INCOME DRAWDOWN

There are currently two types of income drawdown:

Flexi- Access Drawdown

- Any arrangements going into drawdown from 6 April 2015 allow the member flexi-access drawdown.
- The member may take what they want from their money purchase pension pot, when they want it - there are no income limits.
- But, those who take in excess of their tax free cash from their pension funds may trigger the £4,000 money purchase annual allowance (MPAA).

Taxation

Generally speaking, 25% of any benefits crystalised can be taken as tax- free cash.

The fund, less any tax- free cash taken, remains invested in a tax advantaged environment and the member can simply draw an income directly from it, if and when they want. Any amount drawn from the fund is taxed as income.

Capped Drawdown

- Capped drawdown - before 6 April 2015 there were limits on the amount of income that could be taken each year (unless the individual had a certain level of secure pension income - the 'minimum income requirement'). Because of the limits, this type of drawdown is referred to as capped drawdown.
- Existing capped drawdown arrangements on 5th April 2015 (even if transferred) will remain so, and will continue to be subject to the capped drawdown rules unless the member converts the funds to flexi-access drawdown.
- There is a potential funding advantage for original members in remaining in capped drawdown, as they won't be subject to the MPAA.

Existing flexible drawdown arrangements automatically converted to flexi-access drawdown on 6th April 2015.

Taxation

Income paid out under drawdown is taxed as pension income on the recipient in the year of payment.

Any tax- free cash entitlement must be taken when funds are first accessed, otherwise the right to take the tax- free cash in respect of those funds will be lost.

Inheritability of Drawdown Funds

It is now possible to make arrangements for income drawdown funds to be passed down through the generations.

Those in drawdown need to be clear about whom they want their death benefits to go to by completing a form of nomination. If this is absent the Trustee will be guided by the deceased's will.

Each time a drawdown fund is inherited, the tax position is reset, depending on the age at death of the last drawdown account holder.

Death Benefits

If someone dies whilst in capped or flexi-access drawdown (including where someone has a mixture of crystallised and uncrystallised funds under the scheme), the options are:

- Pay lump sums to any beneficiaries - this includes charities and trusts.
- Provide pensions for any beneficiaries - these could be paid either as drawdown or lifetime annuities. Since 6 April 2015, survivors' pensions are not restricted to dependents. But it is only possible to pay pensions to individuals - so, for example, it is not possible to pay a pension to a charity or a trust.

  Drawdown can provide beneficiaries with a sustainable stream of income and allows the fund to potentially grow tax- free, while remaining outside their estate for IHT. And it also offers the possibility of adjusting the level of withdrawals.

Different kinds of death benefit can be paid to different beneficiaries. Also, it is possible for a single beneficiary to receive both a pension and a lump sum from the same scheme.

Taxation

Dependent's drawdown income, where income payments started before 6th April 2015, will continue to be subject to income tax.

The following rules apply to payments which start after 5th April 2015, rather than the date of death. So where the payment of death benefits had been delayed until after 5th April 2015, the beneficiaries were able to take advantage of the new rules.

The tax position is largely based on the member's age at death.

- **Death before age 75**

  Funds in a capped drawdown or flexi-access drawdown arrangement, whether crystallised or uncrystallised, can be taken tax free - either as pension payments or lump sums.

  Lump sums: To be tax- free, lump sums have to be paid within two years of the deceased's date of death. Also, any uncrystallised benefits will be tested against the lifetime allowance, so there could be a tax charge if the benefits exceed the available lifetime allowance.

  A lump sum paid after two years will not be tested against the lifetime allowance. But, from tax year 2016/17, it is taxed at the beneficiary's marginal rate of income tax.

  Drawdown: To be tax- free, there is a two year time limit from the member's date of death for designating uncrystallised funds for drawdown - but not for designating crystallised funds for drawdown. Also, any uncrystallised benefits will be tested against the lifetime allowance.

  Income from uncrystallised funds designated for drawdown after two years will be subject to income tax, but there would be no lifetime allowance test.

Annuities: To be tax- free, there is a two year time limit from the member's date of death for uncrystallised funds used to provide a survivor's annuity - but not crystallised funds. Additionally, survivors' annuities are only tax free if the member died after 2nd December 2014.

If uncrystallised funds are used to provide a survivor's annuity after two years, or if the date of death was before 3rd December 2014, the funds will not be tested against the lifetime allowance, but any income taken will be taxable.

If a joint life annuity has been purchased, the specified survivor will also receive tax- free income, but only if the deceased died after 2nd December 2014.

- **Death after 75**

  Drawdown pensions will be taxed at the beneficiary's marginal rate of income tax as they draw income from it. Similarly, beneficiaries' annuities will be taxed at their marginal rate.

  Alternatively, a lump sum can be paid which, from tax year 2016/17, is taxed at the beneficiary's marginal rate of income tax.