SERVO

PRIVATE WEALTH

Pension Income Options Guide
2026/27 Tax Year

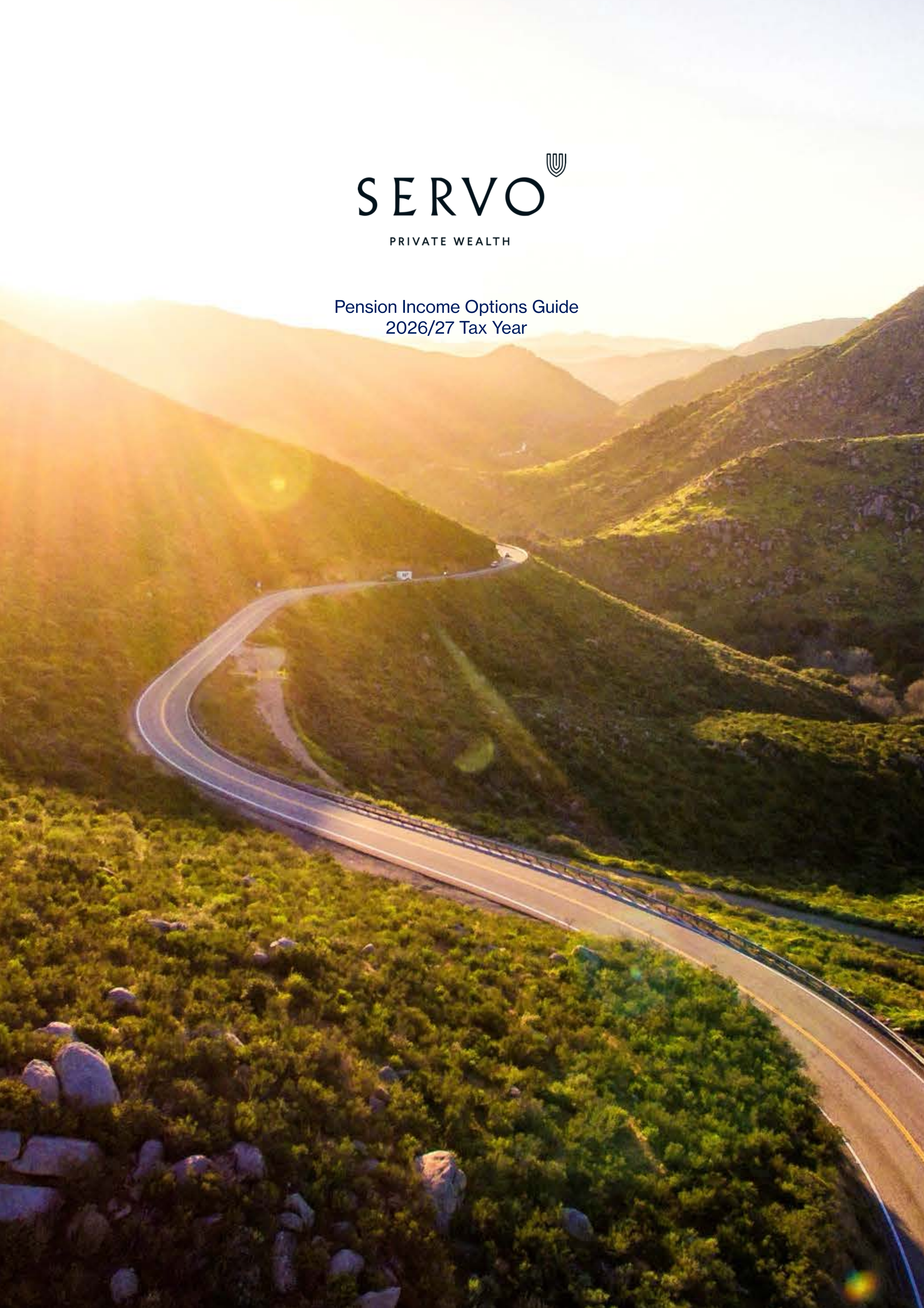


TABLE OF CONTENTS

INTRODUCTION

There are many different types of pension arrangements and the rules and options that apply to one may not necessarily apply to another. Here, we have outlined the general options that are available for taking benefits from most types of money purchase (also known as 'defined contribution') pensions.

Under current legislation, most people can access their pensions at any time from age 55 onwards. There is no upper age limit to drawing benefits: you can choose to leave your pension alone for the rest of your life if you wish, although some providers may require you to take benefits, or transfer them away, by age 75. On death, your pension funds would pass to your nominated beneficiaries.

The minimum age for accessing private pension arrangements will increase from 55 to 57 with effect from April 2028. If you were born after 6 April 1971, this could have an impact on any plans you may have for early retirement or drawing benefits from your pension, such as tax-free cash, at that time. This minimum pension age is likely to increase even further in the future, likely to be set at 10 years before State Pension Age.

Some pension schemes may nevertheless allow a member to retain age 55 (or younger) as the minimum pension access age. Most commonly, this applies to certain 'uniform' pension schemes, such as the police, firefighters and armed forces pension schemes, and also to certain professional sports pension schemes. Some older pension schemes also allow a minimum pension age of 55, where they were written 'to age 55', but this would normally be lost on transferring the fund elsewhere. This is a complex area and only your pension provider will be able to confirm if this applies to you.

TAX FREE CASH ('PENSION COMMENCEMENT LUMP SUM')

When you decide to draw benefits, you can normally choose to take some of your pension as a tax-free cash lump sum. This is technically known as a **Pension Commencement Lump Sum**, or 'PCLS'.

The amount of PCLS that you can draw from your pension is typically up to 25% of the value of your pension fund at the time of the withdrawal. For example, if your pension fund was worth £100,000.00, you could draw up to £25,000.00 (25%) tax-free. In rare circumstances, some pensions may offer a higher amount of PCLS, although this usually only applies to pensions originally funded as occupational pension schemes.

The remaining 75% of your pension fund is subject to Income Tax when you draw it out of the pension. The Income Tax is applied in the same way as if it were income from employment or self-employment (although no National Insurance applies). In other words, you can offset any Personal Allowance you may have available against your pension income, then the remainder, for a UK taxpayer, is taxed at the basic rate, higher rate or additional rate as appropriate, depending on your total income that tax year. Scottish taxpayers are subject to different tax bands and rates.

Depending on which pension income option you choose, you do not have to take all the PCLS in one lump sum, as long as your pension arrangement allows full flexibility.

You could stagger the withdrawals, so you take smaller lump sums of PCLS or withdrawals that combine a small amount of PCLS and some taxable income, to suit your personal income needs and tax position at the time. This is known as 'phased retirement' or a 'phased withdrawal' strategy.

CRYSTALLISED AND UNCRYSTALLISED BENEFITS

When you take benefits from a pension, the process is called **crystallising** the pension fund. If you have not yet drawn benefits from some or all of your pension, that part is called an **uncrystallised fund**. It is possible to hold pensions that are part-crystallised and part-uncrystallised.

Let us look at an example.

Let us say your pension fund is currently worth £100,000.00, and you have never taken any benefits from it. It is currently a 100% uncrystallised fund, so up to £25,000.00 (25%) could be drawn as PCLS, either as a lump sum or in smaller tranches.

You would like to raise £12,500.00 from your investment portfolio, tax efficiently, to help pay for some home improvements. Having reviewed your needs and circumstances, we have determined that raising this £12,500.00 lump sum from your pension fund would be the most suitable option, and that the most tax efficient way of doing so (taking into account your income and tax position) is to draw it as PCLS.

To withdraw £12,500.00 as a PCLS, you need to crystallise *four times* that amount of your pension fund – i.e. £50,000.00 – so that 25% of the crystallised amount can be paid as tax-free cash (i.e. £50,000.00 x 25% = £12,500.00).

£50,000.00 of your £100,000.00 pension fund will be crystallised and your pension fund will be split between two sub-pots: the **crystallised fund** and the **uncrystallised fund**.

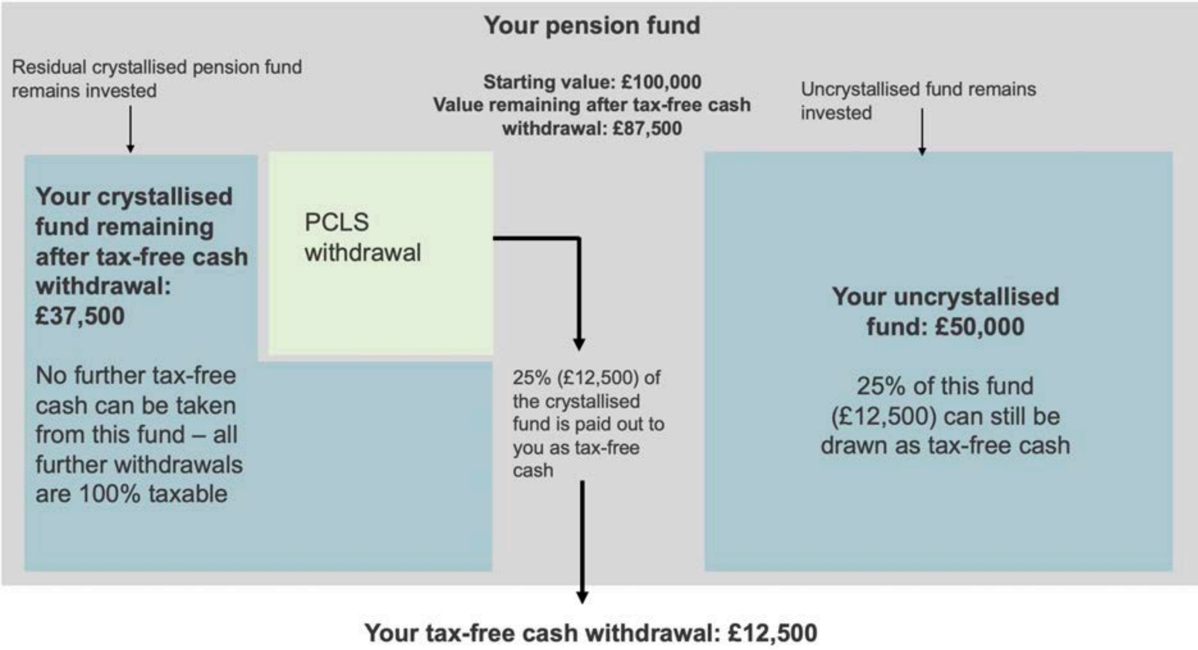
25% of the £50,000.00 crystallised fund will then be paid out to you by the pension provider. This will be paid to you without any tax deducted from it. You will not have any tax liability to pay on this withdrawal.

Therefore, the remaining value of your pension fund after the PCLS of £12,500.00 has been paid out will be £87,500.00, which comprises:

- £37,500.00, being the remaining crystallised fund that has paid out your £12,500.00 tax-free cash. This fund cannot pay any more PCLS, so anything further that you withdraw from this pot in the future would be subject to Income Tax at your marginal rate.
- £50,000.00, being the residual uncrystallised fund that you have not yet drawn benefits from. This fund can still pay up to 25% of its value (a further £12,500.00, ignoring any future investment growth) to you tax-free at any time. The residual 75% of the capital held in this uncrystallised fund would be subject to Income Tax at your marginal rate, in exactly the same way as your crystallised pot, when you come to draw benefits from it.

Both pots can remain invested for as long as you want them to.

Here is what your pension fund would look like afterwards:



When you choose to crystallise pension benefits, there are three main ways you can withdraw them:

- You can use some or all of your pension fund to buy an **annuity** (secure fixed term or lifetime income).
- You can leave the pension fund invested and draw out single or regular lump sum amounts called Uncrystallised Fund Pension Lump Sums (‘**UFPLS**’).
- You can leave the pension fund invested and draw out single or regular lump sum amounts through Flexi-Access Drawdown (‘**FAD**’). The graphic shown earlier is broadly how a FAD withdrawal strategy operates, as UFPLS does not allow you to take PCLS in isolation; you would need to take taxable income at the same time.

A brief description of each option is outlined in the following sections of this guide.

ANNUITIES

When you buy an annuity, you exchange the value of your pension fund for the guarantee of a **known and secure amount of income**. The annuity income is payable either for the rest of your life or for a fixed period of time, whichever you choose.

The amount of annuity income that you receive is dependent on a combination of things, including:

- The value of the pension fund that you are using to purchase the annuity.
- Your age.
- Your health and lifestyle (e.g. whether you are a smoker or you suffer/have suffered from a serious health condition such as diabetes, cancer, etc.).
- The options you choose regarding how your annuity income is to be paid to you (e.g. whether it is to remain level in value, increase with inflation, include dependant's benefits on death, be paid for a guaranteed minimum period of time, etc.)
- Any adviser fees and/or PCLS that will be deducted from your pension fund before the annuity is purchased.
- The amount of time your annuity income is to be paid for (e.g. for the rest of your life, or for a fixed period of 5, 10 or 20 years, etc.).
- The annuity rate offered by the annuity provider.

Annuities generally stop being paid when you die. However, adding **dependants' benefits** and **guaranteed minimum payment periods** to them may prolong their length if you die early in the annuity's payment period. The longer your annuity is paid for, the more value you would have received from it. However, if you set up the annuity with no additional benefits and die a year later, the annuity provider will have benefitted from your pension fund at little cost to itself.

While many life assurers and pension providers offer their own in-house annuity products that sit alongside their pension arrangements, it is often the case that choosing an alternative annuity provider through the **open market option** (i.e. researching the wider annuities market) could help you get a better rate – just like you might with car or home insurance.

It is also often the case that health and lifestyle options are not automatically considered when a provider calculates the annuity rate it will offer you. Some annuity providers specialise in this market and can offer substantially higher annuity rates to smokers or those with health and medical conditions that could impact on their potential life expectancy when compared with someone of their age that had 'normal' health. It is therefore always worth exploring this option if you believe you have anything less than a good medical history. These products are specifically known as **enhanced** or **impaired life annuities.**

When you set up an annuity, it is normally a **once-only decision** (unless you buy a series of fixed term annuities that leave you with pension funds remaining, or pay out capital at the end of the term).

You need to consider it very carefully, as your income needs in early retirement may be different when you reach later retirement. This lack of flexibility means that annuities tend to be more popular among older retirees than younger ones.

Also, annuity rates usually get higher the older you are when you buy them, especially if your health also deteriorates as you age.

Given the inability to vary your annuity income, annuities offer plenty of 'bolt-on' options that help you tailor your income to your specific needs. These include:

- **Guaranteed minimum payment periods.** These enable you to specify that your annuity income should be paid for a minimum amount of time, irrespective of whether you live that long. These guarantee periods are normally set at either 5 or 10 years and are available with only a modest reduction to the annuity rate.
- **Dependant's benefits**. You can choose to have your annuity income paid to someone who is financially dependent on you (e.g. a spouse or civil partner) for the rest of their life, if you die before them. The amount of benefit paid to them can either be at the same rate (100% of your annuity income) or at a lower level (typically either 66% or 50% of your annuity income). This option could substantially prolong the amount of time the annuity is paid for – particularly if your dependant is much younger than you – so this option will have more of an impact on the annuity rate offered to you.
- **Increasing income**. Annuity income can either remain level in value, or you can choose for it to increase either by a fixed amount each year (e.g. 3% pa or 5% pa) or by the rate of inflation, so that it keeps up with the rising cost of living over the longer-term. Opting for increasing annuity income can have the greatest impact on the annuity rate offered to you, as the annuity provider is taking a higher risk that you could live a lot longer than your average life expectancy. Also, with inflation-linked increases (known as 'index-linked' annuities) the provider is taking on an unpredictable future liability if inflation increases significantly. For this reason, it can take several years before the income that you would have received from an increasing annuity overtakes the income that would have been paid to you from a level (non-increasing) annuity.
- **Death benefits**. Some annuities offer additional death benefits known as 'value protection'. In return for a reduction in the annuity rate offered to you, you can choose to have a minimum amount of capital returned to your estate on death. This means that, if you die sooner than expected, at least some of your original pension fund would be returned to your beneficiaries rather than the annuity provider keeping it.

As well as the bolt-on options, some life assurance and pension providers offer investment-linked annuities. These combine the security of a fixed pension income with the option of keeping some or all of the underlying pension fund invested.

If the investment returns are sufficient, it may enable you to draw or sustain a higher level of annuity income than may otherwise be available to you from a traditional annuity product.
Given the development of more flexible pension income options in recent years (i.e. UFPLS and FAD) the market for these hybrid annuity products is relatively small.

Hybrid annuity and drawdown pensions are available, which offer a blend of secure annuity income and the flexibility of having some invested pension fund, and you can also buy short-term annuities to fix your income for, say, 5 years, either with part of your pension fund, or with a return of capital at the end that could be rolled into another annuity if needed.

Annuities are taxed in the same way as employment or self-employment income, although no National Insurance applies to them. After any PCLS has been paid out, the rest of the annuity income is fully subject to Income Tax at your personal marginal rate, under PAYE, if it exceeds your Personal Allowance.

UNCRYSTALLISED FUND PENSION LUMP SUMS (UFPLS)

UFPLS (usually pronounced *'uff-plus'*) is the first of two ways that you can draw benefits out of your pension fund flexibly, but it is more rigid than FAD, which was outlined briefly earlier.

It is very straightforward. Your pension fund remains invested (i.e. uncrystallised) and you simply turn on an income tap whenever you need it.

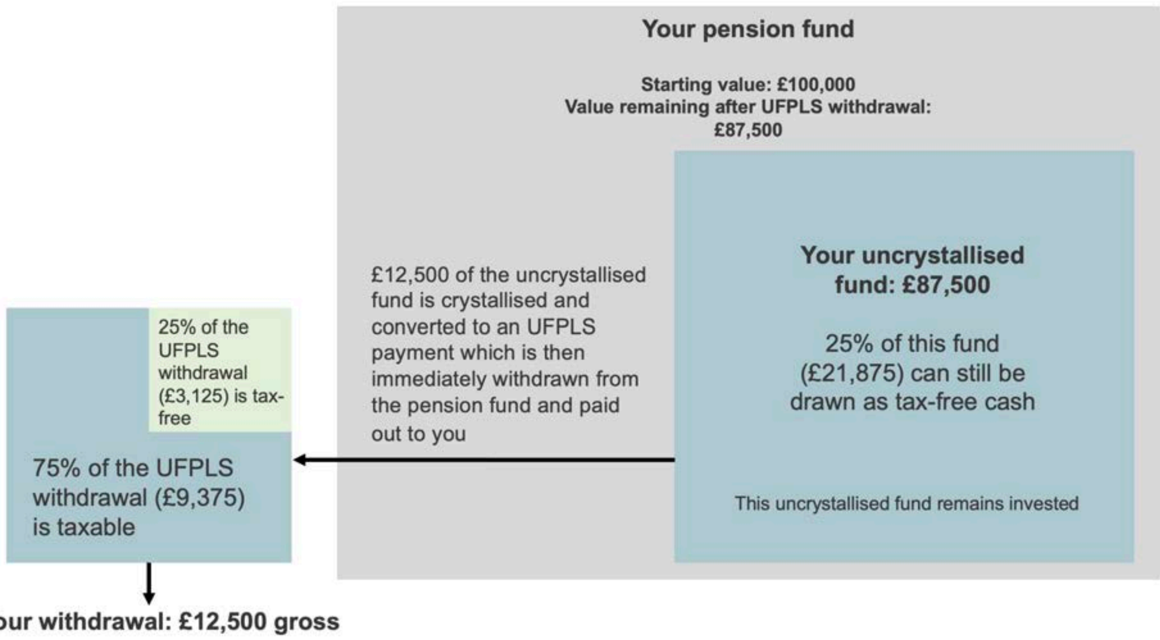
You can take a series of regular or one-off UFPLS payments whenever you require them. They can be anything from a fraction of the pension fund to 100% of its value (although most pension providers stipulate a minimum amount for each withdrawal).

Each UFPLS payment comprises 25% PCLS and 75% taxable income. It is not possible to vary these proportions, unless you have insufficient Lump Sum Allowance remaining to offset the PCLS against, in which case up to 100% of the UFPLS would be taxable. We have provided more information on the Lump Sum Allowance later in this document.

The pension provider will normally apply an emergency tax code to the payment unless it holds an up-to-date tax code for you, so some Income Tax would be deducted from the UFPLS payment automatically on your behalf. You would then need to either reclaim any overpaid tax (you can use HMRC form P55 for this) or pay additional tax through Self-Assessment, depending on your personal tax position that year.

Let us look back at that earlier example again.

In the following scenario, we are assuming that you again take a withdrawal of £12,500.00 from your pension fund, but you take it as an UFPLS rather than 100% PCLS.



In this case, there is no 'sub-pot' created within your pension, like there would be with a FAD strategy. 100% of the pension fund remains uncrystallised – you simply draw out a chunk of it.

The UFPLS withdrawal is £12,500.00 gross, and 25% of it (£3,125.00) is the tax-free PCLS. The residual 75% (£9,375.00) is subject to Income Tax at your marginal tax in the tax year that the withdrawal is made.

- If you are a non-taxpayer, and the whole £9,375.00 taxable element of the UFPLS withdrawal falls within your Personal Allowance, you will have no more tax to pay at the whole £12,500.00 UFPLS withdrawal would be effectively tax-free.
- If the whole £9,375.00 taxable element of the UFPLS withdrawal falls within your basic rate tax band, you would pay 20% Income Tax on it, giving you a total net withdrawal of £10,625.00 (£9,375.00-20%, plus the £3,125.00 tax-free PCLS).
- If the whole £9,375.00 taxable element of the UFPLS withdrawal falls within your higher rate tax band, you will pay 40% Income Tax on the £9,375.00, giving you a total net withdrawal of £8,750.00 (£9,375.00-40%, plus the £3,125.00 tax-free PCLS).

The same premise applies to additional rate taxpayers, who would pay 45% tax on the £9,375.00 taxable element. If the withdrawal straddles multiple tax bands, the tax would be applied at multiple rates according to how much of the withdrawal falls within each tax band. Scottish taxpayers will be subject to Scottish Income Tax rates on their withdrawals.

You can withdraw as much as you like from your pension fund as an UFPLS withdrawal, and it will always be structured in this '25% tax-free and 75% taxable' way (unless, as noted earlier, you do not have sufficient Lump Sum Allowance remaining, in which case it might be up to 100% taxable). While the idea of being able to draw up to 100% of your pension fund out at once may be appealing, it is worth remembering that you could potentially pay up to 45% Income Tax (48% for Scottish taxpayers) on its value. Therefore, drawing your pension fund in smaller lump sums and paying a lower level of tax is generally a more logical strategy.

Flexible withdrawal methods such as UFPLS are advantageous in that they are simpler than Flexi-Access Drawdown (FAD), and give you control over what you draw and when you draw it. The ability to vary the value of your withdrawals can be an effective tax planning method, particularly for those retiring early or phasing their retirement by gradually reducing their hours and earnings over time.

However, the main drawbacks are:

- That the benefits you can take from your pension fund through flexible methods remain subject to ongoing fees and charges and are not guaranteed. They also remain subject to investment risk, so the fund value can rise or fall.
- **Once the pension fund has been exhausted, it is gone for good. It is essential to therefore monitor the investments within your pension fund to ensure the withdrawals you are taking are realistically sustainable.**

  If not, you would need to have alternative assets or income sources available to maintain your lifestyle if the fund runs out too quickly. In the absence of any alternative assets or income sources, it could significantly impact on your lifestyle in older age.

- The amount of annuity income you may be able to secure could be lower in the future, due to delaying this decision and spending some of your pension fund.

Taking UFPLS withdrawals will also trigger the **Money Purchase Annual Allowance**, which means you can only contribute up to £10,000.00 gross per tax year into pensions from that point onwards, with full tax relief being available. Most retired people can only contribute up to £3,600.00 gross per tax year and receive tax relief on it anyway, as they have no earned income, and there is no tax relief on pension contributions after age 75. However, there is a possibility that you might want to take a lump sum while you are still earning, in which case UFPLS might not be the best option if you are likely to make pension contributions of more than £10,000.00 gross pa at a later date.

FLEXI-ACCESS DRAWDOWN (FAD)

The second flexible withdrawal method is known as FAD. It is similar to UFPLS, but more flexible: the split of PCLS and taxable pension income is not fixed at 25% and 75% respectively.

Through FAD, you can choose to take a withdrawal that is 100% PCLS (like in the first example shown earlier) or – once you have drawn out all your PCLS – you could take 100% taxable income withdrawals. You can also draw the standard 25%/75% combination, just like UFPLS, or, unlike UFPLS, more PCLS and less income.

This is an ideal way of drawing benefits to suit your personal tax situation and cash flow needs. For example, if you just want to take 100% of your PCLS, but are not yet ready to draw any taxable benefits from your pension fund (perhaps because you are still working, but want the PCLS to pay off an outstanding mortgage balance, or because you want to make a lump sum gift, now that pension funds are going to be subject to Inheritance Tax), FAD is the only pension income option that will enable you to do that.

The taxation position is the same as with UFPLS, although any tax liability arising on the withdrawal will depend on how much (if any) taxable income is included in it.

The advantages and disadvantages are also the same. If you withdraw more money from the pension fund than the growth the underlying investments within it are able to achieve, after fees, charges and inflation, then your pension fund will go down in value over time and may run out before you die. This could have a serious effect on your lifestyle and wellbeing.

For this reason, it is important to make sure your withdrawals are sustainable. To help with this, the investment strategy within your pension fund needs to be suitable for achieving the level of growth required to maintain your lifestyle throughout the whole of your retirement.

This is why it is essential to have your pension arrangements regularly reviewed and monitored while you are taking benefits through a FAD (or UFPLS) strategy, as **your income and the value of your pension fund are generally not secure or guaranteed**. You will need to bear the cost of those ongoing reviews and, if you pay those charges from your pension fund, they will further impact on the sustainability of your withdrawals.

If you continue to take withdrawals during a period of time when markets are low and your underlying investments have fallen in value, your pension fund could run out even quicker. This is due to the combined effect of falling markets, fees and charges, inflation and your withdrawals all occurring at the same time.

You should also consider the needs of anyone who is financially dependent on you both before and during the process of taking FAD or UFPLS withdrawals. If you die before them, they may still be reliant on your pension fund lasting the rest of their own life and they could potentially live a lot longer than you.

It is important to be vigilant about what you do with any money that you draw from your pension fund.

There are several high profile (and many low profile) scams in the market with so-called investment experts offering to invest your money with ‘guaranteed’ returns that are simply not achievable or suitable. If you are approached by anyone outside of this firm to invest money, whether it is from your pension fund or not, you should contact us before taking any action.

Many older and traditional pension arrangements do not offer FAD and/or UFPLS. It is quite common for investors to transfer their pensions to alternative arrangements or providers that do offer these, in the time leading up to their retirement or required withdrawals.

Taking FAD withdrawals can also trigger the **Money Purchase Annual Allowance**, which means you can only contribute up to £10,000.00 gross per tax year into pensions from that point onwards. However, this only happens once you have taken any withdrawals from the **taxable** value of your pension fund. So, for example, if your FAD withdrawal consists solely of tax-free cash, it will not trigger the Money Purchase Annual Allowance until you start drawing from the residual 75% taxable pension fund. This may make using FAD, and taking PCLS only, more attractive than UFPLS in some cases.

FAD VS. SECURE ANNUITY INCOME

As described earlier, you can secure your pension income at any time by using your remaining pension fund to buy an annuity (i.e. a secure income, either for the rest of your life or for a fixed period of time), even if you use FAD or UFPLS in the meantime.

Annuity rates historically have not been particularly generous for younger retirees. However, the rates become increasingly more attractive the older you are when you buy one. If your pension fund does not achieve sufficient investment returns while you are taking flexible withdrawals, you may find that you are not able to buy as much annuity income as you could have done if you had not taken flexible withdrawals.

The longer you leave it before buying an annuity, the greater this risk is likely to be, as annuity rates go up more each year the older you are. This risk – called **mortality risk** – can be measured by identifying the level of investment returns required from your pension fund each year to provide the same level of annuity income at future ages, based on the value of your pension fund right now. These investments returns are called **critical yields** and pension providers will normally outline the required critical yields in their pension illustration documents.

We can also use cash flow planning to consider whether any proposed flexible pension withdrawals or annuity purchase are likely to be sustainable as part of your long-term financial plan.

OTHER PENSION INCOME OPTIONS

There are special rules that apply to people with smaller pension funds and some occupational pension schemes. These do not form part of the main pension withdrawal options because they only apply in specific circumstances.

SMALL POT LUMP SUMS

Under the 'small pots' rules you may be able to draw up to three separate pension funds as a single lump sum from non-occupational pension schemes, and an unlimited number of occupational pension funds, provided each pension fund is worth less than £10,000.00 and you are over 55 (rising to 57 in April 2028).

The tax treatment of these lump sums is exactly the same as UFPLS lump sums, in that normally 25% will be tax-free and Income Tax will be payable on the remaining 75%, with the provider normally deducting basic rate tax (or emergency tax) automatically from that portion.

The two main benefits of small pots over FAD or UFPLS are that the PCLS portion does not count towards the Lump Sum Allowance or Lump Sum and Death Benefit Allowance, and the taxable income portion does not trigger the Money Purchase Annual Allowance. This can make this option especially useful for people with larger pension funds that exceed their Lump Sum Allowance, to extract some additional PCLS than would otherwise be possible.

SCHEME PENSIONS

Some occupational pension schemes (most notably final salary or 'defined benefit') schemes can pay benefits as **scheme pensions**. These are very similar to annuities in that they are a secure income for life and they are taxed in the same way (although the death benefits are usually subject to Income Tax irrespective of the pensioner's age at the date of their death).

The main difference is that scheme pensions often pay different levels of PCLS and the way that the benefits are paid is normally decided by the scheme Trustees, rather than by the pension-holder. The scheme rules specify whether any dependant's benefits, guaranteed periods, death benefits and payment increases apply. In some cases, this is subject to legislation rather than the scheme rules.

LUMP SUM ALLOWANCE AND LUMP SUM AND DEATH BENEFIT ALLOWANCE

From 6th April 2012 to 6th April 2023, there was a limit on the amount of pension benefits that could be taken without a Lifetime Allowance tax charge applying, known as the **Lifetime Allowance**. The Lifetime Allowance tax charge – which was up to 55% of any pension benefits above the Lifetime Allowance – was abolished from 6th April 2023[1].

At that time, the standard Lifetime Allowance was £1,073,100.00. Some individuals were entitled to higher Lifetime Allowances, where they had Lifetime Allowance protection certificates.

Although the Lifetime Allowance has been removed, there are still limits on the amount of pension savings people can take without a tax charge: the Lifetime Allowance has been replaced by two main new allowances:

- The **Lump Sum Allowance** (LSA) – currently £268,275.00 (which is 25% of the Lifetime Allowance of £1,073,100.00 at the date of its abolition)
- The **Lump Sum and Death Benefit Allowance** – currently £1,073,100.00

There is also an **Overseas Transfer Allowance** – also currently £1,073,100.00 – although it is extremely rare that this will ever apply so we have not provided any details within this document.

The above allowances may be higher if the individual has Lifetime Allowance protection. These allowances are reduced if any benefits were taken from your pension funds between 6th April 2006 and 5th April 2024.

A check is made against each of these allowances when benefits are paid from a pension fund – known as a **Relevant Benefit Crystallisation Event**.

Post 5th April 2024, a Relevant Benefit Crystallisation Event relates solely to the **tax-free element** of the benefits being taken. There are no Relevant Benefit Crystallisation Events for taxable pension income.

The definition of a Relevant Benefit Crystallisation Event depends on whether you are looking at the Lump Sum Allowance or the Lump Sum and Death Benefit Allowance.

LUMP SUM ALLOWANCE

For the Lump Sum Allowance, a Relevant Benefit Crystallisation Event is defined as the individual becoming entitled to:

- A Pension Commencement Lump Sum (PCLS), or
- An Uncrystallised Funds Pension Lump Sum (UFPLS)

[1] Transitional rules applied from 6th April 2023 to 5th April 2024 and the Lifetime Allowance was fully abolished from 6th April 2024.

LUMP SUM AND DEATH BENEFIT ALLOWANCE

For the Lump Sum and Death Benefit Allowance, a Relevant Benefit Crystallisation Event is defined as:

- The individual becoming entitled to a **relevant lump sum,** or
- A person being paid a **relevant lump sum death benefit** in respect of the individual

A relevant lump sum is defined as:

- A PCLS
- A Serious Ill-Health Lump Sum (SIHLS), or
- The tax-free element of an UFPLS payment

A relevant lump sum death benefit means any authorised tax-free lump sum death benefit other than:

- A charity lump sum death benefit, or
- A trivial commutation lump sum death benefit

Although both allowances relate to tax-free benefits, what counts towards them is different. The lump sums tested against the Lump Sum Allowance during the individual's lifetime include:

- PCLS
- The tax-free elements of any UFPLS payments

The tax-free lump sums tested against the Lump Sum and Death Benefit Allowance include:

- PCLS and the tax-free elements of any UFPLS payments
- UFPLS death benefits
- Drawdown pension fund lump sum death benefits and Flexi-Access Drawdown (FAD) lump sum death benefits from benefits crystallised on or after 6th April 2024
- Serious Ill-Health Lump Sums
- Defined benefit scheme lump sum death benefits
- Pension protection lump sum death benefits
- Annuity protection lump sum death benefits

Lump sum death benefits paid after age 75 are subject to Income Tax, even within the allowances. Income Tax applies to lump sums taken above the allowances prior to age 75.

TAX PAYABLE ON THE NON-TAX-FREE BENEFITS

Benefits that exceed the Lump Sum Allowance or the Lump Sum and Death Benefit Allowance are liable to Income Tax at the recipient's marginal rate, in the same way as the 'income' parts of any benefits taken, such as an annuity, or any taxable elements of income taken under FAD or UFPLS.

When we talk about a 'marginal rate' of Income Tax, this means the amount being paid out is added to the recipient's income and taxed accordingly. As an example, if the recipient was tax resident in England and had income of £60,000.00 and received £20,000.00, the whole £20,000.00 falls within the higher rate Income Tax band in the current tax year and will be taxed at 40%.

There is no change to the tax paid if death benefits are paid to a Trust and not directly to a beneficiary, as long as this is within two years of death. Trust taxation is usually quite complex, however.

HOW DOES THE LUMP SUM AND DEATH BENEFIT ALLOWANCE WORK?

As with other changes made by the Act introducing these new allowances, the rules around the payment of death benefits remain mostly unchanged by the Lifetime Allowance's abolition. For example, pension death benefits still need to paid out within two years (to preserve favourable tax treatment), and the tax treatment of benefits pre- and post-age 75 will still be the same, although Inheritance Tax will be due on pension funds before any Income Tax is payable from 6th April 2027.

What has changed is that, from 6th April 2024, tax-free lump sum benefits are now tested against the deceased's Lump Sum and Death Benefit Allowance, rather than the Lifetime Allowance.

It is important to note that if 100% of the Lifetime Allowance has been used before 6th April 2024, the Lump Sum and Death Benefit Allowance is automatically set to zero.

Benefits in excess of the Lump Sum and Death Benefit Allowance are taxed at the recipient's marginal rate of Income Tax.

However, it should be noted that HMRC has confirmed that for lump sum death benefits paid from funds crystallised by individuals before 6th April 2024, who die under the age of 75 after 6th April 2024, these benefits will not be tested against the Lump Sum and Death Benefit Allowance, as they would have been tested within the old the Lifetime Allowance regime.

HMRC has confirmed that it is up to a person's Personal Representatives to notify HMRC if a chargeable amount has arisen, and HMRC will calculate the tax due:

[HMRC - Lifetime allowance guidance newsletter – December 2023 - 7. Lump sum death benefits]

Unfortunately, this means HMRC will not be able to tell the personal representatives how much tax is due until the end of the tax year in which the charge arises.

The new regime may require some further amendment and guidance as it is used in practice, to be communicated by further HMRC newsletters.

HOW ARE BENEFITS TAKEN BEFORE 6TH APRIL 2024 TESTED AGAINST THE NEW ALLOWANCES?

To calculate the Lump Sum Allowance already used, a factor of 25% is applied to the percentage of the Lifetime Allowance (£1,073,100.00) used by the benefit crystallisation. The process therefore automatically assumes that 25% was paid tax-free.

For example, your remaining Lump Sum Allowance would be calculated as:

£268,275.00 – (25% x previously used % of Lifetime Allowance on 5th April 2024 x £1,073,100.00).

Again, this figure of £1,073,100.00 may be higher for individuals holding a Lifetime Allowance protection certificate entitling them to an enhanced value.

- No Serious Ill-Health Lump Sum has been paid

  To calculate the Lump Sum and Death Benefit Allowance already used, if no **Serious Ill-Health Lump Sum** has been paid, the same calculation applies.

  Remaining Lump Sum and Death Benefit Allowance = £1,073,100.00 – (25% x previously used % of Lifetime Allowance on 5th April 2024 x £1,073,100.00).

If a Serious Ill-Health Lump Sum has been paid, the full amount of Lifetime Allowance used is deducted from the Lump Sum and Death Benefit Allowance.

- Serious Ill-Health Lump Sum has been paid

  To calculate the Lump Sum and Death Benefit Allowance already used, when a Serious Ill-Health Lump Sum has been paid:

  Remaining Lump Sum and Death Benefit Allowance = £1,073,100.00 – (previously used % of Lifetime Allowance on 5th April 2024 x £1,073,100.00).

TRANSITIONAL TAX-FREE AMOUNT CERTIFICATES (TTFACS)

If an individual can provide evidence that a lower level of tax-free benefits was previously paid (lower than the normal 25%), or any benefits were crystallised where the Lifetime Allowance was below £1,073,100.00, they can request a **Transitional Tax-Free Amount Certificate**. They must do this before their first Relevant Benefit Crystallisation Event after 6th April 2024.

A Transitional Tax-Free Amount Certificate shows the amount of the individual's lump sum transitional tax-free amount, and the amount of the individual's lump sum and death benefit transitional tax-free amount.

The certificate must contain the following information:

- The individual's name, address and National Insurance number
- The individual's Lifetime Allowance previously-used amount expressed as a percentage of the standard Lifetime Allowance at the time the benefit was taken
- The amount the scheme administrator is satisfied is the individual's lump sum transitional tax-free amount, and
- The amount that the scheme administrator is satisfied is the individual's lump sum and death benefit transitional tax-free amount

Benefits crystallised prior to 6th April 2024 are valued and deducted from the two new allowances. In most cases, the valuation will give a reasonably accurate figure.

However, in certain situations the valuation may not be accurate and could result in the remaining Lump Sum Allowance and Lump Sum and Death Benefit Allowance being reduced by more than they need to be (for example where less than 25% of the fund was paid tax-free). Where that is the case, applying for a Transitional Tax-Free Amount Certificate will ensure the reduction in the available remaining allowances is for the correct amount.

Some of the circumstances where a Transitional Tax-Free Amount Certificate will help the individual are:

- If any benefits were crystallised when the Lifetime Allowance was below £1,073,100.00.
- Transfer to a Qualifying Recognised Overseas Pension Scheme (QROPS).
- A Serious Ill-Health Lump Sum was paid.
- If less than 25% tax-free cash was paid because:
    - Guaranteed Minimum Pension (GMP) restricted the tax-free cash.
    - The crystallised benefits included a disqualifying pension credit.
    - It was a defined benefit scheme, and the tax-free cash taken was not 25% of the benefit's value.

An example may help explain this.

Sophie took her benefits of £750,000 in 2015/16 and used 60% of her Lifetime Allowance. In the 2015/16 tax year, the Lifetime Allowance stood at £1,250,000.

The standard calculation would be - 60% x £1,250,000 x 25% = **£187,500** paid tax-free.

However, part of her benefits included a disqualifying pension credit of £400,000, none of which could be paid tax-free. This meant the actual tax-free cash paid was:

£750,000 - £400,000 = £350,000 x 25% = **£87,500**.

Sophie is eligible to apply for a Transitional Tax-Free Amount Certificate to allow her to receive a higher Lump Sum Allowance, on account of the fact that she was not able to take her maximum entitlement to tax-free cash on the fund that was crystallised prior to 6 April 2024.

To apply for a certificate, an individual has to be a current member of the pension scheme they are asking to produce the certificate, or, the Personal Representative of a deceased scheme member can apply to a scheme the deceased was a member of when they died.

The certificate must be produced within three months of the request.

The request must be accompanied by complete evidence as to the amount of the individual's **Lump Sum and Death Benefit Transitional Tax-Free Amount**.

Complete evidence, in relation to an individual's Lump Sum and Death Benefit Transitional Tax-Free Amount, means evidence of:

- Each lump sum (if any) to which the individual has become entitled, and
- Each lump sum death benefit (if any) that has been paid in respect of the individual, which is comprised, or any part of which is comprised, in the individual's lump sum and death benefit transitional tax-free amount

A pension scheme can refuse to produce one. The most likely reasons would be:

- They believe they have not received complete evidence, or
- There has been a relevant benefit crystallisation event since 5th April 2024.

It is important to note that where someone has a pre-commencement pension but has not had a benefit crystallisation event between 5th April 2006 and 6th April 2024, they cannot apply for a Transitional Tax-Free Amount Certificate.

Different rules apply for individuals with a protected retirement age of under 55 and we will advise accordingly if this is the case.

If a Transitional Tax-Free Amount Certificate is applied for, it must subsequently be used, even if this actually results in lower allowances being available. Therefore, care should be taken in deciding whether an application is appropriate.

INHERITANCE TAX ON PENSIONS

The October 2024 Budget announced that pensions would become subject to Inheritance Tax from 6th April 2027, whereas on death before that date, pension benefits can normally be paid free from Inheritance Tax. The Inheritance Tax exemption will continue to apply to pensions paid to a spouse or civil partner, but otherwise pension funds passed on after death will be subject to Inheritance Tax at up to 40% of their full value.

The amount that is subject to Inheritance Tax will depend on the value of the pension at that time, the value of the other transfers deemed to be made on the same individual's death, and the Nil Rate Bands available.

The Inheritance Tax due will be apportioned between the pension benefits and the rest of the estate and that the remaining pension funds will still be subject to the same Income Tax treatment as describer earlier, based on their value after Inheritance Tax has been deducted.

This change is likely to make spending pension funds during your lifetime much more attractive than is currently the case, and it may affect the way your assets are used to fund your retirement. In many cases, it may be preferable to start drawing money out of your pension to give away, ideally within the regular gift exemptions available, to try to pass on as much as you can to your beneficiaries free from Inheritance Tax, where this money is not needed for your own lifetime needs.

DISCLAIMERS

The content of this document is for information only. It does not represent personal advice or a personal recommendation and should not be interpreted as such. Please do not act on any part of it without first having received individual independent financial advice.

The material is not intended as an offer or solicitation for the purchase or sale of any financial instrument.

The material is not intended to provide, and should not be relied on for, accounting, legal or tax advice, or investment recommendations.

Past performance is not a guide to future performance and may not be repeated.

The value of investments and the income from them may go down as well as up and investors may not get back the amounts originally invested.

The information is based on our understanding of current legislation. Tax rules could change in the future. The value of tax reliefs will depend on an investor's personal circumstances. There cannot be any guarantee that companies that qualify today will remain qualifying for the tax reliefs of these products in the future.

With most stock-market linked investments, your capital is at risk.

SERVO

PRIVATE WEALTH

Servo Private Wealth

First Floor, Unit 8 Bridge Road,
Haywards Heath, West Sussex, RH16 1TX
01444 715200

www.servoprivatewealth.com