The PENSIONS Advisory Service

Spotlight

Income Drawdown

The new pension freedoms (see our Pension Options After April 2015 Spotlight) removed a number of restrictions to the ways in which people could draw down their pension in retirement. This fact sheet outlines the new rules for flexi-access drawdown funds which became available to members of defined contribution (DC) pension schemes from 6 April 2015. DC (or money purchase) pension schemes 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 seek alternative tax or independent 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 sometimes need a fairly large fund to take income drawdown, although the amount of fund varies according the terms of each pension provider. If you have a big enough fund to use income drawdown, you will be able to keep your funds invested and draw an income directly from it for as long as funds last. (See our Spotlight on Income drawdown vs annuity purchase).

Income drawdown provides an alternative option to an annuity if you prefer to have greater control and flexibility over how and when you receive your pension income. Subject to the terms and conditions of your pension scheme, you may be able to leave your pension fund untouched for as long as you like.

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 more flexible version, but both of these had restrictions.

1. Under **capped income** drawdown, the maximum amount of income that could be drawn was 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. This rate was increased from 120% with effect from 27 March 2014.
2. Under **flexible income** 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.

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

- You can still continue with capped income drawdown even with the introduction of flexi-access. If you remain in capped drawdown you will not be impacted by the reduced Money Purchase Annual Allowance (of £4,000) and continue to contribute up to £40,000 per annum to a pension if you wish.
- However, if you want to switch into flexi-access, you could either draw more than the cap (assuming your pension provider allows this), in which case, the capped income drawdown automatically becomes flexi-access.
- Alternatively, you can transfer your capped income drawdown arrangement to a flexi-access drawdown arrangement, which may be with the same provider.

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

If you were in a flexible drawdown arrangement at April 2015 your existing arrangement will automatically become a flexi-access drawdown arrangement without the previous restrictions imposed on flexible drawdown pension arrangements.

Drawdown from April 2015

What rules apply to new drawdown plans from April 2015?

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

1. Just like capped and flexible drawdown, the earliest age you can currently take benefits is 55 or, if in ill-health, possibly earlier.
2. You do not have to meet any of the pre-April 2015 restrictions for either capped or flexible drawdown. This means you can take out as little or as much as you want.
3. You can still build up benefits in another pension arrangement, be it in a defined benefit scheme and/or in a defined contribution scheme.
4. If you do start to draw funds and continue or start to build up benefits elsewhere, you will need to be aware of a change in the Annual Allowance rules which may affect you in the future.

What types of drawdown will be available from April 2015?

There are two main types of drawdown arrangement available.

1. If you take out a **flexi-access drawdown** arrangement, you will generally be able to take out 25% of the funds as a tax free lump sum at outset (and possibly more if you had a protected lump sum). If you do not take any tax free cash sum at outset, you will lose this opportunity at a later date. You can also take your tax free cash sum now, but no income for the time being or until you need to draw down payments. When you decide to draw income, all of it will be subject to tax at your marginal rate of income tax.
2. The 2014 Budget also introduced a new type of flexible product; the **Uncrystallised Funds Pension Lump Sum** (UFPLS). Under this product, you do not take the 25% lump sum payment up front. But each time you draw down a payment, 25% of it will be tax free, with the remaining 75% of each payment subject to income tax at your marginal rate.

Access to drawdown

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 benefits elsewhere. If you can, you will have to transfer your benefits to another pension provider who is offering flexi-access drawdown and who is able and willing to accept the transfer. If you do wish to transfer, you should check with your pension provider as to how much they will charge you to take your money out. You should also check to see that, by transferring out, you will not lose out on any valuable guarantees on your current pension plan. At present few trust based occupational scheme offer a drawdown option, so if you are a member of a scheme run by an employer and a board of trustees, it is likely that you will need to transfer to a provider who offers drawdown.

As my current pension provider is not offering flexi-access I am planning to transfer my benefits. What do I have to do now?

You may have to get independent financial advice and if so it should come from someone who is authorised and regulated by the Financial Conduct Authority (FCA). Indeed, it may be the case that any new pension provider may insist on this. Getting financial advice is important 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 and the pros and cons of making such a transfer based on your own personal circumstances. If you do not know a local financial adviser, you can find a list of these on the following web sites:
https://directory.moneyadviceservice.org.uk , www.unbiased.co.uk or www.findanadviser.org.

I am in a Defined Benefit scheme, can I take out a drawdown arrangement?

If you have benefits in a defined benefits pension scheme 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, as you will need to transfer out of your scheme and give up guaranteed benefits. If your transfer value exceeds £30,000 legally you are required to take independent financial advice regarding such a transfer, as the pension scheme trustees will not be able to authorise a transfer until you have done this and so will not allow you to transfer.

Can I transfer out from all policies into drawdown?

Generally, you will be able to transfer out from all arrangements, 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) 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 and when you exit the plan completely. There may also be an annual administrative charge that applies which might be based on a % of the assets held. You should check carefully what charges apply and how this will impact you based on the benefits you expect to draw from the policy. A financial adviser will be able to assist you in understanding different charging structures.

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 earnings you may have from other sources (such as employment earnings, savings, 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 pension you receive in a tax year. Your pension provider should deduct the tax due using the PAYE system before making the payment.

Can I continue to contribute to a pension when I am in drawdown?

Yes, but the amount you can contribute will vary according to circumstances. If you have taken any income in excess of your tax free cash, then the amount you can contribute to a pension will be the reduced Money Purchase Annual Allowance of £4,000 per annum. However, if you are in a capped drawdown arrangement (taken out before 6 April 2015) or if you have only taken your tax free cash entitlement and no income you can pay contributions at the full Annual Allowance of £40,000 per annum. See our Annual Allowance Spotlight.

Can I pass on any drawdown proceeds to my dependants?

Yes. If you have funds left in your drawdown arrangement the, generally speaking, anything passed to a beneficiary will be tax free if you die before age 75. If you die over age 75 then any lump sum or income taken is taxed at the beneficiary's marginal rate of income tax. Money passed on in this way will be free from Inheritance Tax, but money does need to be passed on within two years of your death being notified to the pension provider *(See our Death and Tax Spotlight).*

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 funds in your pension scheme that you have not put into payment (designated) by the time you are 75, will be tested against the lifetime allowance on your 75th birthday. Any increase in the value of your drawdown pension fund will also be tested against your 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 lifetime allowance was reduced from £1.25m to £1m in April 2016. It will increase to £1,030,000 in April 2018.

Other information about drawdown

Is there a minimum amount of drawdown pension?

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

How much income should I draw down?

Many people underestimate how long they are going to live, and longevity has been rising steadily in the UK in recent years. 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. A financial adviser will be able to assist you in working out your spending needs and the implications of drawing particular levels of income from your fund.

Can I have a cash lump sum when I start to go into a drawdown arrangement?

Yes. You can normally have a cash lump sum which is generally up to 25% of the value of your pension fund if you wish. However, if you take an Uncrystallised Funds Pension Lump Sum type of drawdown, then 25% of each amount drawn down will be tax free rather than all up front.

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

Yes. You can use any remaining funds to secure an annuity but you should check whether there are any exit penalties applying and you should seek independent financial advice and shop around if you are considering buying an annuity.

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

No, there is no longer an upper age limit.

The Pensions Advisory Service is unable to give individual specific advice and you should seek alternative tax or independent financial advice.

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.

Contacting us

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