Factsheet – Income Drawdown – April 2019

What is it?

An Income Drawdown plan is a personal pension plan from which you can draw an income.

From April 2006 to April 2011, the official name for this type of pension plan was an Unsecured Pension (USP) and then we had either a Capped Drawdown or a Flexible Drawdown and from April 2015, we now have Flexi-Access Drawdown.

What does it do?

A Flexi-Access Drawdown plan simply allows you to take benefits from your pension without the need to buy an annuity. As such, you can:

1. Take the pension commencement lump sum (PCLS), also known as tax-free cash, from your pension plan(s) without taking out an annuity.
2. Take an income from your pension fund, with or without the PCLS, without having to buy an immediate annuity.

You retain ownership of the funds so that it can continue to be invested in the same manner as prior to taking benefits. The main features of a Drawdown plan are:

- From the age of 55, you have the ability to decide how much you wish to crystallise (draw benefits from your pension) and when.
- You can elect to crystallise any amount; 25% of which will be paid tax free, with the balance available as taxable income under the PAYE system.
- You can choose to draw only the tax free lump sum and no income.
- You can choose to draw the tax free lump sum and any amount of income up to the value of the remaining 75%, remembering this element is all potentially taxable.
- The income can be paid as a regular income or as a lump.
- Should you elect to draw an income, the amount can be varied, with no limits. You can potentially transfer any number of pension plans (personal and occupational) to one single income drawdown plan.
- You retain ownership of your pension fund and control of your investment.
- There is no change to death benefits for dependents irrespective of whether the pension has been access or not, before the age of 75 – see below.

There is no limit on the amount of income or lump sum you can now take from a pension as you now the flexibility to withdrawal up to 100% of the pension fund at a time to suit you.

Contribution Restrictions - once you do commence taking an income from the Flexi-Access plan, there is a limit on further contributions into your pension. You can normally contribute 100% of your relevant earnings up to £40,000* per annum into a pension and carry forward any unused allowance from the last 3 years. However, if you commence taking an income, you are limited to annual contributions of £4,000 and you cannot use carry forward of any unused annual allowance.

Capped Drawdown

If you had a Capped Drawdown plan as at 5th April 2015, you can continue with the plan rather than go into a Flexi-Access drawdown. The main differences between Capped and Flexi-access drawdowns are:

Income

Whilst Flexi-Access Drawdown has no cap on the income that can be taken, Capped Drawdown rules are as follows:

- The maximum drawdown level is 150% of the amount of an equivalent annuity. The equivalent annuity is based on the individual's actual age and is no longer restricted to age 75 for someone older than this.
- The maximum amount of income that can be withdrawn is reviewed every three years until the end of the year when the individual reaches age 75 and then annually thereafter.

Contributions

With a Capped Drawdown plan, if you have access the income, you may continue to contribute into your pension up to a maximum of £40,000* per annum plus any carry forward of unused allowance from the three previous years, whilst with Flexi-Access the limit is £4,000 (where you have also accessed income in addition to the tax free lump sum).

Taxation

Taxation within the pension fund

The funds in the drawdown plan can continue to be invested in the same tax efficient environment as prior to taking the benefits. This means that there is no income tax or capital gains paid within your pension.

Taxation on benefits:

You can take a commencement lump sum of up to 25% of the value of the fund crystallised and there is no tax payable on this. Any income you take is taxed as income under PAYE at your marginal rate of tax.

Death Benefits

Before April 2015, what benefits could be paid depended upon whether the funds were crystallised or not. Since April 2015 it is the age of the person who dies, at the date of their death, that affects the tax treatment of the benefits, there is no differentiation between crystallised and uncrystallised funds.

However, a lifetime allowance (LTA) check applies to uncrystallised funds. If the value of the death benefits takes them over their remaining lifetime allowance then the beneficiary will need to pay the appropriate lifetime allowance charge. If there is more than one beneficiary the charge is apportioned across the fund they each receive, so one beneficiary isn't burdened with the whole charge.

Pre 75 benefit options – death of the member

The value of the pension fund at the date of death is usually payable to the nominated beneficiaries or dependents, and this is free of income tax provided they are designated within two years of the member's death. If the designation is made after 2 years any income or lump sum paid will be subject to income tax at the beneficiary's marginal rate.

The beneficiaries can choose how they wish to take the benefits, including a lump sum from the scheme, Flexi-Access Drawdown, an annuity or scheme pension.

<u>Post 75 benefit options – death of the member</u>
The value of the pension fund at the date of death is payable to the nominated beneficiaries. Again, the beneficiaries can choose how they wish to take the benefits, including a lump sum from the scheme, Flexi-Access Drawdown, an annuity or scheme pension (where these options are offered by the scheme). However, unlike death benefits before the age of 75 which will be paid tax free, whether lump sum or pension income, death benefits paid where death occurred after age 75 will be taxed at the recipient's marginal rate of income tax.

<u>Death of a beneficiary</u>
If a beneficiary has chosen to take Flexi-Access Drawdown then on their death there may still be remaining funds in the pension. The beneficiary can name their beneficiaries to receive the remaining funds in much the same way as if they had been their funds originally. Their beneficiaries are called successors and need not be associated in any way with the original member. The tax treatment is determined by the current beneficiary's age when they die. This can continue indefinitely, with a successor leaving the fund to another successor as long as some funds remain.

<u>Inheritance Tax</u>
Pension death benefits will not normally be subject to inheritance tax (IHT) regardless of the age of the scheme member at death. However, if pension benefits have been paid from the scheme by way of a lump sum to the member's beneficiaries those funds form part of the recipient's estate for IHT purposes. If the beneficiary chooses to opt for flexi-access drawdown any funds not yet paid out to the beneficiary will remain part of the pension scheme and still outside their estate on their death.

HM Revenue & Customs reserve the right to subject a pension fund to an IHT charge if they feel it has been used for tax avoidance purposes.

<u>Death benefit nomination forms</u>
When a pension scheme member dies, the scheme administrator has to pay the death benefits to someone. The recipient(s) of death benefits are usually chosen at the discretion of the pension scheme trustees or administrator. However, a member / pension holder can nominate whom they wish to receive the benefits, by completing a nomination of beneficiaries form (sometimes called an "expression of wish") and the trustees will usually take this into account, although this is not a binding request.

It is essential that death benefit nomination forms are reviewed frequently and new forms are completed on the death of a member, dependent, nominee or successor to ensure there is always a valid form on file. Should there be no indication of who the scheme administrator should pay the benefits to, this will restrict the options available to any beneficiary who is not deemed to be a dependent of the member.

Another key point is that the nominations of the original member have no bearing or influence on those of the dependent / nominee or successor pensions that may follow.

Benefit Crystallisation Events

There are several benefit crystallisation events. If we focus on those which may affect a client who enters Drawdown, then the following will apply:

Each time benefits are crystallised to provide pension benefits in whichever form e.g. designated to a Drawdown pension, a Benefit Crystallisation Event occurs meaning the benefits crystallised must be tested against the Lifetime Allowance.

At age 75, an automatic test against lifetime allowance will occur; this will effectively calculate the growth in the Drawdown pension between the original date of designation and the market value of the funds at age 75. Any pension funds not crystallised will also be tested against the prevailing LTA. If there is no Lifetime Allowance remaining at this point and there has been excessive growth, there will be a Lifetime Allowance charge.