Income Drawdown Factsheet

Income drawdown is a way of using your pension pot to provide you with a regular income in retirement without the need to purchase an annuity. The income from drawdown is not guaranteed and will vary depending on the fund's performance, so this is a riskier option than annuity purchase, as the amount of future income available from your pension pot via drawdown could be less than from an annuity.

Taking income from your pension pot allows you to retain the pension's investments and to utilize the investment income to provide you with an income in retirement. Income drawdown also gives you much greater flexibility in terms of the amount and the timing of pension income payments.

How income drawdown works?

You can choose to take up to 25% of your pension pot as a tax-free lump sum. The residual value of your pension can then provide you with pension income via income drawdown. The income you receive is not fixed at outset and may be increased or decreased depending on the performance of your investments.

There are two main types of income drawdown product:

- **Capped Drawdown** – continuing only for those who already used Capped Drawdown before 6 April 2015, Capped Drawdown allows you to withdraw pension income from your pension fund, but there is a limit on the amount of income you can take out each year
- **Flexi-access Drawdown** – available from April 2015, Flexi-Access drawdown allows you to withdraw pension income at any level from your pension fund

Your pension fund will be invested in assets that match your income objectives and attitude to risk. You will then decide upon the level of income that you want to withdraw from the pension fund (subject to any maximum income level with Capped Drawdown). The income you receive and the performance of the investments will then be reviewed regularly and may be adjusted depending on your requirements and the performance of your investments.

What is the maximum income under capped drawdown?

With capped drawdown, the scheme administrator will calculate the maximum income that your pension pot (after you have taken your tax-free amount) can pay to you. The maximum income is calculated using GAD (Government Actuary Department) rates. It is reviewed every three years if you are under age 75 and yearly after this. On the review date a new maximum income is calculated – based on your age, the revised fund size and prevailing GAD rates – and set for the next period.

The maximum amount of income that you can take via capped drawdown is broadly equivalent to 150% of the income that would be available to you from a single life annuity.

Exceeding Capped Drawdown limits or taking income via Flexi-access Drawdown

If you withdraw more than your maximum income under Capped Drawdown, or you take any pension income via Flexi-Access Drawdown, then the level of pension contributions into a money purchase plan, that are eligible for tax relief, is reduced to £10,000 each year. This is known as the Money Purchase Annual Allowance.

Uncrystallised Funds Pension Lump Sum

Another option available for withdrawing money from your Pension, that has not been used to buy an annuity or enter into drawdown, is what is called an Uncrystallised Funds Pension Lump Sum (otherwise known as a UFPLS).

A UFPLS allows a person, aged 55 or older, to make one-off or regular cash withdrawals from a Pension.

Whenever you take a UFPLS, 25% of the amount you withdraw will be tax-free, with the remaining 75% added to your other income for the tax year in which it is drawn and taxed in the normal way via PAYE as described below, with the accompanying risks of being pushed into a higher tax band and also possibly being taxed too highly by HMRC. Therefore the timing of such withdrawals (which will also trigger the aforementioned £10,000 Money Purchase Annual Allowance) requires careful consideration.

Risks of Income Drawdown and UFPLS

There are no guarantees of long term income available via income drawdown or UFPLS, which makes them more risky retirement income solutions. If you withdraw too much income from your pension fund, or investments do not perform as expected, or you live longer than anticipated, there is a risk that your pension fund will be depleted. As such, if you decide to take benefits via income drawdown or UFPLS, it is essential to regularly review your fund value, the performance of the investments and the amount of income that you are withdrawing. We will meet with you on at least an annual basis to review the remaining pension fund and your personal circumstances.

Taxation and pension income

Any pension income taken via income drawdown will be added to your income for the year and taxed in the normal way via PAYE. No national insurance is paid on pension income.

If you decide to take a large amount of pension income this could push you into a higher tax band. Also, if you decide to withdraw pension income at the start of a tax year, this could mean that you pay too much income tax and will need to make a reclaim from HMRC.

Your funds will also be tested against the Lifetime Allowance when you access your pot, and again on the earlier of annuity purchase or age 75. If the value of all of your pension savings exceeds the prevailing Lifetime Allowance (£1m in the 2016/17 tax year) further tax charges may apply. Please see our article on Lifetime Allowance for more details.

Death Benefits

You can nominate any individual to receive the value of your pension drawdown fund in the event of your death.

- If you die before the age of 75, any money left in your pension fund will pass tax free to your nominated beneficiaries. They can then withdraw money from the fund as a lump sum or as pension income.
- If you die after the age of 75 and your nominated beneficiaries take money from the pension fund as income or lump sum, they will pay tax at their marginal rate.

If you require further information, please contact us:
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This technical document is for illustrative purposes only and should not be construed as advice or guidance. It is based on our understanding of current taxation, law and practice (August 2016), which is subject to change.

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