levels and bases of, and reliefs from, taxation can change. The information contained is generic in nature and does not take into account your personal situation. No advice is being provided. You should consider whether the information is appropriate to your needs, and where appropriate, seek professional advice from a financial adviser.



Speak to us directly to find out how we can make a difference for you and your family

United Kingdom
T 0800 877 8866

E: wealthplanning@whirelandwm.com
W: www.whirelandplc.com/wealthplanning

WP3006AUG18SW