Drawing an income directly from your pension fund

The options available to you depend on the type of pension you have. A defined contribution pension is one where you build up a pot using your personal contributions and those from your employer, plus tax relief and investment growth.

A defined benefit pension is one where you receive a guaranteed income based on such factors as your salary and the length of service with your employer.

In this fact sheet we focus on defined contribution plans. The options available to members of defined contribution pensions are:

- Draw an income via flexi-access drawdown
- (if available) draw an income via capped drawdown

Flexi-access drawdown
Flexi-access drawdown provides a very flexible and tax efficient means of drawing benefits directly from a pension fund.

An individual can take up to 25% of the pension fund being crystallised as a tax-free lump sum at outset, and the residual fund remains invested within a tax advantaged environment.

The individual can then take regular or ad-hoc income, or lump sum withdrawals from the residual fund to suit their needs and circumstances.

There is no upper limit to the amount the individual can withdraw at any one time. However, each withdrawal is taxed at their marginal rate of income tax, and so consideration should be given to the amount and timing of a withdrawal to minimise any tax paid.

Drawing an income under flexi-access drawdown will trigger the Money Purchase Annual Allowance, restricting any future tax efficient funding to a defined contribution pension to £4,000 per annum thereafter.

Capped drawdown
Before the introduction of flexi-access drawdown on 6 April 2015 individuals could draw an income directly from their pension via a capped drawdown arrangement.

No new capped drawdown arrangements can be established but individuals who held a capped drawdown plan on 6 April 2015 can remain in capped drawdown providing they do not withdraw an income in excess of the cap set by the Government Actuary's Department (GAD).

There is no minimum amount of income which has to be drawn. The maximum level of annual income (the cap) is equivalent to 150% of the income available from a level single life annuity (150% GAD). This income cap is reviewed every three years up until age 75, and annually thereafter.

The main advantage capped drawdown has over flexi-access drawdown is that the reduced *Money Purchase Annual Allowance* is not triggered when income is taken, provided the individual's withdrawal is not in excess of the cap, and thus they can continue to make tax efficient contributions to their pension fund subject to the higher *annual allowance* of £40,000 if the taper does not apply.

On Death
Both flexi-access drawdown and capped drawdown provide an extremely tax-efficient way of passing assets down through the generations, as any unused pension fund can be passed on to a wide range of beneficiaries, and it is very unlikely to ever fall into anyone's estate for inheritance tax purposes.

The tax treatment of the lump sum and any income payments will vary depending upon your age at the time of your death.

Income Security
A retirement income drawn under either flexi-access drawdown or capped drawdown is not a guaranteed income for life solution.

You run the risk of fully extinguishing your pension fund during your lifetime if you draw too heavily from your pension fund in the early years of retirement and/or you experience poor investment performance.

If you are reliant on the income from your pension to meet your essential income needs in retirement then flexi-access drawdown and capped drawdown may not be the most appropriate solution for you.

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Important Information

Our advice has been prepared based on our company's understanding of the current law and HM Revenue and Customs' practice. Whilst we believe the interpretation is correct we cannot guarantee it. Tax treatment may change in the future.

The levels of taxation and annual exemptions from taxation are subject to change and their value will depend upon your individual circumstances.

PLEASE REFER TO OUR SEPARATE DOCUMENT 'GENERAL AND INVESTMENT RISK WARNINGS' FOR ADDITIONAL INFORMATION RELATING TO THE RISKS OF INVESTING.

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