Pension Freedom

Making sure you make the right decisions about your future

The freedom granted by the pension changes is good news for all pension savers. However, the increased options could lead to many people making the wrong decisions and paying unnecessary tax, making professional financial advice all the more important.

Your choices at retirement

Freedom over how you take your tax free cash. Most people can take up to 25% tax-free cash from their pension. You can either take the tax-free cash all in one go or have a portion of any withdrawals you make paid tax free. So, if, for example, you have a pension fund worth £100,000, you will have the choice of:

— Taking £25,000 tax-free cash all at once, with any subsequent withdrawals taxed as income.

— Making a series of withdrawals over time, receiving 25% of each withdrawal tax free. For instance, if you take lump sum withdrawals of £1,000 a month you would receive £250 of each payment tax free with the rest subject to income tax. This could help you manage your tax liability.

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Flexible access from age 55

Those aged at least 55 have freedom over how they take an income from their pension, over and above any tax-free cash. The choices on retirement will be to:

— Take the whole fund as cash in one go.

— Take smaller lump sums, as and when needed.

— Take a regular income.

The latter could be via income drawdown, where you draw directly from the pension fund which remains invested, or via an annuity, where you receive a secure income for life.

Any withdrawals in excess of the tax-free amount will be taxed as income at your marginal rate. So, if you are a basic-rate (20%) taxpayer, any income you draw from your pension will be added to any other income you receive (e.g. your salary). This could push you into the higher (40%) or even top-rate (45%) income tax bracket.

Choosing to take the pension out in stages, rather than in one go, could help you manage your tax liability. It should also be possible to take the tax-free cash straightaway and the taxable income via income drawdown at a later date.

Restrictions on how much you can contribute to pensions

Pension contributions are subject to a £40,000 annual allowance and specific contribution rules.

However, if you make any withdrawals from your pension in addition to any tax-free cash, contributions to defined contribution plans are restricted to £4,000

For every £2 your adjusted income goes over £240,000, your annual allowance for that year drops by £1. The drop is limited so that the minimum tapered annual allowance you can have is £4,000.

Retirement ages to increase

The age at which you can draw your pension is currently 55. This is set to increase to 57 from 2028 and, from then, will increase in line with the rise in the State Pension age, albeit remaining 10 years below.

Tax treatments

The tax treatment of any pension you pass on will depend on certain factors including the age in which you die:

— If you die before age 75, any money left in your pot will be passed onto your beneficiaries tax free in most circumstances. This can then be taken as a lump sum or as retirement income.

— If your pension hasn't been touched and you die before age 75, your beneficiaries may have to pay tax if they do not use the money within the two years of the provider being made aware of the death.

— If you are 75 or older when you die, the pension money will be taxable. Depending on how and when your beneficiaries take the money, the tax charge may vary.

There are three options for your beneficiaries if you die after 75:

— Take the whole fund as cash in one go, this will however be taxed at your beneficiary's marginal rate.

— Take a regular income through an income drawdown or an annuity. The tax on these will be charged at your beneficiary's marginal rate.

— Periodical lump sums through income drawdown. The lump sum payments will be considered as income and therefore will be subject to income tax at your beneficiary's marginal rate.

Unlike previous years, the pension changes have allowed the funds to not only support the people in retirement, but it can enable one generation to support the next and beyond.

If you're looking to access your pension or you'd like advice on your new pension choices, please get in touch.

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