The PENSIONS Advisory Service

Spotlight

Income Drawdown

There are now several different ways in which people with defined contribution (DC) pension plans can choose to draw money from them. This Spotlight outlines the rules for flexi-access drawdown funds (the technical name for income drawdown) which became available to DC pension plans from 6 April 2015. DC (or money purchase) pension plans provide benefits on retirement based on the amount of money that has been paid in to the scheme, how long this money has been invested, the level of charges and investment returns over this period.

The Pensions Advisory Service is unable to give individual specific advice and you should consider taking tax or regulated financial advice.

What is Income Drawdown?

Income drawdown allows you to take income from your pension fund while the fund remains invested and continues to benefit from any investment growth. You may need a reasonably sized fund to take income drawdown. The minimum fund size required varies according to the terms of each pension provider. Some providers have no minimum fund size but a minimum fund of between £20,000 and £40,000 is common. If you have a big enough fund to use income drawdown, you will be able to keep your funds invested and draw an income or lump sums directly from it for as long as funds last. (See our Spotlight on Income Drawdown v Annuity Purchase).

Income drawdown is an alternative option to an annuity if you prefer to have greater control and flexibility over how and when you receive your pension income. Be aware that you may run out of money if you draw down too much money too soon. Subject to the terms and conditions of your drawdown policy, you may be able to choose to draw the tax-free lump sum and leave the rest of your fund untouched for as long as you like.

Drawdown from April 2015

What rules apply to new drawdown plans from April 2015?

From April 2015 all new drawdown arrangements are classified as “flexi-access”. The rules for flexi-access drawdown are as follows: -

1. If you take out a **flexi-access drawdown** arrangement, you will generally be able to take out up to 25% of the funds as a tax-free lump sum upfront (and possibly more if you had a protected lump sum from pension scheme membership before April 2006). If you do not take any tax-free lump sum upfront, you will lose this opportunity. You can also take your tax-free lump sum now but no income for the time being or until you need to draw down payments. When you later decide to draw income or lump sums, all of it will be subject to your marginal rate of income tax.

2. The earliest age you can currently draw money from a pension plan is 55. (You may be able to draw money before age 55 if you are in ill-health which is likely to prevent you from returning to work, or if you are in a scheme which has an earlier retirement age (known as a 'protected pension age')).
3. You can take out as little or as much as you want (subject to any minimum set by your provider).
4. You can still build up benefits in another pension arrangement, be it in a defined benefit scheme and/or in a defined contribution scheme.
5. If you do start to draw taxable funds and wish to continue or start to build up pension benefits elsewhere, you will need to be aware of the Money Purchase Annual Allowance rules which limit how much you and your employer can save into a defined contribution pension plan in the future to £4,000 gross per tax year in total.

Drawdown before April 2015

What drawdown was permitted up to April 2015?

Previously, an individual could take drawdown in one of two ways: either a capped or a flexible version, and both of these have restrictions.

1. Under **capped** drawdown, the maximum amount of income that can be drawn is currently 150% of a single life annuity (i.e., pension) that a person of the same age could purchase based on Government Actuary's Department (GAD) rates.
2. Under **flexible** drawdown, there was no limit on the amount you could draw from the fund as income but you had to have secured gross pension income of at least £12,000 a year from other sources such as the State pension or a final salary pension.

I was in capped drawdown before April 2015 – do I need to make a change?

- You can continue with capped drawdown even with the introduction of flexi-access drawdown. If you remain in capped drawdown you will not be impacted by the reduced Money Purchase Annual Allowance (MPAA) of £4,000 and can continue to contribute up to £40,000 per annum (subject to a maximum of 100% of relevant earnings) to a pension if you wish and can afford to do so.
- If you want to switch into flexi-access drawdown, you could draw more than the cap (assuming your pension provider allows this), in which case, the capped income drawdown automatically becomes flexi-access. The first withdrawal above the cap will trigger the MPAA, so contributions after this trigger date will be limited to £4,000 each tax year.
- You can choose to transfer your capped drawdown arrangement to a flexi-access drawdown arrangement, which may be with the same provider. The first withdrawal from the flexi-access drawdown will trigger the MPAA, so contributions after this trigger date will be limited to £4,000 each tax year.

I was in flexible drawdown before April 2015 – do I need to make a change?

- If you were in a flexible drawdown arrangement by April 2015 your existing arrangement automatically became a flexi-access drawdown arrangement without the £12,000 minimum gross pension income restrictions previously imposed on flexible drawdown pension arrangements. You may make further pension contributions up to the level of the MPAA.

Access to drawdown

How will my drawdown plan be invested?

Your provider will ask you how you want to invest your remaining pot when you move into income drawdown. You will either need to choose your own investments, i.e., those that match your attitude to risk and objectives for your money, or some providers will offer you to choose from simple ready-made investment options which are linked to your retirement plans (these are called Investment Pathways). You could also use a financial adviser to help you choose.

An Investment Pathway is a ready-made investment option, which simplifies the decision of how to invest your remaining pension pot after you've taken your tax-free lump sum. More information on Investment Pathways can be found at https://www.moneyadviceservice.org.uk/en/articles/flexi-access-drawdown and https://www.moneyadviceservice.org.uk/en/tools/drawdown-investment-pathways.

Does my pension provider have to offer flexi-access drawdown?

No. There is no requirement for any pension provider to offer flexi-access drawdown. If your current pension provider is not going to offer this, you will need to find out if you can transfer your plan elsewhere. If you can, you will have to transfer your plan to another pension provider who is offering the drawdown option you want and who is able and willing to accept the transfer. If you do wish to transfer, you should check with your current pension provider as to how much they will charge you to take your money out. You should check to see that, by transferring out, you will not lose out on any valuable guarantees on your current pension plan. You should also ask your new pension provider how much they will charge to set up your drawdown policy and how much they will charge on an ongoing basis for managing your money.

As my current pension provider is not offering drawdown, I am planning to transfer my pension plan. What do I have to do now?

You may wish to get regulated financial advice, which should be from someone who is authorised and regulated by the Financial Conduct Authority (FCA). Whilst generally not a legal requirement some pension providers may insist on this. Getting financial advice may be beneficial as it will help you to identify providers who might offer you the product you require as well as tell you more about how much they will charge you, how to invest the money and the pros and cons of making such a transfer based on your own personal circumstances. If you do not know a local regulated financial adviser, you can find a list of these on the following websites: https://directory.moneyadviceservice.org.uk/en and https://www.thepfs.org/yourmoney/find-an-adviser/

I am in a Defined Benefit scheme. Can I take out a drawdown arrangement?

If you have a defined benefit pension, which you have not yet started to draw, and you wish to take advantage of flexi-access drawdown you will need to consider very carefully as to whether this is in your best interests. You will need to transfer out of your DB scheme and give up a guaranteed income for life. If the transfer value is over £30,000, the law requires that you take regulated financial advice about such a transfer, from an adviser who is specifically authorised to give transfer advice.

Can I transfer out from all Defined Contribution plans into drawdown?

Generally, you will be able to transfer out from a DC plan, but this will depend on the terms of the contract and the type of policy. For instance, if you have what is called a Section 32 contract (commonly known as a Buy-Out Plan) which includes a Guaranteed Minimum Pension (GMP) you may not be able to transfer out.

What charges will apply to a drawdown policy?

These vary considerably from provider to provider and there may be charges applying when you set up the policy, each time you draw benefits or when you exit the plan completely. There will also be an annual charge for administration and investment management – it might be based on a percentage of the assets held. You should check carefully what charges might apply and how this will impact you, based on the benefits you expect to draw from the policy.

Who can I buy a drawdown policy from?

You could ask your current pension provider if they offer drawdown policies. You might also ask a regulated financial adviser to recommend a drawdown provider.

However you find your provider you should shop around:

- Find out what fees you will have to pay – for example for managing the fund, for setting up the policy and for each time you take a payment.
- What options are there for investing your fund?
- How flexible is the policy? How many withdrawals can you make each year?

Flexible alternative to drawdown – taking a series of lump sums

Another way of drawing money flexibly from your pension is to take a series of lump sums. Its technical name is Uncrystallised Funds Pension Lump Sum (UFPLS). It has 2 main differences from drawdown:

1. You do not usually have to move your money to a new policy.
2. You do not take 25% of the fund as one tax-free lump sum upfront. But each time you draw money out, 25% of it will be tax-free with the remaining 75% of each payment subject to income tax at your marginal rate.

Tax and drawdown

What tax will I have to pay when I start drawing income?

Any income you take will be added to the rest of your taxable income in the tax year in which you take it when determining any tax liability. This includes not only all pension income (including the State Pension) but also any other taxable income you may have from other sources (such as employment earnings, interest on savings, share dividends or rental income). However, detailed questions on your tax liabilities are best addressed by a tax expert or financial adviser.

How is my drawdown pension taxed?

You are liable to income tax on any payment of drawdown money you receive in a tax year. Your pension provider should deduct the tax due using the PAYE system before making the payment.

Unless you have just finished work and have a P45 to give to your provider, you are likely to have emergency tax deducted from your first drawdown money. However, if you have been over-taxed by this method, you can claim a rebate of the overpayment.

Can I pass on any drawdown proceeds to my dependants?

Yes. If you have funds left in your drawdown arrangement, then generally speaking anything passed to a beneficiary will be tax-free if you die before age 75. Money does need to be passed on within 2 years of your death being notified to the pension provider. If you die at age 75 or above, your beneficiary will be taxed at their marginal rate.

Your beneficiaries will usually have the option of

- taking the fund as a lump sum;
- using the money to buy an annuity;
- putting the fund into beneficiary's drawdown. This would give them the choice over when and how much money they draw down.

Money passed on in this way will usually be free from Inheritance Tax. (See our Death and Taxes Spotlight for more information).

Is drawdown pension tested against the lifetime allowance?

Your drawdown pension will be tested against your lifetime allowance when you put (designate) pension funds into your drawdown pension fund if you are younger than 75. Any increase in the value of your drawdown pension fund will also be tested against your lifetime allowance on your 75th birthday.

Any funds in your pension scheme that you have not put into drawdown (designated) by the time you are 75, will be tested against the lifetime allowance on your 75th birthday.

If you put pension funds into drawdown pension when you are 75 or over this will not be tested against the lifetime allowance because, as explained above, they will already have been tested when you reached age 75. The standard lifetime allowance is £1,073,100 in the 2021/22 tax year.

Other information about drawdown

Is there a minimum amount of drawdown pension?

No. You do not have to draw any income if you choose not to. Some providers however may apply different charges depending on how much and how frequently you draw an income so you should check this beforehand.

How much income should I draw down?

Many people underestimate how long they are going to live. Average life expectancy for someone in the UK at age 65 is now over 20 years so you should bear this in mind when deciding how much income you wish to draw down. There is an income estimator on the Pension Wise website here: https://www.pensionwise.gov.uk/en/adjustable-income. This may help you plan how much to draw from your fund each year.

Can I draw a tax-free lump sum when I first go into a drawdown arrangement?

Yes. You can normally have a tax-free lump sum which is generally up to 25% of the value of your pension fund if you wish. This decision will normally need to be made at the same time as designating funds to drawdown. If you do not take the tax-free sum upfront, this will no longer be an option later on.

If I am already using income drawdown, can I buy an annuity at any time?

Yes. You can use any remaining funds to buy an annuity but you should check whether there are any exit penalties applying. You should shop around if you are considering buying an annuity. There is an annuity comparison tool on the Money Advice Service's website here: https://www.moneyadviceservice.org.uk/en/tools/annuities. This will enable you to see how much annuity income you could get from your pot. You may also wish to appoint a regulated financial adviser to find the best annuity for you.

Is there an upper age limit for starting a drawdown pension?

No, there is no longer an upper age limit.

Can I transfer my drawdown plan to another company?

Yes. You can usually transfer your drawdown pot between providers if you are not happy with your current provider. You should check with both your existing and your new providers what the charges would be and that your new provider offers investment choices with which you are comfortable.

Can someone help me to understand the options?

Yes. If you are age 50 or over and have a defined contribution pension plan, you can have a Pension Wise appointment. This is a free and impartial guidance service set up by government. The appointment will cover the options available to you including drawdown, taking cash in chunks (uncrystallised funds pension lump sum), taking your pot in one go and annuities.

A Pension Wise appointment is also available if you are already in drawdown and are thinking about a different option for the future (for example, you are now thinking of an annuity).

You can book an appointment by visiting www.pensionwise.gov.uk or calling 0800 138 3944.

As mentioned earlier, you can also consider taking regulated financial advice regarding going into drawdown, or any other options available to you.

About Us

The Pensions Advisory Service (TPAS) works to make pensions accessible and understandable for everyone. We provide independent and impartial information and guidance about pensions, free of charge, to members of the public.

We help with all pension matters covering workplace, personal and stakeholder schemes and also the State Pension. We answer general questions, help with specific queries and offer guidance for people with complaints about their private pension scheme.

The Pensions Advisory Service is provided by Money & Pensions Service

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