SELECT WEALTH®

PENSIONS TECHNICAL GUIDE TO:

YOUR RETIREMENT OPTIONS EXPLAINED

A guide for clients 2024/25

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Pension Transfers and Death (Within 2 Years – ill health)

You need to be aware that where an individual transfers funds from one registered pension scheme to another and dies within two years of the transfer then their executors need to report this on the IHT409 form needed to get probate. HMRC will then investigate and if they consider that the individual knew they had a short life expectancy, they may decide that the amount transferred is assessable to IHT. **DB to DC -** Where there is an intention to give benefits which didn't exist before, such as a defined benefit (DB) to defined contribution (DC) transfer, it may still be subject to IHT.

DC to DC – A discretionary Money Purchase/Defined Contribution (DC) plan switch or transfer may be completed to another discretionary DC arrangement, without the application of IHT, if it is for “genuine commercial reasons” and it is not intended to confer any gratuitous benefit on any person i.e. to increase an individual’s benefits. As this policy is subject to Trustee discretion, IHT should not arise, however, care needs to be taken as this is a relatively new legal development.

QUICK GUIDE

LIFETIME ANNUITY	SCHEME PENSION	PHASED RETIREMENT	EXISTING DRAWDOWN PENSION - CAPPED	FLEXI-ACCESS DRAWDOWN	UFPLS
Regular and secure income for life	Regular and secure income for life	Part of your fund and part of your tax free cash are used in segments to provide annuity income.	Tax free cash lump sum paid at outset and fund remains invested. Income can also be selected if required.	Tax free cash lump sum paid at outset and residual fund (subject to income tax) can be accessed immediately.	A lump sum is paid up to the full value of the plan. No regular income.
Tax free cash provided at outset and fund used to purchase an annuity paid for life.	Tax free cash paid at outset and fund used to provide income for life.	The balance of the fund not used for income / tax free cash remains invested with a view to providing higher future benefits.	The balance of the fund not used for income remains invested with a view to providing higher future benefits.	Immediate access to the entire fund to provide income with no limits. 25% Tax Free Cash the rest subject to income tax.	Immediate access to as much of the fund as required. Of the amount paid out, 25% is paid free of tax with the rest subject to income tax.
Your annuity income is paid at least annually and can increase, decrease or remain level in payment.	Your scheme pension is paid at least annually and can increase or remain level in payment.	Your starting annuity is smaller, but is supplemented by a portion of your tax-free cash sum.	You can choose the income you want, and when you want it, between nil and 150% of an equivalent single life annuity.	You can choose the income you want, and when you want it.	Can be paid monthly. You can choose when and how much of a lump sum you require.
Additional options can be selected at outset such as annual increases, spouse's benefits or guarantees which reduce your own income.	Additional options may be offered at outset such as annual increases, spouse's benefits or guarantees which reduce your own income.	Each year you decide how much fund to use for annuity purchase and how much tax free cash is used to supplement your income.	If investments do well, you may benefit from higher future income payments, and vice versa.	On death, if there is any fund remaining then it is available to pay benefits to your beneficiaries.	As long some funds are left in the plan, if investments do well you may benefit from higher future lump sum payments.
Once you have bought your annuity, you usually cannot change your mind or change benefits. On death there may also be the option of a capital payment less tax.	Pension income paid directly by scheme. Once in payment you cannot change your mind or change the benefits.	Because you don't commit all your funds to buy an annuity immediately, you keep your options open.	On death, the remaining fund is available to pay benefits to your beneficiaries.	Policyholder must advise all other 'active' pension plan providers that they have flexibly accessed their benefits within 91 days, or face possible HMRC fines.	Policyholder must advise all other 'active' pension plan providers that they have flexibly accessed their benefits within 91 days, or face possible HMRC fines.

1. LIFETIME ANNUITY

Overview

An annuity is simply a series of payments made at selected intervals in return for a pension fund. The level of payment is dependent upon age, annuity rate, size of fund and options selected. Annuity rates tend to mirror interest rates since they are related to the returns earned on Fixed Interest Gilt Edge Securities. There are many different types of Annuities and these are covered later on in this section.

Tax Free Cash

Most types of pension plan have the option of taking a tax-free cash lump sum before exchanging the residual fund for a series of payments. Once an annuity has been purchased there is no further entitlement to tax-free cash, therefore the decision of whether to access the cash or not needs to be made at outset.

Income

Annuity payments are taxed at source under the PAYE system. Provided a P45 is presented the annuity will be paid net of your marginal rate of tax and there will be no further tax liability. Payments can be made monthly, quarterly, half yearly or yearly and can be in advance or arrears. Payments can remain level, can decrease or can increase e.g. at a set rate or in line with an index such as the Retail Prices Index.

Death benefits

The option of what type of death benefits to include must be made at outset. The options available are as follows:-

- A spouse's or dependents pension up to 100% of the pension you had received
- A lump sum

Protecting your annuity

There are ways of protecting your annuity if you're worried about what will happen to it if you die soon after you retire.

Commonly known as Value Protection, this option can be included to ensure that on death), the original fund value, less the gross income payments already made, can be paid out. On death before age 75, this will be tax free. On death after age 75, this is taxed at the beneficiaries' marginal rate of income tax.

Guarantee periods allow you to opt for your annuity to pay out for a specific number of years even if you die within this time. On your death the income may continue to be paid for the rest of the guarantee period. You should not look at a guarantee as an alternative to a joint-life annuity, because any income will stop at the end of the guarantee period, not when your spouse or partner dies.

You should note that where the value of the annuity on death is below £30,000 it may be possible for the remaining guaranteed payments to be paid as a lump sum.

Advantages

- You will receive a guaranteed income for life, and you can elect for your spouse/beneficiaries to receive a guaranteed income or a lump sum less tax upon your death.
- Tax-free cash is available at outset.
- There are no additional charges applied to the contract once in force. All charges are taken at outset and are reflected in the annuity rate offered.
- The contract is simple to understand, there is no need to review the contract and there is minimal paperwork needed to start the payment of benefits.

Disadvantages

- There is no opportunity of participating in future investment returns.
- The various options in relation to death benefits and increasing / decreasing income levels etc must be selected at outset and will result in a lower initial pension payment. These selected benefits cannot be altered in the future.

Suitability

Lifetime annuities are most likely to suit individuals who want an absolute guarantee on their pension payments and/or for their spouse/partner. They therefore suit individuals with low attitudes to risk and a requirement for security. They also suit individuals who have relatively small pension funds and who will be heavily reliant on their pension income.

2. WITH PROFIT ANNUITY

Overview

A with profit annuity is similar to a lifetime annuity in that it is simply a series of payments made at selected intervals in return for a pension fund. The level of payment is also dependent upon age, annuity rate, size of fund and options selected. The main difference is that **the initial pension level and future income levels are also dependent on the performance of the underlying with profits fund.**

An assumed future bonus rate (ABR) is selected at outset by the investor. The higher the ABR the greater the initial income, however if the actual bonus rate of the with profit fund does not equal the ABR then the amount of pension payable in future will decrease. Most with profit annuities offer a minimum guaranteed level of pension.

Tax Free Cash

Tax free cash must be withdrawn at outset then the residual fund is exchanged for a series of payments. Once an annuity has been purchased there is no further entitlement to tax-free cash.

Income

Annuity payments are taxed in the same way as described under 'Lifetime Annuity'. **Income will increase or decrease in payment depending on fund performance relative to the ABR.**

Death benefits

The option of what type of death benefits to include must be made at outset. The options available are the same as under the Lifetime Annuity.

Advantages

- You will receive an income for life, and you can elect for your spouse/partner to receive an income or lump sum on death - less tax on death after age 75.
- Tax-free cash is available at outset.
- Charges are taken at outset and are reflected in the annuity rate offered. The with profits fund deducts charges before bonuses are declared.

- The contract is relatively simple to understand and there is minimal paperwork needed to start the payment of benefits.

Disadvantages

- The selected income level is not guaranteed and is subject to increases and decreases based on future investment returns.
- The various options in relation to death benefits etc must be selected at outset and will result in a lower initial pension payment. These selected benefits cannot be altered in the future.

Suitability

With Profit annuities are most likely to suit individuals who want some guarantee on their pension payments but also want the potential to benefit from future investment return. They therefore suit individuals with low to medium attitudes to risk and security. They also suit individuals who have relatively small pension funds and who will be heavily reliant on their pension income.

3. UNIT LINKED ANNUITY

Overview

A unit linked annuity is very similar to a with profit annuity in that it has all the same options and features but is invested in unit linked funds rather than a with profits fund. **The initial pension and future income levels are also dependent on the performance of the underlying unit linked funds.**

Often the investor is allowed to assume a future rate of growth. The higher this assumed rate the greater the initial income, however if the actual growth does not match this rate then the amount of pension payable will decrease.

Tax Free Cash

Tax free cash must be withdrawn at outset then the residual fund is exchanged for a series of payments. Once an annuity has been purchased there is no further entitlement to tax-free cash.

Income

Annuity payments are taxed in the same way as described under ‘Traditional Annuity’**. Income will increase or decrease in payment depending on fund performance relative to the assumed growth rate.**

Death benefits

The option of what type of death benefits to include must be made at outset. The options available are the same as under the Lifetime Annuity.

Advantages

- You will receive an income for life, and you can elect for your spouse/partner to receive an income or lump sum - less tax upon your death after age 75.
- Tax-free cash is available at outset.
- The contract is relatively simple to understand and there is minimal paperwork needed to start the payment of benefits.

Disadvantages

- The selected income level is not guaranteed and is subject to future investment returns.
- Charges will be higher than under a ‘traditional annuity’.
- Any options to provide benefits on death must be selected at outset and will result in a lower initial pension payment. These selected benefits cannot be altered in the future.

Suitability

Unit Linked annuities are most likely to suit individuals who want some guarantee on their pension payments but also want the potential to benefit from future investment return. They therefore suit individuals with low to medium attitudes to risk and security. They also suit individuals who have relatively small pension funds and who will be heavily reliant on their pension income.

4. ENHANCED LIFE OR SPECIAL SITUATION ANNUITIES

Overview

Individuals in poor health (or those with a known medical condition e.g. diabetes) may apply for higher annuity rates due to their shorter life expectancy – this is often subject to a medical examination. Some individuals may be offered enhanced rates due to their lifestyle or physical condition, i.e. smokers or clinically obese.

More recent developments have seen the introduction of Special Situation Annuities, which can be based on occupation and postcode. For example a bricklayer in Yorkshire will be given a higher rate than a stockbroker in Surrey.

In all other respects, these annuities are the same as a Lifetime Annuity.

Suitability

These annuities are most likely to suit individuals who want absolute guarantee on their pension payments and are eligible for the higher rates. They therefore suit individuals with low attitudes to risk and security, although they may also be suitable for individuals with a high attitude to risk but are in ill health.

5. SCHEME PENSION

Overview

This will be the only option – without transferring - for members of their employer's Defined Benefit (also known as Final Salary) Pension Scheme. Those with other types of pension arrangement can also choose this option if they do not wish to purchase a Lifetime Annuity. These pensions are paid either directly from the original pension scheme or on its behalf by an insurance company.

Payment of scheme pensions from Defined Benefit schemes are guaranteed for life.

Tax Free Cash

The scheme pension would allow the option of taking a tax-free cash lump sum at outset. Once income has started, there is no further entitlement to tax-free cash and moving out of the plan cannot be undertaken.

Income

Pension payments are taxed as earned income under the PAYE system as described under 'Lifetime Annuity'.

Death benefits

The death benefits are typically a spouse's or dependant's pension payable for life at a set percentage of the original scheme member's pension e.g. 50% or 66%. There is also usually an option for the full level of pension to continue to be paid if death occurs within a specified 'guaranteed period' e.g. on death within the first 5 years commonly.

Advantages

- You will receive an income for life and you can elect for your spouse/partner to receive an income (subject to income tax) upon your death.
- Money purchase plan scheme pensions are regularly reviewed therefore income could be altered according to changes in health / fund performance.
- Tax-free cash is available at outset.
- The contract is simple to understand and there is minimal paperwork needed to start the payment of benefits.

Disadvantages

- For money purchase schemes, the benefits paid on death could be reduced if investment performance has been poor.
- Any options (if offered by the scheme) to provide benefits on death must be selected at outset and will result in a lower initial pension payment. These selected benefits cannot usually be altered in the future.

Suitability

Final Salary scheme pensions are likely to suit individuals who want a guarantee on their pension payments. They therefore suit individuals with low attitudes to risk and a requirement for security. Money purchase scheme pensions can vary and are likely to suit someone who is prepared to accept these income fluctuations. This would therefore suit individuals who have a balanced attitude to risk.

6. PHASED RETIREMENT

Overview

Phased retirement allows you to control your retirement fund and convert it gradually over a number of years into income. This control is achieved by setting up many contracts (often more than 1,000) and using a number of them each year to provide you with your desired level of income. This income will be made up of part tax-free cash and part annuity. The annuity provides ongoing income for life.

The balance of your pension fund (i.e. the contracts not cashed in or 'vested' to provide you with income) continue to be invested, thus providing you with the possibility of higher future income. This will depend mainly on how much income you take out of the pension fund (especially in the early years) and future investment returns.

Tax Free Cash

Immediate maximum tax-free cash is not available since it is used each year to provide part of your income.

Income

Because the income is made up of annuity payments and a portion of tax-free cash, your overall liability to Income Tax is reduced. Payments are taxed in the same way as a 'Lifetime Annuity and can be made monthly, quarterly, half yearly or yearly, in advance or arrears. Additionally, the payments can remain level, increase or decrease in payment.

Death benefits

The option of what type of death benefits to include is made at outset for the annuity purchases. The residual fund (i.e. units not vested) can be paid, on death, as a lump sum to your nominated beneficiary. Some contracts may allow the unvested benefits to be used to set up a beneficiary's pension plan e.g. a beneficiary's annuity or beneficiary's drawdown plan.

On death pre 75 whether crystallised or not the remaining fund can be paid tax free. On death after age 75, any lump sum payments or income options are taxed at the beneficiaries' marginal rate of income tax.

Advantages

- You retain investment control of the segments of your pension fund not yet used to purchase an annuity.
- As you get older there is the prospect of annuity rates rising and providing you with higher income. It is cheaper for insurance companies to purchase an annuity to provide a given level of income for someone age 70 than for someone age 60 (assuming the returns provided by medium to long-term gilt yields remain the same).
- You will be able to change the shape of your retirement income to reflect your personal circumstances in the future. Each year an annuity is purchased you can choose whether to include death benefits and other options.
- The remaining pension fund (i.e. the policies not cashed in or ‘vested’) can be returned to your beneficiaries free of Inheritance Tax but see tax charges info above.

Disadvantages

- There is no guarantee that your income will be as high as that offered under the lifetime annuity route referred to earlier.
- You must still purchase an annuity to provide income whenever you draw part of your tax-free cash. Of course, annuity rates at that time may not be favourable.
- Deferring the purchase of the annuity does not guarantee a higher level of future income, as annuity rates can go down as well as up and the value of the continued investment of your pension fund may go down as well as up.
- The value of your remaining pension fund, when aggregated with any annuity you have purchased, may not achieve an equivalent level of income to that which could have been purchased with the whole fund at outset via a Lifetime Annuity. This is because withdrawals of tax-free cash and annuities purchased will erode the value of your pension fund if investment returns are not sufficient to make up the balance (including charges for the ongoing administration of the plan).
- You may feel that the prospect of future higher income does not compensate you for not being able to enjoy a guaranteed and secure level of income today and for the rest of your life.
- You will not receive all of your tax-free cash as a lump sum at outset, because you are using this cash to supplement your income.

Suitability

Phased Retirement is most likely to suit individuals who want to gradually retire, i.e. self-employed, or those individuals who are likely to be higher rate taxpayers. They also suit individuals with a medium or higher attitude to risk and security because there is an element of risk involved due to the balance of the pension fund remaining invested or those who have no immediate need for the Tax Free Cash to be taken up front.

7. DRAWDOWN PENSION

Overview

There have been many different versions of Drawdown over the years:

For plans set up prior to **6th April 2015**, the most common type was:

Capped Drawdown - An annual income can be taken from the invested pension fund, if required. This income may vary between limits, set at outset by the Government Actuary's Department (GAD). The maximum limit is reviewed every 3 years up until age 75 and then annually thereafter. The figure is derived from tables published by the Government Actuaries Dept (GAD) and is based on your fund size, age and the current gilt yield. This maximum current limit is broadly equal to 150% of a single life annuity that you could have purchased at that point. There is no minimum limit.

For individuals who took out these plans prior to April 2015, they will continue to run as they are providing income is kept below the 150% of GAD rates. Where this is the case the £60,000 annual allowance (2024/25) for new money purchase pension contributions will remain. For high earners (income in excess of £200,000) or for those who have already flexibly accessed other pension plans, the annual allowance may be lower.

However, if more income than the 150% limit is taken, the plan automatically 'tips into' Flexi-access Drawdown and will trigger the money purchase annual allowance. Once triggered, any future money purchase pension contributions will automatically be limited to a £10,000. You will also not be able to undertake any future carry forward payments into money purchase pension schemes.

The policyholder can also request for the plan to be converted into a Flexi Access Drawdown if they wish.

From 6th April 2015

Flexi Access Drawdown – this operates in the same way as Capped Drawdown though there is no limit on the income taken. After you have taken your entitlement to the tax free lump sum at outset (usually 25% of the policy value), you can choose to take as much or as little of the remaining pot as you wish and it will be added to any other income you have in that tax year to determine the income tax rate that will apply.

Please note that if you draw any income from this plan, your future money purchase pension contributions will be limited to a £10,000 maximum Annual Allowance.

If taking an income stream from a Flexi Access Drawdown plan, the policyholder must alert all scheme administrators (of active plans) that they have flexibly accessed benefits within a 91 day reporting window. Failure to do so will lead to HMRC fines. This responsibility lies with the policyholder.

Tax Free Cash

Most types of pension plan have the option of taking a tax-free cash lump sum before exchanging the residual fund for a series of payments. Ordinarily up to 25% of the fund – subject to a Lump Sum Allowance of £268,275 - may be taken as tax-free cash, however if the pension funds are or were part of an Occupational Pension Scheme or the individual had applied for transitional protection, then the available tax free cash may be greater. Tax Free Cash must be taken at outset and once drawn; there will be no further entitlement.

Income

A pension income does not have to be taken from the Flexi Access or Capped Drawdown options but if this is required, income is taxed as earned income under the PAYE system.

Death benefits

On death pre 75 the funds remaining in the plan will be paid out tax free whether they are paid as beneficiary's lump sum or an income.

Those aged 75 and over who haven't yet started their pension, or are taking a drawdown pension will be able to pass on their remaining benefits to any beneficiary who will then be able to take it as a beneficiary's drawdown pension or beneficiary's annuity or as a lump sum taxed at their marginal rate of income tax.

Advantages

- You are able to take all of your tax-free cash lump sum entitlement at outset.
- You do not receive a set income but are able to vary it to suit your personal circumstances, to supplement other sources of income or you have the option of taking it all at outset.
- 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.
- There are flexible death benefits

Disadvantages

- You may run out of money and have no pension left.
- Benefits are means tested by the DWP.
- High income withdrawals may not be sustainable during the deferral period
- Taking large 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 the annuity is eventually purchased and could also affect the long term financial security of your spouse/partner.
- The investment returns may be less than those shown in the illustrations.
- 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 with only a small increase more recently. This trend may continue.
- A careful investment portfolio needs to be constructed which will involve some investment risk. This means the fund value could fall which could affect your future income levels.
- Withdrawing too much income in early years may have an adverse effect on preserving your pension purchasing power or preserving the capital value of your fund.
- Increased flexibility brings increased costs and the need to review arrangements on an on-going 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.
- The Financial Conduct Authority (FCA) has particular concerns in relation to mortality risk. If you purchase an annuity, you may benefit from a cross subsidy from those annuitants that die relatively early. This cross subsidy is not present with Drawdown Pensions and so to provide a comparable income, a higher investment return will be required. The impact of mortality can be expressed as an annual percentage rate by which the net investment performance of the remaining personal pension fund would have to exceed the interest rate implicit in an annuity in order to break even. This effect has become known as the ‘mortality drag’.
- The charges are explicit whereas under an annuity they are inherent in the annuity rate offered.

Inheritance Tax Issues

The Government has confirmed that IHT will not typically apply to death benefits from pension schemes. They will however, be monitoring this issue so that pension schemes do not become a vehicle solely for IHT avoidance.

Critical Yield – Existing Capped Drawdown Only – where providers may calculate

Critical yields are illustrated by product providers using a common prescribed basis. There are two types (A and B).

Type A – the growth rate needed on the “drawdown” investment sufficient to provide and maintain an income equal to that obtainable under an equivalent immediate annuity.

Type B – the growth rates necessary to provide and maintain the actual level of income chosen.

Suitability

Both Capped and Flexi-access Drawdown (including combination plans) would be generally suited to the relatively sophisticated investor, who is capable of fully understanding the risks involved.

The contract can be used as a useful tax planning tool and a means of accessing pension fund tax free cash without having to take the full taxable income.

Taxation post 2015 – Flexi-access Drawdown Examples

The pension provider might hold a current P45 form for the person making the withdrawal, and therefore know the tax code to be applied for the year. This could be because you have just stopped working or are no longer claiming Job Seekers Allowance. Where a current P45 is held, the pension provider can deduct the correct amount of tax from payments as they are made.

However, where a current P45 is not held, the pension provider will have to deduct tax from the payment at a temporary rate (called emergency rate). In most cases, this will mean that you may be due a tax refund.

The method for claiming the tax back will depend on your circumstances – for instance, on what other income you have in that tax year and whether you have emptied your pension fund.

Here are 4 scenarios:

Scenario 1.

If someone chooses to empty their pension fund in a single withdrawal, and their pension provider does not hold a current P45 for them, the provider will deduct tax from the payment at a temporary rate (called emergency rate). They will then send the person a P45 form, which sets out how much tax they have paid in the year.

In most of these cases, the person making the withdrawal will be due a tax refund. Either they can wait until after the end of the tax year, when HMRC will reconcile their account and make any repayment owed as part of its normal PAYE process, or they can claim the tax back in the same year. To do this, they will need to send HMRC their P45, along with 1 of 2 new forms: a P50Z if they have no other PAYE or pension income (other than the state pension) and a P53Z if they have other employments or pensions.

Scenario 2.

If someone chooses to make regular withdrawals across the tax year, and their pension provider does not hold a current P45 for them, the first payment will be taxed at the temporary rate. HMRC will then work with the pension provider to issue a new tax code so that the subsequent withdrawals made over the year will correct the person's tax position.

Scenario 3.

If someone chooses to make one withdrawal that does not empty their pension pot – or intends to make a series of unplanned/irregular withdrawals across the year – the pension provider will deduct tax at the temporary rate unless it holds a current P45. In most cases, this will mean that the person making the withdrawal will be due a tax refund.

Those making a single withdrawal in the tax year have 2 options: they can an either wait until after the end of the tax year, when HMRC will reconcile their account and make any repayment owed as part of its normal PAYE process, or they can claim tax back in the same year. They can do this by completing a new P55 form and sending it to HMRC so that their tax can be calculated and any repayment made.

Those intending to make a series of withdrawals at irregular times across the tax year should talk to their pension provider. Having applied the temporary rate of tax to the first payment, in some cases the provider might be able to report a zero payment for the months where no withdrawal is made, and work with HMRC to tax subsequent withdrawals and correct the person's tax position.

Scenario 4.

All of the same processes also apply for those who are in Self-Assessment (SA), with any overpaid tax repaid by HMRC through a credit on the person's SA account.

Release of Tax Forms – reclaiming overpaid tax

Three new forms were made available from 6 April 2015 for individuals to claim back overpayments of tax on pension flexibility payments taxed at emergency code.

P50Z - individuals members should only use the P50Z form if:

- they've taken a pension flexibility payment that uses up their pension pot and
- they have no other income

P53Z – individuals should only use the P53Z form if:

- they've taken a pension flexibility payment that uses up their pension pot and
- they have other taxable income in this tax year

P55 – individuals should only use the P55 form if:

- they've taken a pension flexibility payment that does not use up all of that fund
- they have only taken one payment and do not intend to take a further payment from the same pension scheme this tax year and
- the pension body is unable to make any tax refund

Means Testing – DWP

There are rules around how pension benefits, will be treated in the calculation of an individual's entitlement to the following income-related benefits:

- Employment and Support Allowance (income-related)
- Housing Benefit
- Income Support
- Jobseeker's Allowance (income-based)
- Pension Credit
- Universal Credit

These rules apply from an individual's qualifying age for Pension Credit, i.e. a female's SPA for women and for men, the SPA of a woman with the same date of birth.

For individuals living on their own, the means-testing is done solely on the individual, for those living as a couple (whether or not they are married or in a civil partnership) the means-testing is undertaken on the couple and either party's pension funds could impact on either party's means-tested benefits. In both cases, wherever we use the term 'claimant' we mean the individual, or the individual and their partner as appropriate.

Whilst we set out the new rules below, it is worth mentioning that these are less stringent than the rules that applied prior to 6 April 2015. Under those rules, for many means-tested benefits, the notional income rules applied from age 55 for personal pension plans and the scheme's NPA in respect of occupational pension schemes.

The New Rules

The DWP state that in all cases, it is the responsibility of each individual claimant to inform the DWP and, where appropriate the Local Authority, if they or their partner, withdraw any benefits from a money purchase pension scheme.

Already the DWP are provided details by HMRC of bank interest received by individuals so that they can cross check this information with claimants. One would assume that in due course they will look to obtain similar data relating to pension schemes. It should of course not be forgotten that the DWP run the existing Pension Tracing Agency.

1. Claimants Where They Have Not Attained the Qualifying Age for Pension Credit.

   Where a claimant below the qualifying age for Pension Credit does not access any benefits from a money purchase (or any pension for that matter) pension scheme then the existence of an uncrystallised pension will not impact on the eligibility for any means-tested benefits.

   However, as soon as benefits are crystallised the claimant must inform the DWP and where appropriate the Local Authority.

   The benefits crystallised will be treated as either income or capital, depending on, for example, how regularly withdrawals are made.

2. Claimants Who Have Attained the Qualifying Age for Pension Credit.

   Claimants who have attained the qualifying age for Pension Credit are expected to use their pensions to help support themselves. Where benefits are taken in a form other than an annuity after reaching the qualifying age for Pension Credit, an amount of income taken into account when calculating any means-tested benefits is the greater of the 'notional' income or the actual income withdrawn.

   'Notional' income is an amount equivalent to the income the claimant is expected to have received if an annuity had been secured.

Deprivation Rule

If a claimant spends, transfers or gifts away any money withdrawn from a pension the DWP will consider whether the claimant has deliberately deprived themselves of that money in order to secure (or increase) a benefit entitlement

If the DWP decide that the claimant has deliberately deprived themselves, they will be treated as still having that money and it will be taken into account as income or capital when calculating benefit entitlement.

Blended and Hybrid Solutions

For individuals who would like a guaranteed income, but with an option to forgo or reinvest part of this should circumstances change, then a different approach – part annuity, part drawdown – combined together is also an option. This provides some flexibility to alter the overall income once any baseline guaranteed element that is required.

This combined approach is the best of both worlds. You will be able to enjoy the Flexi-access Drawdown facility with the added security of a guaranteed income for life and can be done in two distinct ways.

Blended Solution:

A combination of separate retirement solutions, facilitated through a number of individual product wrappers. This might be where a provider has two existing products that allow FAD and an annuity, and bringing them together under one named proposition, or where the adviser separately identifies the best annuity rate and best drawdown product and utilises both to plan for the client's retirement and then monitors both elements on an on-going basis. Unused income/annuity payments can be rolled up in the Drawdown element if not needed for the future, subject to recycling limits / rules and payment of any additional tax due. However this approach provides the adviser and client with the advantage of complete choice over the selection of the different elements of the 'package'.

Hybrid solution:

This differs from a blended solution in that the income producing assets are held within a single, trustee held investment within a single product wrapper. Income is accumulated within a pension cash account, with the option for it to be retained in cash, reinvested or paid out to the clients bank account through FAD. This allows for control over the timing of regular and one-off payments as well as providing additional tax benefits over a blended solution due to being able to retain or reinvest excess cash within the tax wrapper before it is distributed, so it not being subject to additional taxation. Another potential benefit is while funds remain within the wrapper they will be treated as FAD funds for the purposes of 'death benefits'.

Both options offer the benefits of

- **A Guaranteed element/annuity** – providing a secure income for life.
- **Flexible investment options** – providing access to a range of carefully selected funds giving your clients the opportunity for investment growth and a flexible income.

8. UNCRYSTALLISED FUNDS PENSION LUMP SUM (UFPLS)

Overview

From 6th April 2015, a new type of payment was introduced which will allow for a lump sum to be paid from an existing money purchase pension plan. An investor can withdraw as little or as much as they wish from their plan and any payment will allow for 25% of the monies to be paid tax free and the remainder will be subject to the marginal rate of income tax.

This piece of legislation is likely to be useful for so called ‘Zombie’ companies who are no longer open for new business e.g. Reassure and Phoenix. It ensures that all policy holders enjoy the same pensions freedom even if the particular provider does not want to offer a Flexi-access drawdown contract.

If you use this option, any future money purchase pension contributions will automatically be limited to £10,000. You will also not be able to undertake any future carry forward payments into money purchase pension schemes.

If taking an income stream by using either of the above plans the policyholder must alert all scheme administrators (of active plans) that they have flexibly accessed benefits within a 91 day reporting window. Failure to do so will lead to HMRC fines. This responsibility lies with the policyholder.

Tax Free Cash

Most types of pension plan have the option of taking a tax-free cash lump sum before exchanging the residual fund for a series of payments. Ordinarily up to 25% of the fund – subject to the Lump Sum Allowance of £268,275 - may be taken as tax-free cash, however if the pension funds are or were part of an Occupational Pension Scheme or the individual had applied for transitional protection, then the available tax free cash may be greater than 25%. You should note that these higher entitlements **cannot be paid** if you use the UFPLS option as only 25% of the payment will be paid tax free.

Income

With this option, a lump sum is paid rather than a regular income with 75% of the lump sum paid being subject to income tax under the PAYE system.

It should be noted that with the UFPLS option, income tax may be under an emergency coding initially. This may mean that you will need to liaise with your local Income Tax office to correct the level of tax paid (if necessary).

Death benefits

On death pre 75 any funds remaining in the plan will be paid out tax free, usually as a lump sum although some pension plans may offer income options for beneficiaries on death.

For those aged 75 and over, any remaining funds can be paid out as a lump sum or by a beneficiary's income option. This will be taxed at the beneficiary's marginal income tax rate.

Advantages

- You are able to take as much or as little of your existing pension plan as necessary.
- You are able to mitigate your liability to personal income tax in certain years.
- It offers one of the most straightforward and simple options for pension payments at retirement.

Disadvantages

- You may run out of money and have no pension left.
- Benefits are means tested by the DWP.
- Any funds remaining in the plan are subject to investment risk. This means the fund value could fall, which could affect your future income levels.
- You may feel that the flexibility of having payments made in the form of a lump sum as and when required does not compensate for the known income available from an annuity now and for the rest of your life.
- The Financial Conduct Authority (FCA) has particular concerns in relation to mortality risk. If you purchase an annuity, you may benefit from a cross subsidy from those annuitants that die relatively early. This cross subsidy would not be present in a plan from which UFPLS payments are made so to provide a comparable income, a higher investment return would be required. The impact of mortality can be expressed as an annual percentage rate by which the net investment performance of the remaining personal pension fund would have to exceed the interest rate implicit in an annuity in order to break even. This effect has become known as the 'mortality drag'.

Inheritance Tax Issues

The Government has confirmed that IHT will not typically apply to death benefits from pension schemes. They will however, be monitoring this issue so that pension schemes do not become a vehicle solely for IHT avoidance.

Suitability

The UFPLS option would be suited to an investor who already has enough income from other sources to rely on in retirement. Alternatively, it may be appropriate for an investor who only has a very small amount of money in a pension plan and the alternative retirement income options would prove to be uneconomical.

Taxation Post 2015 and Means Testing – DWP UPFLS Examples

Please refer to pages 22 - 23 of this booklet.

9. THIRD WAY PENSIONS

(sometimes referred to as Guaranteed Drawdown / Guaranteed Income Options)

Overview

Against a background of increased volatility in stock markets, perceived poor rates being offered for Lifetime Annuities, concerns regarding future inflation and the fact that people are now living longer, the retirement market was in need of a new type of product. These new plans are commonly known as 'Third Way' products and they are already very popular in the US and Japan. Essentially, they fit in between a Lifetime Annuity and a 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 does differ 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. 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.

Flexi-access Drawdown – the second type of Third Way plan is structured as a Drawdown Pension 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. Finally, 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 you use either of these options, any future money purchase pension contributions will automatically be limited to £10,000 per annum. You will also not be able to undertake any future carry forward payments into money purchase pension schemes.

If taking an income stream by using either of these options, the policyholder must alert all scheme administrators (of active plans) that they have flexibly accessed benefits within a 91 day reporting window. Failure to do so will lead to HMRC fines. This responsibility lies with the policyholder.

Tax Free Cash

Most types of pension plan have the option of taking a tax-free cash lump sum before exchanging the residual fund for a series of payments. Ordinarily up to 25% of the fund may be taken as tax-free cash, subject to the Lump Sum Allowance of £268,275, however if the pension funds are or were part of an Occupational Pension Scheme or the individual had applied for transitional protection, then the available tax free cash may be greater than 25%. Tax Free Cash must be taken at outset and once drawn; there will be no further entitlement.

Income

No maximum. This income is taxed as earned income under the PAYE system.

Death benefits

If you die whilst in a Third Way product the death benefits can differ depending on how the particular plan you are using has been set up e.g. annuity based, or flexi-access drawdown based. You therefore need to check the specific product terms and Key Features.

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 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

- You may run out of money and have no pension left.
- Benefits are means tested by the DWP.
- High income withdrawals may not be sustainable during the deferral period.
- 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 the annuity is eventually purchased and could also affect the long term financial security of your spouse/partner.
- The investment returns may be less than those shown in the illustrations.
- 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 with only a slight increase more recently. 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.
- Withdrawing too much income in early years may have an adverse effect on preserving your pension purchasing power or preserving the capital value of your fund.
- Increased flexibility and the addition of guarantees bring increased costs and the need to review arrangements on an on-going 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.
- You may be prevented from withdrawing your chosen level of income due to the action of the GAD limits.
- The Financial Conduct Authority (FCA) has particular concerns in relation to mortality risk. If you purchase an annuity, you may benefit from a cross subsidy from those annuitants that die relatively early. This cross subsidy is not present with Unsecured Income plans and so to provide a comparable income, a higher investment return will be required. The impact of mortality can be expressed as an annual percentage rate by which the net investment performance of the remaining personal pension fund would have to exceed the interest rate implicit in an annuity in order to break even. This effect has become known as the 'mortality drag'.
- If you opt for an annuity version of the Third Way plan the charges are typically built into the annuity rates offered. If you decide to choose a Drawdown Pension version of a Third Way plan, the charges are added on top.
- Both of these are generally more expensive than a traditional annuity or Drawdown pension plan.

Inheritance Tax Issues

The Government has confirmed that IHT will not typically apply to death benefits from pension schemes. They will however, be monitoring this issue so that pension schemes do not become a vehicle for IHT avoidance.

Suitability

Both versions of this Third Way plan would generally suit a relatively sophisticated investor, who is capable of fully understanding the mechanics of the plan and the risks involved. The contract can be used as a useful tax planning tool and a means of accessing pension fund tax free cash without having to take the full taxable income and it importantly allows the individual to defer annuity purchase until their future plans are clearer. The availability of guarantees allows this type of contract to be suited to more cautious individuals who would not normally suit a Drawdown Pension plan however, the guarantees do come at a cost.

10. TRIVIALITY

Overview

The triviality and small pots rules were made available from age 55 (as opposed to age 60 as it was historically) from April 2015. The age will rise to 57 on 6 April 2028, unless the individual has transitional protection.

The ‘general triviality’ combined limit of £30,000 is only available for Defined Benefit (Final Salary) schemes.

All such commutations must take place within a single 12 month period from the ‘nominated date’ and must extinguish all the member’s rights under the scheme or annuity.

The nominated date can be within at any point within the last 3 months so this may allow some flexibility if the fund value is just over £30,000 currently.

Once this period expires, it is no longer possible to commute any further small pension funds (with the exception of the small pot/stranded pot rules – see below). Previously, triviality had to occur before the individuals 75^{th} birthday but this rule no longer applies since 6^{th} April 2011.

The ‘small/stranded £10,000 pot’ rules will continue to be available to both Defined Benefit and Defined contribution schemes.

There is no need to quantify the members interests in other, unrelated pension arrangements. An individual can only have 3 small pot payments (for personal pensions) during their lifetime. Stranded pot payments (for occupational pensions) carry no such limit.

Tax Free Cash

Tax free cash can still be drawn and this will be a maximum of 25% of the fund value. If the pension funds are or were part of an Occupational Pension Scheme or the individual had applied for transitional protection, then the available tax free cash may be greater than 25%. You should note that these higher entitlements **cannot be paid** if you use any of the above triviality options as only 25% of the payment can be paid tax free.

Taxation

From the amount of money paid, 75% will be subject to income tax.

11. TAKING BENEFITS

Lifetime Allowance - The lifetime allowance 'charge' was removed from 6 April 2023 - the legislation for this was included in the Finance (No.2) Act 2023.

From 6 April 2024, the lifetime allowance has been removed. This doesn't mean there are no limits on the amount of pension savings people can take without a tax charge; the lifetime allowance is being replaced by new allowances.

What will replace the lifetime allowance?

The lifetime allowance is being replaced with three different allowances:

- the lump sum allowance (LSA) - £268,275
- the lump sum and death benefit allowance (LSDBA) - £1,073,100

Both of these allowances limit the amount of **tax-free benefits** that can be paid.

There is also:

- the overseas transfer allowance - £1,073,100

A check is made against these allowances when benefits are paid.

These allowances may be higher if the individual has lifetime allowance protection.

These allowances are reduced if benefits were taken between 6 April 2006 and 5 April 2024.

Please note:

- Unit prices can fall as well as rise
- Past performance is not necessarily a guide to future performance and past performance may not necessarily be repeated
- This guidance is based on present legislation which may be subject to change

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This information is based on our current understanding and is subject to change without notice.

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The value of investments and the income from them can go down as well as up and you may not get back the amount originally invested.

HM Revenue and Customs practice and the law relating to taxation are complex and subject to individual circumstances and changes which cannot be foreseen.

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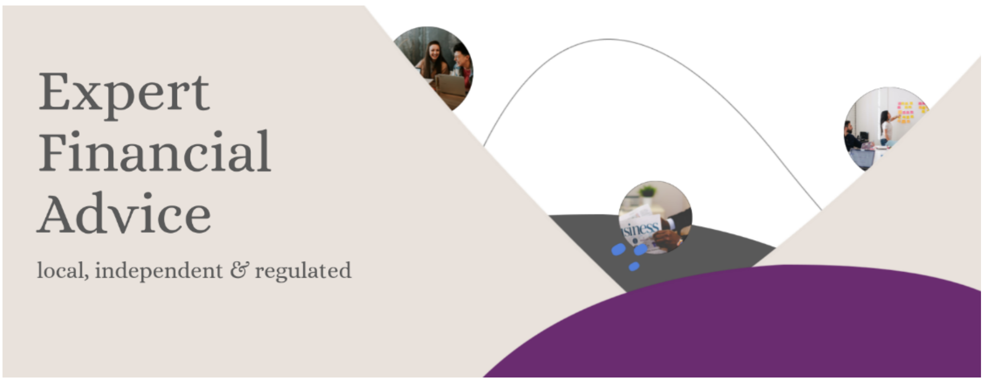

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