Briefing

Flexi-Access Drawdown

This technical briefing details the rules regarding Flexi-Access Drawdown. There are also technical briefings on the Uncrystallised Funds Pension Lump Sum option and the new death benefit flexibility.

Flexibly accessing pension

The Taxation of Pensions Act 2014 allows pension savers who have reached pension age to draw from their pension funds without limit from 6 April 2015. This radically changes the principle that pension savings should be used to provide an income over the saver's lifetime. There are also fundamental changes to the benefits available on death.

> Savers making use of the new pension freedoms are said to have 'flexibly accessed pension'. They can do this in a number of ways.

Three likely, popular ways in which they may do so are by drawing income from a 'Flexi-Access Drawdown' fund, receiving an 'Uncrystallised Funds Pension Lump Sum' or immediately before receiving income from a 'Flexible Annuity'.

Flexi-Access Drawdown

From 6 April 2015, the method of providing drawdown income for those not already in drawdown will be from a Flexi-Access Drawdown fund. It will not be possible to set up a new capped drawdown fund (other than for transfers of existing cases) or a new flexible drawdown fund from 6 April 2015.

Funds designated as available for Flexi-Access Drawdown will remain invested in the pension arrangement and withdrawals can be made with any payments being taxed as income. Tax should be deducted at source under PAYE.

There is no limit, other than availability of funds, on how much can be drawn out each year, including the possibility of drawing out all of the fund in one taxable instalment. If this is the intention when funds are first accessed, then the Uncrystallised Funds Pension Lump Sum may be more appropriate (for more information read our UFPLS briefing note).

Because there is no annual limit, there is also no concept of a pension year. There is no requirement to purchase an annuity at any stage, though this is an option.

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beyond the expected

Money Purchase Annual Allowance

If you flexibly access pension, such as by receiving income from a Flexi-Access Drawdown fund, then the consequence is you will be subject to more restrictive rules on how much you can save tax efficiently within a money purchase pension fund for the rest of your life. The restriction was brought in to forestall abuse of the new pension freedoms, which enable salary to be paid into a pension plan and then drawn out more or less immediately with a view to saving income tax.

> Currently, the standard Annual Allowance (AA) is £40,000 gross (tax year 2017/18) and you can use up to three past years of unused allowances. If you flexibly access pension, a reduced AA, known as the 'Money Purchase Annual Allowance' (MPAA) applies to contributions to a money purchase pension arrangement.

This reduced allowance is £4,000 gross per tax year, with effect from 6 April 2017 and furthermore, carry forward of unused allowances is lost. However, those members who have defined benefit pension arrangements will still be able to accrue up to a further £36,000 gross worth of benefits in those arrangements per tax year, on top of the £4,000 gross MPAA.

Note that it is the first payment of income rather than the set-up of a drawdown fund that triggers application of the MPAA. This means that the Pension Commencement Lump Sum (commonly known as tax-free cash) can be paid in isolation and a Flexi-Access Drawdown fund set up without the reduction in the AA – until such time as income is drawn from the Flexi-Access Drawdown fund.

Existing Capped Drawdown Funds

Existing capped drawdown funds will, by default, continue as capped drawdown funds with the same pension years and scheduled pension review dates.

These funds can be converted to Flexi-Access Drawdown funds on or after 6 April 2015 by:

- notifying the Scheme Administrator and receiving acceptance from them; or
- drawing more than the current maximum capped amount; or
- where there is a transfer, notifying the Scheme Administrator of the receiving scheme as part of the transfer process

Notifications can be given prior to 6 April 2015 but in that case conversion happens on 6 April 2015 when the new rules take effect.

Whilst converting to Flexi-Access Drawdown will save the cost of pension reviews (which could include the cost of updating property valuations), it does come with the downside of invoking the MPAA and so may not be suitable for everyone.

If there is an existing capped drawdown fund in place on 5 April 2015, any additional unvested funds requiring to be drawn after 5 April 2015 could be allocated to the existing capped drawdown fund rather than to a new Flexi-Access Drawdown fund. This would enable the pension commencement lump sum and capped drawdown income to be paid without triggering the MPAA.

Existing Flexible Drawdown Funds

Existing flexible drawdown funds will be automatically converted to Flexi-Access Drawdown funds on 6 April 2015, and the MPAA will automatically apply from that date. Given that those with flexible drawdown funds have an effective AA of nil, the 'reduced' AA for them actually represents an increase in the scope for contributions.

Long-term Planning

Any potential for a change in Government will raise concern over whether these relatively new rules will persist. Of course there is no certainty, but it would be hard politically for a new government to remove these popular policies, which are also expected to increase tax receipts in the short term.

If there is abuse of the new rules though, then that may give sufficient justification to curtail the new freedoms, whether there is a new government or not.

This document is for information only and should not be construed as advice.

Summary

Flexi-Access Drawdown is the new income drawdown route from 6 April 2015 – it is not possible to set up other forms of drawdown. Flexi-Access Drawdown allows unrestricted access to pension funds at retirement, but will mean a reduced AA called the Money Purchase Annual Allowance.

Those in capped drawdown can keep the standard AA and carry forward rules by keeping income within the capped limits, or switch to Flexi-Access Drawdown if contribution allowances are not important. A capped drawdown fund can be added to even after 5 April 2015, but a new one cannot be set up. There are significant risks associated with this decision and could affect the value of future income.

As the pension pot will remain invested there is a risk that the investment could go down. Excessive income withdrawals will reduce the capacity for income in the future.

Please contact your Barnett Waddingham consultant if you would like to discuss any of the above topics in more detail. Alternatively contact us via the following:

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