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So, you think you're safe from the £1m pension trap?

Many young savers with modest retirement pots could be hit by the reduction of the lifetime allowance to £1m. By **Ruth Emery**

A PENSION pot worth £1m is the preserve of chief executives and overpaid bankers, and would never be something you would have to worry about, right? Wrong.

Savers with modest pension pots currently worth as little as £40,000 could be caught in a new £1m trap set by the chancellor that will penalise the prudent, an exclusive report for Money reveals today.

In April, the maximum size of total pension assets allowed without incurring a tax charge will drop from £1.25m to £1m, the third cut since George Osborne became chancellor in 2010. Any savings above this level when you begin to draw the pension will be subject to tax of up to 55%.

It is a controversial cut by a Conservative chancellor, and one that will hit younger workers, who are unlikely to have any idea of how profoundly the change could affect them in the future.

Take the example of a 35-year-old woman who currently has a pension of £37,750. By the time she reaches 65, it could be worth more than £1m, according to analysis by the financial adviser Tilney Bestinvest. Similarly, a 45-year-old man with pensions currently worth £220,000 could amass £1m over the next two decades. This assumes £1,000 is paid into their pensions each month, including employer's contribution and tax relief, and annual investment growth of 5% (see table, right).

Gary Smith, a financial planner at Tilney Bestinvest, said: "The reduction in the lifetime allowance will potentially impact significant numbers of people. And we're not just talking about wealthy City types, but also senior NHS staff and other public servants, middle-class professionals and those who have simply saved diligently and made wise investment choices."

"Lifetime allowance" might sound like a boring technical term, but it is vital that savers understand how it works and that they could be stung by this stealth tax.

While a government paper published last month estimated that about 55,000 people have pension assets worth between £1m and £1.25m, and could, therefore, be affected in 2016-17, experts believe hundreds of thousands of savers will eventually be hit.

The lower limit was announced by Osborne last year and will be introduced on April 6. He said in his budget speech last March: "The gross cost of tax relief has continued to rise through this parliament, up almost £4bn. That is not sustainable. So from next year, we will further reduce the lifetime allowance from £1.25m to £1m."

The limit has been steadily eroded over the past six years. In 2011-12, savers could have built up a pot as big as £1.8m without penalty. The £1m trick is all the more sneaky because Osborne has spoken in the past about how the lifetime allowance is a tax on good investment decisions. In 2004 — when in opposition — he told MPs the allowance was "a curious and perverse incentive" and warned that it would catch not just "the super-wealthy".

Many savers are confused and panicked by the change. The pension and investment firm Fidelity International told Money that the proportion of call-centre queries on the lifetime allowance had rocketed from 2% to 9% between October and December. Half of all questions at its retirement seminars are now about the lifetime allowance.

HOW MANY PEOPLE WILL BE AFFECTED?

Experts dispute the 55,000 figure. Rachel Vahey, a pensions expert, said: "The government's estimate is too conservative. It's impossible to know what pension assets people have in total. Schemes may be able to pinpoint those who have more than £1m with them, but they wouldn't know what other pensions somebody has. The total amount of assets is not collected anywhere." However, many more people will be caught in the future. The Treasury told Money: "The reduction of the lifetime allowance affects only 4% of the wealthiest pension savers approaching retirement."

Analysis by the investment firm Old Mutual Wealth shows this 4% figure equates to about 460,000 savers aged 50-65 who could lose out.

COULD I BE CAUGHT?

Workers with gold-plated final salary schemes, typically in the public sector but also provided by large companies such as BP and Rolls-Royce in the past, could be hit. Young savers who have a decent-sized pot already, and those who have enjoyed high investment returns or regularly pay in large contributions, could also top the £1m limit.

Adrian Walker, retirement planning manager at Old Mutual Wealth, said: "Working out whether you are likely to be affected is not an exact science as it refers to the value of your pensions in the future. The danger is if people don't realise and are hit with an unexpected tax charge when they take money from their pension." Check the table to see if your current pension could breach the limit when you get to 65.

Will you be caught in the £1m trap?

Yes, if this is the value of your pension pot now and you pay in…

Your age now	*£500 a month until 65**	*£1,000 a month until 65**
35	£134,600	£37,750
36	£147,630	£52,238
37	£161,312	£67,449
38	£175,677	£83,422
39	£190,761	£100,193
40	£206,599	£117,803
41	£223,229	£136,293
42	£240,690	£155,707
43	£259,025	£176,093
44	£278,276	£197,497
45	£298,490	£219.972
46	£319,714	£243,571
47	£342,000	£268,349
48	£365,400	£294,367
49	£389,970	£321,685
50	£415,769	£350,369
51	£442,857	£380,488
52	£471,300	£412,112
53	£501,165	£445,318
54	£532,523	£480,184
55	£565,449	£516,793
56	£600,022	£555,233
57	£636,323	£595,594
58	£674,439	£637,974
59	£714,461	£682,473
60	£756,484	£729,196
61	£800,608	£778,256
62	£846,939	£829,769
63	£895,586	£883,857
64	£946,665	£940,650

Assumes 5% annual investment growth net of charges.
**Consists of employee and employer contribution plus tax relief*

Source: Tilney Bestinvest

Final salary schemes are more difficult to calculate. The first year of income is usually multiplied by 20 to give a capital value to test against the lifetime allowance. This means a £50,000-a-year final salary entitlement would equal £1m.

Phil Wood, who runs his own technology firm, Tomkat Consulting, is worried about breaching the limit. The married father-of-two from Windsor, Berkshire, is 47 and has two pensions worth a total of more than £300,000, plus a final salary scheme that will pay about £2,000 a year, equivalent to a £40,000 pot. So together, his pension assets are worth about £340,000. According to our table, he could exceed the limit when he reaches 65.

"For the government to bring the limit down by £250,000 is quite harsh. I'm speaking to my financial adviser from Chase de Vere to work out how to avoid it, perhaps by investing in property instead," he said.

WHY IS THE LIMIT BEING LOWERED?

The Treasury said the reform "will create a balanced system that protects the public finances". The sums involved are certainly striking: the reduction to £1m will net the Treasury £300m in 2016-17, according to government figures. Over the next four years, it will raise a huge £1.86bn.

It is not the first time the lifetime allowance has been reduced. In 2012-13 it was cut from £1.8m to £1.5m, and then cut again in 2014-15 to £1.25m.

There is also a limit on how much can be saved into a pension each year and attract tax relief — and, again, it has been slashed. It was cut from £50,000 to £40,000 in April 2014 and will be reduced on a sliding scale to £10,000 on April 6 for those earning more than £150,000.

As a sweetener, Osborne has pledged to raise the lifetime allowance from 2018-19 in line with inflation. Yet Walker of Old Mutual Wealth points out that, based on government assumed increases in the consumer prices index of 1.9% a year, it will take 12 years from 2018-19 to get back to the current allowance of £1.25m.

When the limit starts to increase, younger savers will be able to build up pots worth more than £1m without penalty. But given the government's record of tinkering, it is anyone's guess what lifetime allowance, or indeed tax charge, will exist in the future.

Smith at Tilney Bestinvest said: "The cut to £1m sends another negative signal about the tendency of politicians to meddle with pensions and treat them like a piggy bank."