OPTIONS WHEN TAKING YOUR PENSION

The purpose of these notes is to try and explain some of the common options open to clients when they come to take their retirement benefits from a money purchase type pension plan. These notes have been completely revised for the post 2015 pensions regime.

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1. INTRODUCTION

The intention of this guide is to show the different choices available to you and to enable due consideration to be given to the advantages and disadvantages of each. We will not advise any client without a separate report detailing our specific recommendations for your particular circumstances.

Since April 2011 there is no longer a requirement to purchase an annuity by age 75 as this upper age limit has been removed. This means that annuity purchase can be postponed indefinitely or avoided completely in suitable circumstances.

From December 2012 annuity providers will no longer be allowed to differentiate between genders when calculating annuity rates and this is likely to have a detrimental effect on some annuity rates (particularly for males or where joint life annuities are purchased).

From April 2015 the new flexi drawdown regime means that there is no restriction on how much income you take and the frequency which you take same. Each pension plan provides 25% tax free money and 75% taxable money, whether you retire before or after age 75.

From August 2015 it is possible to withdraw the whole pension (or parts of the uncrystallised pension) as an uncrystallised fund pension lump sum (UFPLS). This is received 25% tax free cash and 75% taxable income.

From April 2028 the minimum age (for unprotected occupations) to take your pension benefits rises to age 57 from the current age of 55. Thereafter, the earliest date to take pension benefits will be 10 years before the state pension age (SPA).

This note is designed for individuals considering how to take their pension benefits be they at retirement, as a dependant, nominee or successor.

2. GUARANTEED OR DRAWDOWN?

2.1 Guaranteed Annuity

An annuity is a stream of income received for a certain period of time in exchange for a lump sum of money. For example, a lifetime annuity pays out a certain amount per month for the rest of the annuitant's life, backed by the insurance company. The annuitant is the "insured" person upon whose lifetime pay-outs are based and who also will receive the monthly payments.

The specific amount paid out each month is based in large part on the age and life expectancy of the annuitant, as well as current interest rates. If the annuitant lives to life expectancy, the total amount received in income will exceed the initial cash instalment. However, if the annuitant does not live to life expectancy, the total received could be less than the original cash instalment, particularly if death were to occur only within a couple of years of purchasing the annuity.

2.2 Drawdown

A drawdown income is an amount of money taken from a pension fund, usually at regular intervals. The amount withdrawn is at the behest of the annuitant. There are no guarantees that the income received will last out the lifetime of the annuitant.

3. WHAT ARE THE BASIC OPTIONS WHEN YOU REACH RETIREMENT AGE?

Your retirement income options can be summarised as follows:

3.1 Stay With Your Existing Pension Provider

You may leave your existing pension fund with your current provider. Then, if you wish, take a tax free cash sum (known as a pension commencement lump sum (PCLS) and utilise your current provider's annuity rates to purchase a conventional lifetime annuity, which guarantees a lifetime income.

Taking a conventional lifetime annuity does not trigger the money purchase annual allowance (MPAA).

3.2 Take An Open Market Option (OMO)

You may exercise a transfer of the whole value of your pension fund to another provider, taking your tax free cash and a better lifetime annuity rate (known as exercising the open market option).

3.3 Take A Scheme Pension

You may transfer your pension fund to a provider offering a scheme pension (usually only available with defined benefit and occupational money purchase schemes). This allows for income levels to be actuarially determined based on your personal circumstances. Scheme pensions cannot reduce and must be paid by a pension scheme or insurance company.

Taking a scheme pension does not trigger the MPAA as long as there are 11 or more members of the scheme.

3.4 Transfer To A Drawdown Pension

You may transfer the whole value of your pension fund into a drawdown pension. This allows you to vary future income levels to fit in with your overall financial plan, either by use of drawdown pension or short term annuity purchase. The only drawdown product available to new retirees post April 2015 is the flexi-access drawdown.

Flexi-access drawdown triggers the MPAA.

3.5 Take Your Pension As Uncrystallised Funds Pension Lump Sums (UFPLS)

Simply, take your pension in chunks as uncrystallised pension fund lump sums, 25% tax free and 75% taxable. This is not available for defined benefit (DB) schemes, however, trivial pensions have been significantly improved (see below).

UFPLS triggers the MPAA.

3.6 Take a Small Pots Payment (Money Purchase (MP) Plans Only)

If your pension plan has less than £10,000 within it you can encash the whole plan.

It is possible to take up to 3 small pots pensions from personal pensions (non occupational schemes) or as many as you like from occupational schemes (i.e. executive pensions).

To take a small pots pension you must:

- Be aged 55 or above; and
- You have some unused lifetime allowance left; and
- The payment eliminates your rights under the scheme in question; and
- If you have not previously taken benefits from the scheme paying the lump sum, only 75% of the lump sum will be taxable (as pension income). The other 25% will be paid tax free.

Taking a small pot will not trigger the MPAA and does not count towards your lifetime allowance (LTA).

If the pension is already crystallised then the payment is subject to income tax at your highest levels. If pension is uncrystallised you can take 25% tax free, 75% taxable.

3.6.1 Trivial Commutation (DB Pensions Only)

With the advent of UFPLS the government believe there is no need for trivial commutation in money purchase pensions, however, they still apply to defined benefit occupational schemes.

The rules are very similar to the small pots rules above, except that the total value of the members benefits *within each scheme* must be no more than £30,000 + any small pots benefits. Payments are not restricted to £10,000 but the payment must extinguish all of the member's benefits within the DB scheme.

Trivial commutation of DB benefits does not trigger the MPAA or go towards the LTA.

4. TAX TREATMENT OF PENSIONS IN PAYMENT

4.1 Tax Free Cash

Tax free cash is usually (although not always) 25% of the accumulated pension fund, or its equivalent within a final salary defined benefits scheme.

As a generalisation, it is usually better for people to take their maximum tax free cash from a money purchase pension and to take no tax free cash from a final salary pension fund. This does, however, depend upon individual circumstances (the plan may have guaranteed annuity rates for instance) and should be fully assessed individually.

Care needs to be taken when taking tax free cash if ongoing pension contributions are wanted, see our notes "The tax Treatment Of Pension Contributions".

4.1.1 Personal Pensions / Stakeholder

Usually a personal pension fund carries the option to commute 25% of the fund as a tax free lump sum. Personal pension buy out plans (and drawdown schemes from company pension arrangements) will usually follow the rules of their original company pension schemes, although they may well generate 25% tax free cash if this is more generous than the original rules permitted.

4.1.2 Company Money Purchase Pension Plans

Again, tax free cash will usually be 25% of the value of your pension plan. Some people will have obtained protected tax free cash which is a greater percentage of the fund due to pre A-Day (6/4/2006) company pension scheme rules. You should always check the tax free cash position (which can be very complicated) if you believe your entitlement may be better than 25% of the fund value.

4.1.3 Company Defined Benefit (DB) Pensions

These will usually have a prescribed level of tax free cash and then an optional higher level of tax free cash to give an equivalent 25% of the fund tax free. These additional tax free cash offers are usually terrible value for money.

Care needs to be taken with additional voluntary contribution (AVC) plans as some schemes allow 100% of an AVC plan to be taken as tax free cash.

4.2 Pension Income

Is technically "non-savings income" so earned income is subject to income tax at your highest rates. It does not attract National Insurance taxation.

It should be noted that all pension income (other than drawdown income from certain death benefit proceeds) is subject to PAYE. This means if you take a lump of income (i.e. a UFPLS) then the initial tax treatment could be draconian since you will be taxed as week 1 month . For example:

Fred takes a UFPLS of £20,000. He has no other income in this tax year. The tax treatment is:

Gross Payment	£20,000		
Of which tax free cash	£5,000		
So taxable payment	£15,000		
	Band	**Cumulative**	**Tax**
Taxable Bands Are:			
Annual Allowance of £11,850/ 12 is:	£988	£988	-
Basic Rate (20%) band is £34,500/12)	£2,875	£3,863	(£575)
Higher Rate Band is (£150,000 - £34,500)/12	£9,625	£13,488	(£3,850)
Balance of payment at 45% tax	£1,513	£15,000	(£681)
Totals	£15,000		(£5,106)
Gross requested	£20,000		
Net Pension received	£9,894		
Plus Tax Free Cash	£5,000		
Total	£14,894		
Rate Of Tax On Pension	34.04%		

Instead, if Fred were to take the required cash as flexi-access drawdown he could then receive his cash monthly and after a month or two hopefully would get a proper tax code. This would then deduct the correct tax. Failing this, Fred waits until the tax year end and either submits a request for a tax refund (P55).

https://www.gov.uk/government/publications/flexibly-accessed-pension-payment-repayment-claim-tax-year-2015-2016-p55

or gets the cash back when he completes his tax return.

The correct tax (assuming no other income) is:

Gross Payment	£20,000
Of which tax free cash	£5,000
So taxable payment	£15,000
Total Taxable Income In Year	£15,000
Annual Allowance	(£11,850)
So taxable income is	£3,150
Tax at 20%	(£630)
Taxable Income	£15,000
Less Tax	(£630)
Plus tax free cash	£5,000
Net Sum Due	£19,370
Overall Rate of tax	(4.20%)

4.1 Temporary Non-Residence

To prevent individuals going abroad, becoming non resident and then taking all of their pension funds tax free, new legislation allows HMRC to get their tax if the individual returns to the UK within 5 years. There is a de minimis of £100,000, however, not many people are going to go to the hassle of moving abroad to save a maximum £44,000 in tax.

5. LIFETIME ALLOWANCE TAX CHARGE (LTA)

At retirement (and each time you take UFPLS) your benefits will be checked against your maximum lifetime allowance (£1,030,000 in 2018/19). If they exceed the current LTA or your protected LTA (whichever is greater) you will have to pay tax of 25% on each pension payment or 55% if paid as a lump sum on all benefits above the lifetime allowance.

The choice of which option to take depends upon your other income tax:

	55% Lump Sum	**25% Pension**
Pension Fund	£100,000	£100,000
LTA Charge	(£55,000)	(£25,000)
Net Fund	£45,000	£75,000
Money Received After Tax At 20%	£45,000	£60,000
Money Received After Tax @ 40%	£45,000	£45,000
Money Received After Tax @ 60%	£45,000	£30,000
Money Received After Tax @ 45%	£45,000	£41,250

The LTA has been dropping over the years and can be predicted to be (assuming 2.5% CPI)

From	To	Protection	Value
Before 2006		Enhanced	Value of Fund
Before 2006		Multiple of LTA (Primary)	
06/04/2006	06/04/2012	Fixed Protection	£1,800,000
06/04/2012	06/04/2014	Fixed Protection	£1,500,000
06/04/2014	06/04/2016	Fixed Protection	£1,250,000
06/04/2016	06/04/2016	Individual Protection	£1,250,000
06/04/2016	06/04/2018		£1,000,000
06/04/2018	06/04/2019		£1,030,000
06/04/2020	06/04/2021		£1,055,750
06/04/2021	06/04/2022		£1,082,144
06/04/2022	06/04/2023		£1,109,197
06/04/2023	06/04/2024		£1,136,927
06/04/2024	06/04/2025		£1,165,350
06/04/2025	06/04/2026		£1,194,484
06/04/2026	06/04/2027		£1,224,346
06/04/2027	06/04/2028		£1,254,955
06/04/2028	06/04/2029		£1,286,329
06/04/2029	06/04/2030		£1,318,487

5.1 When Is The LTA Tested?

The system of testing the LTA is called Benefit Crystallisation Events or BCEs. There are now 15 different times a BCE is triggered, however, for these notes any crystallisation (taking benefits) other than trivial ones will trigger a lifetime allowance check (see our separate notes on LTA Protection for further information).

The first BCE since 2006 (when LTAs were introduced) will trigger a BCE against pre 2006 benefits. Where those benefits are drawdown then the benefit will be assessed as the maximum Government Actuary's Department (GAD) income at the last review x 80% x 25 to create an equivalent fund to test against the LTA.

If you are in drawdown, or have any pension benefits not crystallised into scheme pensions by the time you get to age 75, you will be tested against the LTA applicable at the time or the LTA you have if higher.

5.2 Triggering The Money Purchase Annual Allowance (MPAA)

Throughout this FAQ we mention the MPAA. Further information on how the MPAA works can be found in our "The Tax Treatment Of Pension Contribution Notes".

6. DEATH BENEFITS

The tax treatment of death benefits depends on what age you are when you die and what type of pension you are receiving. Please see our separate notes “The Tax Treatment Of Pension Death Benefits”

7. STANDARD GUARANTEED ANNUITY OPTIONS

The main options available are:

7.1 Reversionary Benefits

7.1.1 Single Life

This type of pension would be paid for the annuitant’s life alone. If the annuitant dies one month after starting the pension, the annuity ceases and the insurance company pockets the cash. On the other hand, if the annuitant lives to 125 the insurance company will keep paying.

7.1.2 Joint Life

Here the annuity is paid in full until the last annuitant dies, so a couple take out the pension which continues at the same level throughout their joint lives. Post April 2015 the couple can be the annuitant and anyone they nominate. The person benefiting as a survivor need not be a dependant or spouse.

7.1.3 Reversionary Annuity

With a reversionary annuity the pension is payable in full for the lifetime of the annuitant and then on their death a reduced pension will be payable to their dependant or nominee.

Typically, the annuity reduces by 1/3 or 1/2 on the annuitant’s death, i.e. the full pension is £10,000 pa which reduces to £6,667 or £5,000 pa for the remainder of the life of the dependant when the annuitant dies.

With any annuity which makes provision for a survivor (e.g. a widow) it is usual to name that person at outset. However, it is possible, by special arrangement, to have the definition of a survivor to include any nominee. A good example would be where a wife predeceases a husband who then remarries. When he dies, the annuity could be paid to the new wife so long as special provisions are made.

7.1.4 With Or Without Proportion

When you die, an annuity with proportion will pay a proportionate amount to cover the period from the last payment until the date of death. This is most valuable when income payments are made on an annual basis. This option is only available for payments made in arrears.

Without proportion represents the cheaper option.

7.1.5 Guarantee Period

It is possible to establish a guarantee period on the annuity (can be for any period). By way of example, with a 5 year guarantee if the annuitant were to die after 12 months of payments had been made, their estate would receive the value of a further 48 payments. After the first 5 years of the plan no further guarantees apply.

New rules allow non occupational annuities to have guarantee periods as long as they like.

7.2 Income Payments

7.2.1 Frequency Of Income

At the outset you may select how often you want to receive income each year. Most people choose monthly, but you can be paid quarterly, half-yearly or annually.

7.2.2 Income Paid In Advance Or In Arrears

Payments can be made either in advance or arrears. If you opt for monthly income and purchase your annuity on 1st January and you receive your payment on that day, you are being paid in advance. If your first payment is not made until 1st February, you are being paid in arrears.

Payments made annually in arrears would give the highest income figure but the first payment would not be received until a year after annuity purchase.

7.3 Different Income Options

7.3.1 Guaranteed Annuity Rates

Some annuity providers have guaranteed annuity rates written into their contracts which may provide you with a considerably higher income than would normally be available. If such rates are available it is often the case that the benefits must be taken in a certain form, i.e. single life, yearly in arrears.

7.3.2 With Profits and Unit Liked Plans

These are plans which are invested on annuity principles, however, that annuity assumes an average growth rate from the underlying funds. These should be more certain than drawdown however anyone who held an Equitable with profits annuity in the 1990s knows this is not necessarily the case!

7.4 Flexible Lifetime Annuities

Flexible lifetime annuities can rise or fall in value and as such can trigger a money purchase annual allowance (MPAA) restriction. Flexible lifetime annuities are also referred to as variable or third way annuities.

Up until recently the UK retirement market had been dominated by providers of conventional lifetime annuities and drawdown pension (formerly income withdrawal) plans. New products are increasingly emerging which attempt to combine the certainty of a conventional annuity with the prospect of investment growth seen with drawdown pension, i.e. in an attempt to offer the best of both worlds.

With a flexible annuity the range of income which the annuitant may draw is up to the annuity provider, however, the income can go down significantly as well as up.

Generally speaking these flexible (variable or third way) annuities fall into three main categories:

- Annuities with Flexibility - these are similar to conventional lifetime annuities, i.e. payable throughout lifetime but with a degree of income and/or investment flexibility.

- Fixed Term Annuities – these provide a guaranteed income for a set period of time with a guaranteed or reviewable maturity value.

- Drawdown Pension with Income Guarantees – these are similar to standard drawdown pension plans but with some level of underpinning income guarantee which will continue no matter how the underlying investment performs. Some plans provide an income for life whilst with others the guarantee is for a specific time period.

7.5 Scheme Pensions

This is a pension provided by the pension scheme itself (i.e. a big final salary scheme or a group occupational money purchase plan) or by an insurance company nominated by the scheme administrator along the lines of a traditional pension annuity mentioned above. For the purpose of the lifetime allowance (LTA) it is not the fund used to purchase the scheme pension, but the scheme pension multiplied by 20 which counts. This can have major advantages dependent upon the scheme pension type (i.e. level escalating etc). There are occasions where individuals with personal pensions are best to seek a scheme pension rather than a lifetime annuity.

Scheme pensions do not crystallise the MPAA, their maximum guarantee period is 10 years.

7.6 Pros & Cons For Guaranteed Annuities

7.6.1 Advantages

- A guaranteed lifetime annuity is guaranteed for life.
- A conventional lifetime annuity will not normally reduce.
- The annuity can increase each year.
- A conventional lifetime annuity will not trigger the MPAA.
- Can provide guaranteed benefits to survivors.
- Can include a guaranteed period.
- Survivor benefits below age 75 are usually tax free.
- A scheme pension is determined by an actuary with the maximum income based on your age, sex, state of health, mortality, any escalation or guaranteed period and fund value. In many situations this will potentially allow a larger income to be taken.
- It is possible to provide a dependant's scheme pension although it cannot be higher than the scheme pension the deceased received.

Disadvantages

- There are rules set by HMRC with regards to increasing and decreasing the amount of scheme pension you can take and if these are breached, substantial tax charges may apply to your fund.
- Scheme death benefits are not attractive.
- Once started generally cannot be varied.
- Income will cease on annuitant's death and remaining fund value will go to provider.
- Flexible annuities will trigger the MPAA.
- Decisions regarding survivor benefits have to be decided at outset.
- Inflexible.

7.7 Summary

For many the inflexibility and relatively low returns from traditional annuities are unacceptable. On the other hand, if you have a low capacity for loss (i.e. you cannot cope with your pension fund falling in value by a significant amount) and you do not require more income than a suitable annuity will give you then this is a sound "sleep at night" proposition.

8. SCHEME AND LIFETIME ANNUITIES OPTIONS

With a traditional annuity the annuitant (person receiving the pension) gives cash to an insurance company in exchange for a guaranteed income for the rest of their lives. Once the annuitant dies, the income ceases and the insurance company keeps the initial investment.

The big problem with annuities is that the rates keep dropping. This is due in part to the low interest rates, but also to the increase in longevity. The following table indicates the problem:

At Birth	Males	Females
1901	45	49
1945	68	72
2000	75	80
2008	78	82
2018	102	104

(National Office of Statistics.)

A combination of low interest rates, a poor economic environment, sex equality in annuity rates and significant new legislative requirements on annuity providers means the rates are truly awful.

Based on a fund value (after tax free cash) of £100,000, both spouses being exactly aged 65 and there being no guarantee periods the current rates (April 2018) are approximately:

	Single	Joint
Fund Value	£100,000	£100,000
Level	£5,568	£4,638
2.5% Escalation	£4,157	£3,264
5% Escalation	£2,972	£2,283
RPI Escalation	£3,234	£2,535

These rates assume you are in tip top health. If you have a medical condition then better rates are available using enhanced annuity rates.

8.1 Escalation

Post A-Day escalation is optional. The figures in (6) above illustrate what effect escalation has on payments for single and joint life annuities.

8.1.1 Level

This provides the highest annuity rate, but the income remains level for the rest of the annuitant's life. At an average rate of inflation of 3% a £10,000 pa annuity paid now will be worth £7,300 in real terms after 10 years, or £6,300 in real terms after 15 years.

8.1.2 Fixed Escalation

Typically, escalation can be fixed at 3% or 5% pa. Recent quotations have shown that 5% fixed escalation can give a lower pension than Retail Price Index (RPI) linked payments.

8.1.3 CPI Escalation

This is the new consumer prices index which the government introduced in the hope it would be less than RPI. The main difference between CPI and RPI is that RPI includes mortgage interest rates and CPI does not. However, CPI uses the geometric mean whilst RPI the arithmetical mean. This difference does reduce CPI by on average about 1% from RPI. If you wish to know more go to the Office of National Statistics website at http://www.ons.gov.uk/ and search for geometric where you will find a PDF explaining the differences.

8.1.4 RPI Escalation

As the name suggests, the pension increases each year in line with RPI. It is not generally possible to obtain escalation by the All Earnings Index (AEI) which is, of course, the real level necessary to maintain the earning power of a pension.

8.1.5 LPI Escalation

Limited Prices Increase (LPI indexation) is an increase in your pension by RPI, but with a cap of (usually) 5% pa maximum. In this way the insurers know that if high inflation returns their risks are reduced. The maximum level of LPI for benefits accrued post 6th April 2005 is 2.5% pa.

8.2 With Profit Or Equity Escalation

This concept can be a little difficult to grasp, however, the basic principle is that the annuity will rise if the insurance company's investments outperform agreed parameters. By way of an example, an annuity may be taken out which will remain level as long as the insurance company's pension fund grows at 6% or more each year. If the pension funds grow at more than 6% in any year then the annuitant will get a higher pension. If the funds grow at less than the 6% figure then the pension may fall.

We have used with profit annuities extensively in the past and overall they have proved to be very good investments. We have also had a salutary lesson with the Equitable Life fiasco where it is impossible for with profit annuitants to move to an alternative more secure / better provider. Some Equitable Life policyholders have also seen their income drop by 30% post the collapse of Equitable Life.

8.3 Impaired Life Annuities

It is now possible (and common) to obtain underwritten annuities for individuals in ill health. One obvious form of enhanced annuity, which can sometimes pay dividends, is for cigarette smokers. In the same way that smokers can now pay 25% more for their life cover, smokers could obtain up to 15% to 20% better annuity rates.

Whilst we would always look to underwriting any medical problems, severe ill health is sometimes better dealt with via a drawdown or high level reversionary annuity.

8.3.1 Advantages

- You receive a guaranteed level of gross income for life.
- Your spouse/dependants can enjoy a guaranteed level of gross income, in the event of your death (if this option is selected at outset).
- Your pension can be payable for a guaranteed minimum period of time (e.g. 5 or 10 years).
- You will be able to access your tax free cash lump sum immediately, (although you will receive a lower pension) to spend or invest as you wish.

8.3.2 Disadvantages

- They are inflexible and irreversible as the level of income is fixed at outset (except for any regular increases chosen) and cannot respond to changing personal financial circumstances.
- The level of income is fixed at outset (except for any regular increases chosen) and will depend upon the level of annuity rates available at that time.
- The income will not keep pace with inflation (unless the annuity is set up to increase each year and the increase rate matches or exceeds inflation).
- There is no possibility of benefiting from future investment growth on your pension fund, although an implicit rate of investment growth has been assumed when setting the annuity rate to provide your income.
- In the event of death, depending upon the type of annuity you have purchased, benefits to your dependants could be lower than those enjoyed under some of the other options available to you and briefly explained in this guide.

8.4 Phased Retirement

Is available for most of these options (see 11 below).

9. DRAWDOWN PENSIONS

With the guaranteed annuity rates having been so bad most clients with pension funds are opting for the drawdown option. The cost of setting up drawdown products leads us to recommend that total drawdown funds (husband and wife for instance) should exceed £100,000. Drawdown can be taken from age 55 until death.

9.1 Tax Treatment

The sum that is drawn down is taxed in the same way as an annuity, i.e. usually 25% tax free cash and 75% paying a taxable income. The fund that is not drawn down remains invested in a tax free environment and will ultimately be available for beneficiaries when the pensioner dies.

9.2 Mortality Drag

Unlike a purchased annuity where the future income level is certain, there is no guarantee that the fund remaining will grow sufficiently in the future to maintain the level of income. On a like for like basis income drawdown should never match a guaranteed annuity as it cannot benefit from the mortality bonus. When you purchase a conventional lifetime annuity with a pension company the actuary of that company will assess the likely lifespan of a male/female of the age concerned. The life expectancy increases the older you get so, at age 65, a male is expected to live for a further 21 years and females 24 years. The actuary will then assume everyone lives for say 22.5 years, thus creating a rate which (after allowing for his profit) uses up the annuity purchase price over 22.5 years. This means, of course, that if you live for 30 years you are getting a much better deal than could be the case if you managed your own fund. On the other hand if you die young, clearly the IDD is better for your dependants.

9.3 Unisex Benefit Or Disadvantage

Post the European ruling on equal rights, the annuity from drawdown can reflect a male life being shorter than a female life.

9.4 Capped Drawdown (CDD)

Capped drawdown was available until the 6th April 2015. All new drawdown products are flexi-access drawdowns mentioned below. If you have an existing CDD and do not break the rules then you can remain in CDD.

The maximum income is the equivalent of 150% of the best rate available on the Financial Conduct Authority (FCA) published comparative rate tables. You will see reference to GAD within our pension notes. This is the Government Actuaries Department and it is the rates they set which matter. The minimum income is zero.

CDD pensions must be actuarially reviewed every 3 years up to age 75 and annually there afterwards (and in practice they need reviewing from an investment perspective at least every year).

No new capped drawdown can be approved post April 2015 but you can add to existing capped drawdown or move to a flexi-access drawdown if you wish.

CDD drawdown and just taking your PCLS do not trigger the MPAA.

9.5 Pros And Cons

9.5.1 Advantages

- Does not trigger the MPAA.
- Additional funds can be added to CDD.
- Can access 100% PCLS at outset.
- Useful for tax planning.
- Fund remains for nominees post death.
- Beneficiaries can choose income or capital sum.
- Tax position on death before 75 very favourable.
- Fund available to successors free from inheritance tax (IHT).

9.5.2 Disadvantages

- All of income subject to investment risk.
- Charges may be higher than a guaranteed annuity.
- Must have annual reviews.

9.6 Flexi-Access Drawdown (FDD)

All future drawdowns will be flexi-access drawdowns.

Flexi-access drawdown triggers the MPAA, however, taking tax free cash alone from a flexi-access drawdown does not trigger the MPAA.

Other than the fact you can have as much taxable income as you like there are few differences between flexi-access drawdown and capped drawdown.

9.7 Short Term Annuities

After taking your tax free cash lump sum your fund is initially divided into two separate elements. The first element will be used to secure a temporary annuity not exceeding five years. As a temporary annuity costs less to provide than a similar lifetime annuity, the bulk of your fund will be available for investment.

After the chosen period, the temporary annuity will cease and the investment is gone, the idea being that your remaining assets within the drawdown fund have grown to replenish funds during the short term annuity period.

Additional pension benefits can be taken before the end of the term of the existing short-term annuity contract. Where drawdown pension is used or additional short-term annuity contracts are purchased, the level of income already paid, or to be paid, from the existing annuity contract must be taken into account (if subject to the capped drawdown rules) when considering how much additional drawdown pension/short term annuity can be paid or secured.

As with standard annuities, there is no return on death unless you select an annuity certain (which guarantees payment of the annuity for the term chosen even if you should die sooner) and or a spouse/dependant’s pension. However, this product does allow you to change the spouse/dependant’s pension provisions at each review to reflect changes in your circumstances.

10. UNCRYSTALLISED FUND PENSION LUMP SUM (UFPLS)

This is not a drawdown option as for every UFPLS taken the entire fund matures.

As the name suggests, you have an uncrystallised fund from which you take a lump sum. The lump sum is in the form 25% tax free cash and 75% taxable income. Each UFPLS is a single payment never to be repeated.

Each time you take an UFPLS it is a benefit crystallisation event (BCE) so the payment is assessed against your LTA (see 5). You cannot take UFPLS post 75 if you had no LTA left when your funds were tested (BCE) at age 75.

You cannot have UFPLS if you have primary or enhanced protection from the LTA, or indeed any arrangement which has greater than 25% tax free cash within it.

Assuming the UFPLS is within your LTA you get:

25% tax free lump sum
75% added to your taxable income

Taking UFPLS triggers the lower MPAA.

10.1 Pros And Cons

10.1.1 Advantages

- You can choose how you take benefits.
- 25% of each payment is tax free.
- Useful for tax planning.
- No restriction on income taken.
- Any uncrystallised funds on death available to beneficiaries.

10.1.2 Disadvantages

- Lacks flexibility - you have to take 25% tax free and remainder taxable.
- Charges may be higher than a guaranteed annuity.
- Triggers MPAA.
- Remaining fund subject to investment risk.
- Uncrystallised funds will still require reviews.

11. PHASED RETIREMENT

Phased retirement can be used in conjunction with both lifetime annuities or income drawdown. It can also be undertaken using UFPLS.

We have not done a conventional annuity drawdown for many years so will concentrate here on the options of using a flexi-access drawdown plan which is the most flexible option.

The main use of phasing is for tax planning. An individual may want to top up their current income using their pension and, therefore, may require a high level of net income in relation to the gross income received.

We have often used phased retirement to keep an individual within their tax free allowances or indeed basic rates of tax. Rather than use UFPLS or small pots (where you haver to take all the benefits at once) we move the pension into a phased drawdown:

Mr W has a pension fund of £28,000. He has just reached state retirement age but only receives £7,800 a year state pension. He has no other income from any source. The following assumes a net fund growth of 5% and inflation of the taxable income allowance of 2.5% pa:

Year	Fund Value	Encashment	Tax Free Cash	Taxable Pension	State Pension	Total Income
1	£28,000	£3,733	£933	£2,800	£7,800	£10,600
2	£25,480	£4,087	£1,022	£3,065	£7,800	£10,865
3	£22,463	£4,449	£1,112	£3,337	£7,800	£11,137
4	£18,914	£4,820	£1,205	£3,615	£7,800	£11,415
5	£14,799	£5,200	£1,300	£3,900	£7,800	£11,700
6	£10,079	£5,591	£1,398	£4,193	£7,800	£11,993
7	£4,713	£4,713	£1,178	£3,535	£7,800	£11,335

So we have used up Mr W's entire fund tax free over a period of 7 years. Using flexi-access drawdown we could of course have taken 25% of the entire fund in year 1 then topped up Mr W's pension from his taxable income in subsequent years. The options are endless.

11.1 Keeping Within The 20% Tax Band

Again, using flexi-access drawdown with or without phasing is a very sensible way of paying out a pension fund. For many clients we take very high levels of income on early retirement only to throttle back on income withdrawal as guaranteed final salary and state pensions become payable.

The big disadvantage of phased and UFPLS is that with the new lower lifetime allowance (LTA) each time you take part of your pension you have to be tested against the LTA. This ultimately means that should your funds do well in retirement, then you may end up with a 55% tax charge on part of your fund.

12. OTHER CONSIDERATIONS

12.1 Protected Rights

Since April 2012 protected rights are no more and the full range of benefits are available to old protected rights plans. Perversely, protected rights funds do have to remain segregated in drawdown even though the rates and benefits are the same.

12.2 Ill Health Pensions

A member can take pension benefits before the minimum age if they are physically or mentally unable to carry out their work. Normal taxation applies unless medical evidence confirms the member is in serious ill health where upon the benefits will be subject to death payment taxation. Please see our notes on the tax treatment of death benefits.

12.3 Change Of Legislation

The last 5 years have seen pension legislation changing weekly let alone yearly! Everything in these notes can change at a moments notice and planning today in the hope that the legislation will be the same in 5 years time is a very optimistic approach to take!

12.1 Advice For All

The government will guarantee that individuals approaching retirement will receive free and impartial face to face guidance to help them make the choices that best suit their needs. The government will introduce a new duty on pension providers and trust based pension schemes to deliver this ‘guidance guarantee’.

The government will make available a £20 million development fund to get the initiative up and running. Face to face meetings can also be arranged free of charge at your local Citizen’s Advice Bureau (CAB).

Excellent guidance can be obtained on your pension choices from the Pension Wise service:

https://www.pensionwise.gov.uk/

13. SUMMARY

Clearly, everyone would like the maximum pension with minimum risk. Unfortunately, this utopia is unavailable. At the end of the day, the type of annuity received will be a compromise between security and immediate income requirements. Whilst we expect most people to choose drawdown this will, without self control and regular review, lead to a lot of paupers in their later years….

An excellent rule of thumb for any drawdown of assets is the William Bengen Withdrawal Rate. Back in 1996 Bengen calculated that taking no more than 4% of an asset based portfolio value each year would ensure that your income lasted for the remainder of your life. There is evidence now that in the UK that figure should be nearer to 3.5%. If you want a starting point then 3.5% of your pension fund each year would be a good one.

Please note that whilst every effort is made to ensure that the information contained within this explanation is correct, these notes are by necessity brief and of a generalised nature. Clients should seek specific personalised advice prior to undertaking any arrangement. These notes are named 07.2018 Options When Taking Your Pension and were last updated in July 2018. Whilst we have done our best to ensure facts are current to this date laws and options are changing constantly so always check before action.

E.&.O.E.