# Summary information on Pensions

**What is the Basic State Pension?**

For anyone reaching state pension age (SPA) on or after 6 April 2016, the complex state pension system for people who attained SPA before that date has been replaced by a simpler, single-tier state pension, called the New State Pension. For people who have paid or been credited with 35 years of NICs, the full rate of the New State Pension in 2018/19 is set at £164.35 a week.

People with fewer than 35 qualifying years, but who satisfy a minimum qualifying period of 10 years, will have their state pension proportionately reduced.

**What is the minimum age at which I can take my pension?**

The state pension age for women will increase to 65 by November 2018 and therefore align state pension retirement ages for men and women from this point.

The state pension age for both men and women will then increase:

- From 65 to 66 between December 2018 and October 2020
- From 66 to 67 between April 2026 and April 2028; then
- From 67 to 68 between April 2037 and April 2039

Registered pension schemes can currently be accessed from age 55, although the Government have proposed that this be increased to age 57 from 2028 and then to always be set at 10 years prior to state pension age.

**What is the maximum contribution that can be paid in to my pension?**

You may contribute to as many pension plans as you want and there is no upper limit on the total contribution that can be paid. However, there is a limit on the amount of personal contribution that can benefit from tax relief and this is the greater of £3,600 and 100% of your 'relevant UK earnings' which would include self-employed profits, salary, wages, bonuses, overtime and commission.

The amount of employer contributions are unlimited and are not restricted by the employee's earnings although, in practice, care should be taken to ensure that employer and individual contributions combined do not exceed the annual allowance (including any unused annual allowance that can be carried forward).

**How much tax free cash be taken from my pension?**

Typically is it possible to take up to 25% of the value of the benefits being taken as a tax free lump sum. There are, however, some circumstances where an individual's tax fee cash entitlement can be more than this.

**What is the annual allowance?**

The annual allowance effectively places an annual limit of (currently) £40,000 on the total amount of tax efficient 'pension input' that can be made to registered pension schemes (both occupational and personal). For individuals with both 'threshold income' over £110,000 and 'adjusted income' over £150,000 the standard £40,000 annual allowance will be reduced by £1 for every £2 of 'adjusted income' they have over £150,000. This is subject to a maximum reduction of £30,000 so individuals with 'adjusted income' of £210,000 or more will have a £10,000 annual allowance.

It is possible, subject to certain conditions, to carry forward unused annual allowance from the three previous tax years to the current tax year. This can allow pension provision valued above the annual allowance to be made in a tax year without triggering an annual allowance charge.

**What is the lifetime allowance?**

The lifetime allowance is the maximum amount of benefits an individual can build up in registered pension schemes without suffering a tax charge when benefits are taken. The Standard Lifetime Allowance for tax year 2018/19 is £1,030,000.

If the value of the benefits being taken exceed an individual's available lifetime allowance then a Lifetime Allowance Charge (LAC) is due on the excess. This tax charge is 55% if taken as a cash lump sum or 25% (plus income tax at the individuals marginal rate) if taken as a pension.

**How are the benefits of my pension taxed in the event of my death?**

In the event of your death before age 75 it is possible for a beneficiary to inherit your pension fund tax free where the lump is within your available lifetime allowance and is paid out within 2 years of the pension provider becoming aware of your death. Any lump sum payable in excess of your available lifetime allowance will be subject to a 55% lifetime allowance tax charge payable by the recipient.

In the event of your death after age 75 any lump sum received by a beneficiary would be subject to income tax at the recipient's marginal rate.

***Pensions***

**What is the minimum age at which I can take my pension?**

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Registered pension schemes can currently be accessed from age 55, although The Government have proposed that this be increased to age 57 from 2028 and then to always be set at 10 years prior to state retirement age.

**Are there any tax consequences when I take my pension benefits?**

The lifetime allowance is the maximum amount of benefits an individual can build up in registered pension schemes without suffering a tax charge when benefits are taken. The Standard Lifetime Allowance for tax year 2018/19 is £1,030,000.

If the value of the benefits being taken exceed an individual's available lifetime allowance then a Lifetime Allowance Charge (LAC) is due on the excess. This tax charge is 55% if taken as a cash lump sum or 25% (plus income tax at the individuals marginal rate) if taken as a pension.

**What are the main options I have when taking my pension?**

**RETIREMENT OPTIONS**

This document outlines the different choices available to you and the advantages and disadvantages of each.

<u>Secured Pension</u>

1. You may use the whole of your pension fund, after any tax free cash has been paid, to purchase a conventional annuity from the provider which offers the best annuity rate on the open market.

2. Alternatively, it may be possible, after any tax free cash has been paid, to instead purchase an annuity from your current pension provider. However, if your current provider does pay annuities, this will normally only be attractive if the annuity offered by the current provider is higher than the best comparative annuity available on the open market. This might be the case if, for example, your current plan has 'guaranteed annuity rates.'

3. You may use the whole of your pension fund, after any tax free cash has been paid, to purchase a 'with-profits' annuity, either from your current provider (if available) or another provider.

4. You may use the whole of your pension fund, after any tax free cash has been paid, to purchase a unit linked annuity either from your current provider (if available) or another provider.

5. You may convert your retirement fund to an annuity income in stages, over a number of years. This is commonly referred to as staggered vesting or phased retirement and depending on scheme rules this is now possible both before and after age 75.

<u>Flexi-Access Drawdown</u>

6. You may designate the whole of your pension fund, after any tax free cash has been paid, into a flexi-access drawdown pension. Any tax free cash must be paid by the provider of your flexi-access drawdown pension and you will then be able to draw any amount from the balance of your invested

fund, whenever you want to. The whole amount of any withdrawals taken by you after the tax free cash sum has been paid will then be subject to income tax at your marginal rate(s).

Lump sum death benefits can also be paid from flexi-access drawdown funds at any age. For lump sums paid before 6 April 2015, this tax charge was 55%. However, for lump sum payments made after 5 April 2015 this tax charge is reduced to 0% if death occurs before age 75. If death occurs on or after age 75, this tax charge is levied at the recipients marginal rate (reduced from 45% in 2015/16).

Uncrystallised Funds Pension Lump Sum (UFPLS)

7. Under the UFPLS option, an individual can take a single or series of lump sums from their uncrystallised money purchase funds, of any amount, without actually having to designate them to drawdown first. 25% of the payment is normally tax free with the balance subject to income tax at the recipient's marginal rate.

Trivial Commutation

8. As long as certain conditions are met, it may be possible to take all your pension benefits, from a defined benefit arrangement, as a lump sum if the value of all your benefits under all arrangements, including any already in payment, does not exceed £30,000.

Small pot lump sum

9. As long as certain conditions are met, it may also be possible to take all your pension benefits, from either a defined contribution or defined benefit arrangement, as a 'small pots' lump sum if the value of the benefits being commuted (ignoring the value of any other benefits you may have) does not exceed £10,000.

**Secured Pension**

This will either be a lifetime annuity or a 'scheme' pension.

- A lifetime annuity is simply an annuity payable by an insurance company which the member has chosen. Most lifetime annuities are not investment linked, although it is possible to purchase a with-profits or unit linked annuity.
- A scheme pension is provided by a pension scheme or, where the pension is payable by an insurance company, it is selected by the scheme administrator.
- A final salary scheme can only provide a scheme pension.
- A money purchase scheme can also pay a scheme pension. Whilst however it is possible for a money purchase scheme to elect to pay a scheme pension out of their own funds on a 'pay as you go' basis, very few schemes will actually do this in practice

Both lifetime annuities and scheme pensions:

- Must be paid at least yearly
- Can be secured on a single or joint life basis

- Can include a guarantee period which ensures that the pension is paid for a minimum period, regardless of when you die
- Can include capital protection, which pays a lump sum on death
- May be transferred to another provider, but no further tax free cash is available following transfer
- Can be level or increase in payment

A potentially important difference between a lifetime annuity and a scheme pension however is the way that they are tested against the lifetime allowance when benefits are taken.

**Secured pension and the lifetime allowance**

If it is a scheme pension, the deemed value of the benefits being taken is 20 times the initial annual rate of pension plus the value of any tax free cash.

If it is a lifetime annuity, it is simply the total value of the fund (the 'purchase price') before any tax free cash is paid.

Depending on the type of pension purchased therefore, using the 20 times pension formula for a scheme pension from a money purchase scheme can lead to either a higher or lower value than the actual value of the fund.

What this means in practice is that if the cost of securing a scheme pension is more than £20 of fund per £1pa of pension (i.e. equivalent to an annuity rate of less than 5%) then the scheme pension route will use up less of the lifetime allowance. However, if the cost of securing the scheme pension is less than £20 of fund per £1pa of pension (i.e. equivalent to an annuity rate of more than 5%) then the scheme pension route will use up more of the lifetime allowance.

For someone not close to their lifetime allowance, this will not be an issue but in situations where choosing a scheme pension could potentially give rise to a lifetime allowance charge, this could be an important factor to consider.

**Conventional Annuities**

The amount payable depends primarily on:

- The Purchase Price
- The amount of tax free cash taken
- The ancillary benefits chosen (such as escalation and survivor pensions)
- The client's age
- The client's state of health
- Current gilt yields

**Level v Escalating**

A level annuity pays the same amount of income year after year. It pays a higher income compared to the initial starting income available under an escalating annuity, which will take a number of years to catch up and exceed a level annuity.

An escalating annuity, on the other hand, increases each year. The higher the level of escalation chosen, the lower the initial income. It is possible to select a fixed rate of increase each year normally in the range of 3% to 7.5%. Alternatively, you can choose to link increases to reflect changes in the Retail Prices Index (RPI). However, if you select an RPI linked annuity, your income is not guaranteed to increase each year as the RPI may not rise, and if it fell, so would your income. Annuities can also escalate in line with Limited Price Indexation (LPI). LPI means your income increases each year in line with the RPI but subject to a maximum of 5%.

**Joint life annuity**

A joint life last survivor annuity pays an income until the second person dies. For annuities bought before 6 April 2015, only a surviving 'dependant' of the deceased (normally their spouse or civil partner) can receive these payments. For joint life annuities bought after 5 April 2015, however, the tax rules have been changed to allow joint life annuities to be passed on to any beneficiary.

The annuity can continue at the same level to a survivor although most people elect for the income to continue at a rate of either 1/2 or 2/3 of the amount payable on first death.

**Frequency of Income**

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

**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 May and you receive your payment on that day, you are being paid in advance. If your first payment is not made until 1st June, you are being paid in arrears.

**With Or Without Proportion**

If paid in arrears, the payment can be with or without proportion.

*With Proportion* means that if the annuitant dies in-between annuity payments, a proportion of the outstanding annuity payment is paid up to the date of death. This option is most valuable when income payments are made on an annual basis.

*Without Proportion* means that the annuity ceases on the last payment made prior to death.

**Taxation of Income**

Annuity income paid to the original annuitant will be subject to income tax at their marginal rate(s). If a joint life annuity has been purchased, however, how the annuity income paid to the survivor will be taxed will depend on whether or not the original annuitant died before or after age 75.

- If death occurs before age 75, the annuity income will be tax free in the hands of the surviving beneficiary, but
- If death occurs on or after age 75, the annuity income received by the surviving beneficiary will be subject to income tax in their own hands based on their own marginal rate(s)

**Capital Protection**

This option allows for a return of fund on death, equal to the difference between the purchase price (net of any tax free cash that has been paid to you) and the gross income payments received, and less a tax charge. For lump sums paid before 6 April 2015, this tax charge was 55%.

However, for lump sum payments made after 5 April 2015:

- If death occurs before age 75, this tax charge is 0%; and
- If death occurs after age 75, this tax charge is levied at the recipient's marginal rate (reduced from 45% in 2015/16).

**Guarantee Periods**

Choosing a guarantee period ensures that the annuity is paid for a minimum period, regardless of when you die, and a choice of either 5 or 10 years is normally available. From 6 April 2015, however, the 10 year limit on guarantee periods has been removed, thus enabling guarantee periods of any length to be offered by providers. The guarantee means that, on your death, your estate or a nominated beneficiary would continue to receive the balance of any annuity payments due between the date of your death and the end of the guarantee period. Alternatively, from 6 April 2015, the outstanding balance on death during a guarantee period could instead be paid as a lump as long as the amount payable is less than £30,000.

Payments under a guarantee period can be paid to any nominated beneficiary; they do not need to be paid to a financial dependant such as a spouse.

**Impaired Life/ Enhanced Annuities**

Some annuity providers offer annuities which pay you a higher than normal income if you have a medical condition which can reduce your normal life expectancy. These will either be 'enhanced' or 'impaired life' annuities.

An impaired life annuity is for people who have a shortened life expectancy due to a chronic and usually terminal illness, typically where life expectancy is less than 5 years.

An enhanced annuity is available for less severe ailments for people who suffer from one or a combination of health or lifestyle conditions, where life expectancy is reduced to a less significant extent. Examples of conditions that will qualify for an enhanced annuity include angina, high blood pressure, high cholesterol, obesity, smoking and asthma.

Some providers also offer improved terms to people who have had particular occupations or live in certain parts of the country.

**Advantages of a conventional annuity**

- Annuity rates may be attractive
- You will receive a guaranteed level of income for life
- Your pension can include a guarantee period in order to ensure that the annuity is paid for a minimum period regardless of when you die
- You can access the tax free cash sum immediately
- You may exceed your life expectancy and 'profit' from your annuity
- Simple

**Disadvantages of a conventional annuity**

- Annuity rates may be low
- If a level annuity is selected, the real value of the annuity will erode over time
- The level of income cannot be varied to accommodate changing personal financial circumstances
- Ancillary benefits, such as a spouses pension, have to be selected at outset and cannot be changed
- It may be the case that you do not exceed your life expectancy and therefore suffer a 'loss' as a result of buying an annuity

**PHASED RETIREMENT (ANNUITY PURCHASE)**

Most personal pensions are arranged not as a single plan, but as a cluster of many separate plans, often called 'segments'. These segments can then be used to buy annuities at different times both before and after you reach the age of 75. This process is called 'phased retirement'.

Each time you convert a segment to an annuity, you can first take part of the segment's fund as tax-free cash (normally 25% of the segment). Converting segments regularly, and typically once a year, means you can effectively use the tax-free cash, as well as the annuity, to provide you with your income.

The main drawback is that if you stagger the conversion of segments into annuities you will not be able to take all your tax-free cash from your total pension fund at outset as a single lump sum payment.

Phased retirement however can be a very useful financial planning tool, especially if you want to ease back gradually on work and start to replace your earnings with pension income.

**Advantages of Phased Retirement**

- Can phase in income in line with income needs

- TFC can form part of the income stream
- Delayed commitment to the type of annuity for the whole fund can be very useful if you are unsure about your own or your spouse's health
- Annuity rates should improve with age
- Uncrystallised funds remain invested and grow virtually tax free, potentially generating higher income and TFC
- Uncrystallised funds can be paid out as a tax free lump sum on death before age 75. It should be noted, however, that if death occurs before age 75, payments made after 5 April 2015 from crystallised funds can also now be paid as a tax free lump sum.

**Disadvantages of Phased Retirement**

- Maximum TFC not available at outset
- Investment performance could be poor
- Annuity rates could get worse
- The need for regular reviews of both investment performance and income means it is more complex and expensive than converting the whole fund to a conventional annuity at outset

**FLEXIBLE ANNUITIES**

In line with its commitment to deliver a more flexible pension's regime, from 6 April 2015 the Government will now allow product providers to sell annuities that can increase and decrease in payment. For example, an annuity could increase in payment each year for the first few years then decrease in payment once a pensioner reaches state pension age.

**FLEXI- ACCESS DRAWDOWN**

What is flexi-access Drawdown?

Flexi-access drawdown is a new type of income drawdown from 6 April 2015 which allows individuals of pension age to draw any amount from their money purchase pension fund, whenever they want to. This option therefore enables 'unlimited' amounts to be withdrawn at any time. The first 25% of the fund that is being crystallised can normally be paid as a tax free cash sum, but the whole amount of any withdrawals taken by the individual over and above the initial tax free cash sum will be subject to income tax at the member's highest marginal rate in the tax year they are paid.

Existing pre 6 April 2015 flexible drawdown arrangements automatically converted to flexi-access drawdown on 6 April 2015 but unlike the under the 'old' flexible drawdown rules, there is no longer any requirement for someone accessing flexi-access drawdown for the first time after 5 April 2015 to have a minimum level of secure income.

As well as being an option for a member's own pension funds, flexi-access drawdown can also be used, after the member has died, to pay a drawdown pension to a beneficiary of the member even if the beneficiary is under the normal minimum pension age (currently age 55).

Are flexi-access drawdown pension funds tested against the lifetime allowance?

Normally, benefits are only tested against the lifetime allowance once. If however funds are designated to flexi-access drawdown, there can be two tests during the member's lifetime:

- The first when initially going into income drawdown, and
- The second if the fund is used to buy an annuity or (if earlier) the member is still in drawdown when they reach age 75

The crystallised value of the benefits at the first test is the amount of tax free cash paid **plus** the residual value of the fund designated to drawdown.

At the second benefit crystallisation event, it's the value of the remaining drawdown fund **less** the amount originally moved into drawdown that is tested against the member's available lifetime allowance.

If the member's available lifetime allowance is exceeded after either or both of these benefit crystallisation events, the 'excess' will be subject to a lifetime allowance tax charge.

Can pension contributions continue after a member has designated their funds to flexi-access Drawdown?

Taking the tax free cash sum and designating the balance to flexi-access drawdown will not, in itself, have any impact on the amount of tax-relievable pension contributions that can continue to made by or on behalf of that individual to money purchase (defined contribution) pension arrangements.

When, however, an individual who has designated funds to flexi-access drawdown first takes any income from that flexi-access drawdown pension, (and assuming that they haven't already accessed benefits 'flexibly' from any other money purchase pension arrangements before this one), this will trigger the £4,000 money purchase annual allowance (reduced from £10,000 in 2015/16 and 2016/17).

Once the £4,000 MPAA has been triggered, this means that they will still have an overall annual allowance of £40,000 but no more than a maximum of £4,000 can be paid to money purchase schemes without incurring an annual allowance tax charge. Carry forward of unused annual allowance cannot be used to increase the MPAA beyond £4,000.

If someone dies in flexi-access drawdown, what death benefits can be paid and how would they be taxed?

If a member in flexi-access drawdown dies, the remaining funds on death can be paid as a:

- Dependant's pension (payable as a dependant's scheme pension, dependant's lifetime annuity or a dependant's flexi-access drawdown); and/or
- Nominee's lifetime annuity; and/or
- Nominee's flexi-access drawdown pension; and/or
- Lump sum to one or more individuals (or into trust), and/or

- Charity lump sum death benefit (but only if there are no surviving dependants of the member and the member has nominated the charity)

On the death of an individual in receipt of a dependant's or nominee's flexi-access drawdown pension any remaining funds can then be paid as another dependant's flexi-access drawdown pension, a successor's flexi-access drawdown pension or as a lump sum.

*Who is a nominee?*

This is an individual who has been nominated by a member (or failing that, the scheme administrator) who is not a dependant of the deceased member, to receive a flexi-access drawdown pension.

This change therefore means that, unlike the situation prior to 6 April 2015 where the only option for a non-dependant of the deceased member was to receive a lump sum, any individual can inherit unused drawdown funds on the death of the member and continue in drawdown in their own name.

*Who is a successor?*

Where an individual dies whilst in receipt of a dependant's or nominee's flexi-access drawdown pension, and leaves a residual fund, an alternative to paying this residual fund as a lump would be to instead pay it as flexi-access drawdown pension to another nominated individual, defined as 'a successor'. The drawdown pension that has been inherited by the successor would then become a successor's flexi-access drawdown pension fund. On the death of a successor, they can then nominate another individual to receive another successor's flexi-access drawdown pension.

These changes therefore allow accumulated pension wealth to potentially cascade down the generations, whilst continuing to benefit from the tax advantages that the pension wrapper provides.

*How is a drawdown lump sum death benefit taxed?*

For lump sums paid after 5 April 2015, this will depend on whether or not the member died before or after they had attained age 75.

<u>Death before age 75</u>

Drawdown funds paid as a lump sum within two years of death to a dependant or nominee will be tax-free. There is no test against the deceased's lifetime allowance.

If the drawdown funds are instead paid as a lump after two years, the lump sum will be taxed at the recipient's marginal rate (reduced from 45% in 2015/16). There is no test against the deceased's lifetime allowance.

<u>Death after age 75</u>

Any drawdown funds paid as a lump sum to a dependant or nominee will be taxed at the recipient's marginal rate (reduced from 45% in 2015/16). This will apply regardless of whether the lump sum is paid within 2 years of death. There is no test against the deceased's lifetime allowance.

*How will flexi-access income withdrawals be taxed, following the death of the member, in the hands of a dependant or nominee?*

<u>Death before age 75</u>

If the member dies in drawdown before age 75, the payment of any income withdrawals to a dependant or nominee will be tax free. There is no two year window for having to designate the funds to drawdown for a beneficiary in order for the income received to be tax free and there is no test against the deceased's lifetime allowance.

<u>Death after age 75</u>

If the member dies in drawdown after age 75, the payment of any income withdrawals to a dependant or nominee will be subject to income tax in the recipient's hands at their marginal rate.

This will apply regardless of whether the designation is made within 2 years of death. There is no test against the deceased's lifetime allowance.

*How will flexi-access income withdrawals be taxed, following the death of a dependant or nominee, in the hands of a successor?*

Each time a pension fund is inherited, the tax rate will be reset by the age at death of the last drawdown account holder.

For example Jim, a widower, dies age 83 and nominates his son John to receive his drawdown fund. As Jim died after age 75, John is taxable at his marginal rate on any income withdrawals. However, if John dies before age 75 and leaves the remaining fund to his daughter Jane, Jane can take withdrawals from her successor's drawdown pension tax free.

**<u>Drawdown and IHT</u>**

The Government have confirmed that there will be no IHT charge on lump sum death benefits, irrespective of whether they are in respect of uncrystallised or crystallised rights and whether the member dies before or after age 75. This, however, will be subject to meeting the other requirements for benefits to be paid IHT free such as the need for the benefits to be paid at the discretion of the scheme administrator/ trustees.

It is also important to note that the 'error or omission to act' provisions in section 3(3) of the Inheritance Tax Act 1984 will cease to apply to pension arrangements with effect from 6 April 2011, where the error or omission took place on or after 6 April 2011.

This, therefore, should mean that there will be no potential IHT liability arising when someone in ill-health dies within 2 years of entering drawdown (and who therefore failed to exercise their right to purchase an annuity) or someone in income drawdown dies within 2 years of deliberately reducing their withdrawals in order to enhance the lump sum death benefit payable and the resultant lump sum is paid to someone other than a 'relevant' dependant or charity.

**Flexi-access drawdown - Pros and Cons**

**Advantages**

- You will be able to take the maximum tax free cash lump sum immediately to spend or invest without having to convert the rest of the fund to an annuity.
- If you take the tax free cash only (and assuming that you have not already accessed pension benefits 'flexibly' from another pension arrangement) you will not trigger the £4,000 money purchase annual allowance until such time that you chose to take any income withdrawals from the balance of your fund that has been designated to flexi-access drawdown.
- Variable Income - If you do require an income you may choose to take any level of income that you require, without limit, whether it be a regular income or on an ad-hoc basis.
- After taking into account any other sources of income which may be available to you, you will be able to plan in advance the level of income that you wish to take each year from your flexi-access drawdown pension.
- You can structure your income to mitigate your liability to Income Tax. For example, by reducing drawdown income in some tax years, you may be able to avoid a higher rate tax liability.
- The pension fund (less any income withdrawn and associated charges) will continue to be invested in a tax efficient environment until you decide to purchase an annuity or continue drawdown past age 75.
- Depending upon investment returns, which can fall as well as rise and are not guaranteed, this may provide the opportunity to achieve sufficient growth to improve the ultimate benefits when (and if) you decide the time is right to purchase an annuity.
- You may be able to use income drawdown as part of your Inheritance Tax planning by taking varying levels of income, and using all or part of that income to make gifts to take advantage of annual exemptions.
- Flexible options on death. For example, a surviving beneficiary (such as your spouse) could continue drawdown in their own name, buy an annuity or take the residual fund as a lump sum. If you die before age 75, any lump sum or pension benefits paid as an income to a beneficiary should be tax- free in the hands of the recipient.
- As you get older there is the prospect of annuity rates rising and therefore providing a higher income. This is because it is cheaper for insurance companies to purchase an annuity to provide a given level of income for someone aged, say 70, than someone aged 60.

**Disadvantages**

- A careful investment portfolio needs to be drawn up which will involve investment risk and a reliance upon investment management.
- A minimum level of growth must be achieved by the remaining pension fund in drawdown in order to maintain its value after the income payments have been taken (assuming an income is taken of course). If this 'critical yield' is not achieved the fund may be unable to purchase an annuity equivalent to that which could have been purchased at outset if income withdrawals had not been selected.

- Any investment returns may be less than those shown in the illustrations.
- Should a high level of income be taken, then unless there is exceptional growth the withdrawals may not be sustainable.
- Deferment of the purchase of an annuity may result in less favourable annuity rates if and when a purchase is eventually made.
- In addition, the investment fund may be depleted, either through investment performance or withdrawals, to the extent that even if current annuity rates are maintained, the annuity which can be purchased in the future will drop.
- As soon as you take any income withdrawals from your flexi-access drawdown pension (and assuming you haven't already accessed benefits 'flexibly' from any other money purchase pension arrangements before this one), this will trigger the £4,000 money purchase annual allowance.
- All income withdrawals are liable to income tax at your highest marginal rate, although it is possible under drawdown to defer any income payments which may be surplus to requirements.
- Increased flexibility brings increased costs and the need to review arrangements on an ongoing basis.
- Lump sum death benefits paid from drawdown funds, on death after age 75, are taxed at the recipient's marginal rate (reduced from 45% in 2015/16).
- You may feel that the prospect of future higher income does not compensate you for being able to enjoy a guaranteed and secure level of income today and for the rest of your life.
- Annuity providers make a profit from the fact that some individuals die sooner than is expected and use some of this 'mortality profit' to enhance current annuity rates. By delaying the purchase of your annuity, the benefit of this potential profit, which can be significant, may be lost.

**UNCRYSTALLISED FUNDS PENSION LUMP SUM**

From 6 April 2015, and subject to the pension provider allowing it, members of pension age will be able to take what they want from their money purchase pension pot, whenever they want it.

As an alternative to entering flexi-access drawdown, this can be achieved by taking an uncrystallised funds pension lump sum (UFPLS).

Under the UFPLS option, an individual can take a single or series of lump sums from their uncrystallised funds, without having to designate them to drawdown first.

25% of the amount paid will normally be tax-free, with the remainder taxable as pension income.

The conditions that need to be met are as follows:

- It can only be paid from uncrystallised rights held under a money purchase arrangement
- The individual must be at least 55 or (if younger) meet the ill-health early retirement conditions
- If under 75, the member must have enough lifetime allowance available to cover the full amount of the UFPLS

- If over 75, the member only needs to have some lifetime allowance left when they want to take the UFPLS (but if the UFPLS is more than their available lifetime allowance, the tax free part of the payment will be limited)

Once a UFPLS has been paid, the member will then be subject to the £4,000 money purchase annual allowance.

However, an individual cannot be paid a UFPLS if:

- They have registered PCLS rights under either primary protection or enhanced protection; or
- They have a lifetime allowance enhancement factor (e.g. because they have received a pension credit on divorce from a pension already in payment) and the available portion of their lump sum allowance is less than 25% of the proposed uncrystallised funds pension lump sum.

**THIRD WAY PENSIONS**

Third Way Pensions fit in between a conventional annuity and an Income Drawdown plan as they offer the chance to still participate in stock market growth but with guarantees attached to either income, capital or both. Whilst each specific product differs in its features, the 'Third Way' pension is usually structured in one of two ways:

Annuity - This option is commonly structured as a fixed term, value protected annuity plan, typically running for 5 years at a time, with the option to include guarantees to protect maturity values or the level of income. Unlike a traditional lifetime annuity, these products tend to offer the ability to alter income levels between certain limits and importantly, also allow the facility to provide a lump sum on death.

Income Drawdown - The second type of Third Way plan is structured as an Income Drawdown plan but with the option to apply a guarantee to the initial investment so that your fund value will never fall below what you originally paid into the plan. Some plans also allow all or a portion of any growth in the plan's value to be locked in and a new minimum guaranteed level is then set. The option to select a guaranteed level of income is also commonly available.

Under both of the above options, you can choose to immediately take a tax-free cash lump sum and then, instead of buying an annuity, leave the remainder of the fund invested in a tax-efficient environment. If the income is not guaranteed it may vary between set limits, and will be reviewed at some point between 1 year and 5 years depending on the product chosen.

**Advantages**

- You are able to take all of your tax-free cash lump sum entitlement at outset
- Unless a guaranteed income is selected, you do not have to receive a set income but are able to vary it to suit your personal circumstances, up to a maximum limit, to supplement other sources of income
- You are able to mitigate your liability to personal income tax in certain years

- You have the potential to benefit from good investment performance in a tax-efficient environment and to exercise control over your own investment portfolio
- You are able to add a safeguard in the form of a guarantee to limit any drop in your fund value and some products allow gains to be locked in

**Disadvantages**

- Taking withdrawals may erode the capital value of the fund, especially if investment returns are poor and a high level of income is being taken. This could result in a lower income when an annuity is eventually purchased and could also affect the long term financial security of your spouse/partner
- Annuity rates may be at a worse level when annuity purchase takes place. Although annuity rates generally increase with age, they have fallen dramatically during the past 15 years. This trend may continue
- A careful investment portfolio needs to be constructed which will involve some investment risk. If capital guarantees are not included then this means the fund value could fall which could affect your future income levels
- Increased flexibility and the addition of guarantees bring increased costs and the need to review arrangements on a regular basis
- There is no guarantee that your future income will be as high as that offered by an annuity purchased today
- You may feel the prospect of the future higher income does not compensate for the known income available from an annuity now and for the rest of your life

## ***Pension Transfers***

**Overview of the types of pension plan**

**Occupational Scheme**

Occupational pensions are pensions provided by your employer. There are two main types of occupational scheme.

**Defined Benefit (Final Salary) Schemes:**

Schemes set up on a defined benefits basis are commonly referred to as final salary schemes. Under this type of scheme the benefits received are determined by the member's number of year's pensionable service and their salary at or near retirement.

**Defined Contribution (Money Purchase) schemes**:

Occupational Schemes set up on a defined contribution basis are commonly referred to as money purchase schemes. Under this type of scheme the contributions paid by the employer and employee (where appropriate) are 'defined' and invested in a fund which benefits from tax free growth. In a money purchase scheme the return on your investment is not guaranteed and the eventual benefits payable will depend on the size of the pension fund created by the contributions made.

**Stakeholders**

Stakeholder Pensions are low charging individual money purchase schemes that were introduced in 2001 as an alternative to personal pensions in order to encourage more people to plan for retirement. All Stakeholders must meet certain minimum standards, the most notable one's being that there are no initial charges, no ongoing charges (other than an Annual Management Charge (AMC) which cannot exceed 1.5% in the first 10 years) and no penalties for stopping contributions or transferring to a new provider.

**Personal Pensions**

A Personal Pension plan is also an individual money purchase scheme, but unlike a stakeholder it is not subject to the same strict charging criteria, although there are a number of Personal Pension plans on the market that offer 'stakeholder friendly' terms. However, unlike a Stakeholder plan, the providers of Personal Pension plans reserve the right to amend the charging structure in respect of their personal plans in the future if they so wish.

Like a Stakeholder, at retirement, up to 25% of the fund can be taken as a tax free cash sum with the balance being used to purchase a pension which would be taxed as earned income.

**Self-invested Personal Pensions (SIPPs)**

SIPPs are a type of personal pension designed for people who want to manage their own investments. Most SIPPs allow investment in a very wide range of funds as-well as investments in assets such as commercial property, offices, shops or factory premises. SIPPs often have higher charges than stakeholders and personal pensions and it is for this reason that they may only be suitable for more experienced investors with large funds.

**Section 32 buyout**

First introduced in 1981, the paid-up pension rights and entitlements in respect of a previous employer's occupational pension scheme can be transferred to section 32 buyout policies.

Where the scheme member is transferring guaranteed minimum pension (GMP) rights from a contracted out scheme to a S32, the GMP must be retained and revalued following the transfer. The S32 provider must then meet its liability for paying the GMP from age 60 (for women) or 65 (for men), although benefits can be taken earlier from age 55 as long as there are sufficient funds within the S32 at that time to cover the GMP re-valued to 60/65. This is therefore different to the situation on transfer to a PP or Stakeholder scheme where the cash equivalent transfer value of the accrued GMP rights are instead converted to a money purchase fund and the right to a GMP is gone. However, whereas 25% of a money purchase fund can be taken as a tax free cash sum, a GMP cannot be commuted to pay tax free cash. For some people, this could be an important consideration.

**Non Profit Deferred Annuity**

When a final salary pension scheme is wound up, the proceeds are often used to buy annuities from an insurance company which match the pensions that the members have earned in the scheme. This 'deferred annuity' replaces the guaranteed pension that would have been paid by the previous scheme and increases both before and during retirement in accordance with the former schemes rules.

**The Lifetime Allowance**

The lifetime allowance is the maximum amount of benefits an individual can build up in registered pension schemes without suffering a tax charge when benefits are taken. The Standard Lifetime Allowance for tax year 2018/19 is £1,030,000.

If the value of the benefits being taken exceed an individual's available lifetime allowance then a Lifetime Allowance Charge (LAC) is due on the excess. This tax charge is 55% if taken as a cash lump sum or 25% (plus income tax at the individuals marginal rate) if taken as a pension.

**IHT and Lump Sum Pension Death Benefits**

Any lump sum death benefits will usually be paid free of Inheritance Tax provided they are paid within 2 years of the scheme becoming aware of the death of the member and the member has not made a 'binding nomination' (in other words, the scheme must have discretion to whom they pay these benefits). It is important to be aware however that a charge to Inheritance Tax (IHT) could arise where a member of a pension scheme in poor health has transferred benefits from one scheme to another and subsequently dies within 2 years.

**Investment considerations for those with a SIPP or SSAS**

**Permitted investments**

The fact that the concept of prohibited investments no longer applies means that pension schemes can - in theory anyway - invest in whatever they like. However, there are controls over pension scheme investments that restrict investment options in practice and direct investments in things like residential property, works of art, vintage cars and fine wine will incur heavy tax charges.

**Connected transactions**

The ban on connected party transactions has been lifted although HMRC will monitor this for any possible abuse after 5 April 2006. This should be a big boost to the self-employed - and particularly solicitors, accountants and other partnerships - who prior to 6 April 2006 were not able to sell a business property from themselves or their partnership to their pension scheme.

**Taxable Property**

The taxable property rules heavily tax and therefore effectively prohibit investments in the two areas that created so much excitement and press coverage in the build up to A-day - residential property and most tangible moveable assets. Tangible moveable assets are anything that you can touch and move and therefore includes a wide range of assets such as works of art, antiques, jewellery, fine wine, classic cars, yachts, and plant and machinery. To date, only Gold Bullion has been specifically excluded from the definition of a tangible moveable asset.

**Investing in the shares of the employer**

No more than a maximum of 5% of the market value of an occupational schemes assets can be invested in the shares of the sponsoring employer or an associated company with an aggregate restriction of no more than 20% if the shares are held in more than one sponsoring employer or an associated company.

**Loans to a Sponsoring employer**

Loans to the employer from the pension fund is one way a pension scheme can be used to raise finance for commercial purposes whilst simultaneously providing an investment return to the fund which will benefit the pension scheme. Loans to members of a pension scheme (or any person who is 'connected' to a member of the scheme) are not 'permitted' and would therefore give rise to an unauthorised payment tax charge. A loan from an occupational scheme to a sponsoring employer can however be made subject to certain criteria being met.

**Borrowing**

Pension schemes can borrow for any legitimate purpose which is intended to benefit the pension scheme such as to help fund the purchase of a new asset, improve an existing asset. Since 6 April 2006, the level of borrowing has been simplified and is now a maximum of 50% of the net asset value of the scheme.

**Using a Pension scheme to purchase a commercial property**

It is possible to use a pension scheme to purchase a commercial property. Using the pension scheme to purchase the property could provide an initial cost saving given that tax-exempt money would be used to fund the purchase. The market rate of rent paid by the company to the pension fund would also reduce the company's corporation tax liability and would be a tax free receipt in the pension fund. Property is however an illiquid asset and can be hard to sell. Purchasing the property could also contribute to a lack of diversification within the scheme.