R04 2020/2021
Decumulation phase
Part 1: Taking the benefits, an overview

This first part will try to give an overview of the whole process without going into too much detail. It will only cover the options in a money purchase arrangement.

The milestones are to:

- Understand when a member can access an uncrystallised fund.
- Know in outline the main options a member has in accessing their benefits together with how these are taxed
- Know in outline the options open to other persons on the member's death and how these are taxed

When benefits can be taken

In the accumulation phase the benefits are said to be **uncrystallised** or in plain English, unused. The fundamental rule is that the member can normally only access an uncrystallised fund or take benefits once they are above the minimum pension age (MPA) which is currently 55.

As ever there are a few exceptions to this rule.

- Benefits can be accessed by the member before MPA if they qualify for an **ill health pension.**
- Benefits can also be accessed at any age if the member qualifies for a **serious ill health lump sum payment.**
- Some individuals may be allowed to take benefits before MPA because HMRC have agreed an earlier retirement age.

Once the member has reached MPA or qualifies under ill health (not serious ill health) benefits can be taken in several ways. The member does not need to crystallise all the fund but can take as much or as little as they require.

Ben has an uncrystallised fund of £400,000. On reaching MPA he could crystallise £100,000 leaving the remaining £300,000 uncrystallised.

How benefits can be taken

The main options open to the member when accessing benefits are:

- Purchase a lifetime annuity
- Designate the crystallised fund as a Flexible Access Drawdown Fund (FAD)
- Take an Uncrystallised Fund Pension Lump Sum (UFPLS)
- Use the small or stranded pots facility

With a lifetime annuity and FAD, the member can also take 25% of the crystallised fund as a tax-free **Pension Commencement Lump Sum (PCLS)**

Susan crystallises £200,000. She can take £50,000 as a PCLS and use the remaining £150,000 to buy a lifetime annuity or designate it as a FAD.

Before moving on let's clarify the key differences between a lifetime annuity and a FAD.

- A lifetime annuity is a purchase where the member uses the whole or part of their pension fund to buy a guaranteed income for their (and possibly another person's) life. The member knows there is no danger of the income stopping before they die. On the other hand, the capital used to buy the annuity is lost so cannot be passed on to anyone else.
- With a FAD fund the member can take as much or as little as they like. There is of course a danger that the fund will be exhausted before the member dies. If there is any money remaining in the FAD on the member's death this can be passed on.

A PCLS cannot be taken in isolation. Someone who has an uncrystallised fund of £100,000 cannot take £25,000 as a PCLS and leave the remaining £75,000 uncrystallised. It must be used to buy a lifetime annuity or be designated as a FAD

A **UFPLS** is an ad hoc withdrawal from an uncrystallised fund. There is no separate PCLS but 25% of each withdrawal is subject to tax.

Melissa takes £100,000 of her £600,000 fund as a UFPLS. £25,000 would be tax free and £75,000 would be subject to income tax. The remaining £500,000 remains uncrystallised

In addition, a member can take benefits under the small/stranded pots rules where an individual fund is below £10,000. As with UFPLS 25% is tax free and 75% is taxable.

Note that these are not either/or choices and it's possible to use a combination of them.

Jane's main fund is £160,000. She decides to take £40,000 as a PCLS and uses £80,000 of the remainder to buy a lifetime annuity and designate £40,000 as a FAD

- A Lifetime Annuity is described as a **Secured Benefit.**
- A FAD and a UFPLS are **Flexible Benefits** and may result in the member being subject to the Money Purchase Annual Allowance (MPAA)

Taxation of member benefits

This is generally straightforward. Apart from the PCLS and 25% of a UFPLS all income from a lifetime annuity or a withdrawal from a FAD is classed as the member's non-savings income.

Income from a lifetime annuity will be paid as a regular amount with tax deducted. Normally the provider will have the member's tax code so the correct amount of tax will be taken.

With a FAD the member can take as much or as little as they like. Tax is only charged when a withdrawal is made.

Tamsin designated £200,000 into a FAD in 19/20 but made no withdrawals, so no tax was due. In 20/21 she withdrew £10,000 so assuming this is all in basic rate £2,000 tax would be due.

At the start of this section a further option, a serious ill health lump sum payment was mentioned. This can be paid if the member's life expectancy is less than 12 months and is tax free if crystallisation takes place before 75. The payment is subject to tax based on the member's situation if crystallisation takes place after 75.

Survivor benefits

All pensions allow benefits to be paid to someone else on the member's death.

A lifetime annuity can only benefit a survivor if a joint life annuity was purchased and/or there were some type of guarantee included. The income from a joint life annuity will be paid for the rest of that person's life. Similarly, any guaranteed income or lump sum can be paid to a designated person.

A wider range of options are available if:

- The member had uncrystallised funds on their death.
- The member had funds in a FAD on their death

Here a person or persons nominated by the member before their death can choose to take the fund as:

- A cash lump sum
- A survivor's lifetime annuity
- A survivor's FAD.

These will be looked at in much more detail in a later part.

Taxation of survivor benefits

This is very straightforward. All benefits will be tax free in the hands of the recipient if:

- The member was under 75 at date of death and the scheme was notified within two years of death

The benefits will be taxed as the beneficiary's non-savings income if:

- The member was over 75 at date of death.
- The member was under 75 at date of death but the scheme was not notified within two years of death

That concludes this part so you should now have an outline understanding of:

- Understand when a member can access an uncrystallised fund.
- Know in outline the main options a member has in accessing their benefits together with how these are taxed
- Know in outline the options open to other persons on the member's death and how these are taxed