Weighing up client choices for taking pension benefits

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Following the introduction of the pension flexibilities in April 2015, individuals now have a much wider choice over how to take their pension benefits up to the Lifetime Allowance (LTA). Of course it very much depends on (i) the options available under the member's pension scheme, and (ii) the member's personal circumstances. Amongst the options are flexi-access drawdown (FAD) and the nattily titled Uncrystallised Funds Pension Lump Sum (UFPLS). This article looks at some of the points to consider and pros and cons of these 2 options.

FAD	**UFPLS**
Possible to take tax free cash (PCLS) only.	Can only be taken as a tax free lump sum plus taxable income
Protected/enhanced PCLS available provided whole fund crystallised	Tax free lump sum is limited to 25%
Does not trigger MPAA if PCLS only taken. MPAA triggered once first income payment taken	Triggers MPAA when first UFPLS taken
Income can be varied to suit needs and mitigate income tax	Income will be paid as a taxable lump sum and cannot be deferred
LTA test required each time new funds are crystallised but not where income begins from previously designated funds	LTA test required each time UFPLS taken
Phased crystallisation usually possible so that target income can be provided via a combination of PCLS and income.	Phased crystallisation via a series of UFPLS payments may be possible depending on provider's requirements
On death pre 75, any remaining fund paid out tax free as lump sum or income	On death pre 75, any remaining fund paid out tax free as lump sum or income
On death post 75, any remaining fund paid out as a lump sum or income, subject to recipient's marginal rate of income tax.	On death post 75, any remaining fund paid out as a lump sum or income, subject to recipient's marginal rate of income tax.
LTA test at 75 against the net growth in the drawdown fund. Any unused (uncrystallised) funds are tested against the member's remaining LTA.	Any unused funds are tested against the member's remaining LTA.
No PCLS option available where a disqualifying pension credit exists.	Not available where a disqualifying pension credit exists.
Protection from the LTA charge continues. Enhanced tax free cash available provided all benefits crystallised at the same time	Not available where enhanced or primary protection exists, or where there is protected tax free cash > 25%

Example

James, aged 58, has a pension fund valued at £840,000. He wishes to receive net income of £30,000 per year.

James could do this by either:

- Taking UFPLS of £32,600 each year. £8,150 would be paid as a tax free lump sum, and £24,450 would be subject to 20% tax of £2,520, assuming the full personal allowance is available. The net annual income would be £30,080. However, if this is taken as a one off lump sum, James needs to be aware that the taxable part of the UFPLS will be taxed as if it were a regular payment and will incur income tax at the higher and additional rates. He will need to reclaim any initial overpayment of income tax from HMRC.

Or

- Using FAD, which, as the name suggests, allows more flexible options, for example:
- Crystallising £120,000 each year and receiving £30,000 tax free with no income. After 7 years James would need to start drawing down income if he wanted to maintain the same level of income.
- Alternatively he could crystallise £72,600 each year, of with £18,150 would be PCLS and £11,850 could be drawn down as income, making full use of the personal allowance.
- Or he could crystallise £32,600 each year, which would be taxed the same way as for UFPLS, although the income could be paid over the course of the year, rather than all at once thereby mitigating overpayment of tax.

FAD provides the option to vary the amount of tax free income depending on the individual's tax position.

Points to consider

Does the provider insist on a minimum amount that can be taken or must be left in the fund?

- Is there a limit on how many withdrawals can be taken?
- Is there a charge for withdrawals?
- Does the investment strategy for remaining funds need revision?
- If taking a small pot (valued at £10,000 or less) is an option, this does not count towards the LTA or trigger the MPAA.
- Taking a large taxable lump sum may mean that the emergency tax code is applied and too much tax may be deducted. The member will need to request a refund of any overpaid tax.
- Taking taxable income may impact on how other income sources are taxed.

To conclude, in practice there may well be differences in terms of costs and charges, availability and ease of administration.

Sanlam offer both FAD and UFPLS via Portal and OneSIPP in our legacy personal pension products can switch without charge to access these options.

We hope this gives you some food for thought but as ever, if you have any queries please contact us at **technical@sanlam.co.uk**