R04 2020/2021
Decumulation Phase
Part 4: Flexible Benefits

This will deal with the remaining methods so the milestones are to understand:

- The difference between drawdown and annuities.
- The principles of flexi access drawdown
- How UPFLS works
- The main issues in managing flexible income
- The options with pre April 2015 drawdown arrangements
- When benefits can be taken under small pots rule
- When the Money Purchase Annual Allowance will be triggered

Whilst an annuity guarantees a fixed level of income for life the package cannot be renegotiated.

- If rates rise the annuitant can't benefit from these.
- If a joint life annuity has been purchased and the second life dies first no one else can benefit. Even if the second life outlives the purchaser the pension cannot be passed on.
- There is also a real possibility that you may receive less in income than the purchase price.

The alternative is to draw money directly from the fund and two methods are available for benefits crystallised after April 6 2015:

- Flexi Access Drawdown (FAD)
- Uncrystallised Fund Pension Lump Sum or UFPLS.

Both offer more flexibility than an annuity but cannot provide a guaranteed lifetime income.

Flexible Access Drawdown

Typically the member would take 25% of the crystallised amount as a PCLS and designate the remainder as a FAD. They can then withdraw any amount they wish either on a regular or on an ad hoc basis. The member also has the option of using any undrawn funds in the FAD to buy a lifetime annuity at some point in the future.

The withdrawals can be taken directly from the FAD, in effect using it as a bank account, or through buying short term annuities payable for a maximum of 5 years. You cannot take a PCLS from these as that was taken when the FAD account was set up.

Further uncrystallised funds can be transferred into an existing FAD but no further input, that is new money can be placed into the FAD fund. Further input to other pension arrangements are permitted although these will be subject to the MPAA.

All withdrawals from a FAD are subject to income tax at the member's non-savings rate. This is where care needs to be exercised since a large withdrawal could take someone into a higher tax rate band. If a basic rate tax payer took £200,000 from a FAD part of it would be taxed at 45% and they would lose all their personal allowance for that tax year.

Andy has a fund of £200,000 and takes £50,000 as a PCLS and puts £150,000 into Flexi Access. He then withdraws all of this.

If his Income for the year before this event is £20,000 his tax for 20/21 would be:

Income	£20,000
Less PA	£12,500
	£7,500 @ 20%= £1,500

Taking all the FAD will increase his income to £170,000 so he will lose all his personal allowance.

His total tax liability will be:

£37,500 @ 20% =	£7,500
£112,500 @ 40% =	£45,000
£20,000 @ 45%	£9,000
	£61,500

FAD gives far more flexibility over how benefits are taken compared to an annuity. This can be useful to someone who carries on working on a self-employed basis and whose earnings fluctuate.

Helen sets up a consultancy business after leaving full time employment. In 19/20 she earned £50,000 and takes nothing from her FAD

In 20/21 she decides to take on less work and withdraws £30,000 from the FAD

A FAD can also be used to release the PCLS

George needs £25,000 as a lump sum but wants no additional income at this stage. He could crystallise £100,000 taking £25,000 as the PCLS and leaving £75,000 in the FAD account untouched.

A greater lump sum could be taken although part of it would be taxed. If George needed £50,000 he could take the additional £25,000 from the FAD. Assuming he is a higher rate tax payer he would have to withdraw £41,666.

UFPLS

A UFPLS is a withdrawal from an uncrystallised fund in which 25% of the amount taken is tax free and the remaining 75% taxable. The remaining fund remains uncrystallised. It is not possible to take a UFPLS from a FAD account.

David takes a £100,000 UFPLS from his fund out so £25,000 will be tax free and the remaining £75,000 taxable.

The remainder of the fund remains uncrystallised so David can continue to contribute and use it at any time to buy a lifetime annuity, put it into FAD or do another UFPLS. As it is uncrystallised it offers the prospect of taking a further 25% of the fund as a PCLS.

Having taken a UFPLS of £100,000 David has still got a £300,000 uncrystallised fund. If he puts that into a FAD at that point he could take £75,000 as a PCLS. If he leaves it uncrystallised and it increases to £400,000 he could then take £100,000.

This is a key difference between UFPLS and FAD. With Flexi Access you crystallise all or part of the fund taking up to 25% as a PCLS and then withdrawing cash from this as you wish. With UFPLS you simply take a withdrawal from the uncrystallised fund.

As we have seen 75% of a UPFLS is taxable but unless the pension provider has the member's tax code they must apply what is known as a month 1 basis. This means that even though the withdrawal may be a one-off payment HMRC will treat it as the first of a series of regular monthly payments. This will result in an overpayment of tax which can be reclaimed but it may cause cash flow problems for the individual. This also applies to withdrawals from a Flexible Access Account.

For a £60,000 UFPLS, £15,000 will be tax free and the remaining £45,000 is taxable. The administrator must make an immediate tax deduction of £18,605

1/12th of PA	£1,042	0%	0
1/12th of basic rate band	£3,125	20%	£625
1/12 of higher rate band	£9,375	40%	£3,750
Remainder	£31,458	45%	£14,156
Total			£18,531

Managing flexible income

Assuming the member wants to ensure the fund will produce a lifetime income then the performance of the fund must be constantly monitored and adjusted. This contrasts with a lifetime annuity where once it is purchased the income will arrive every month in the member's bank account and no further work is required.

Sustainable income

The main risk in moving into FAD (or using UFPLS) is that the fund could be exhausted whilst the individual is alive. In simple terms the investment growth should be sufficient to replace the income withdrawn.

Pre-April 2015 drawdown

Some form of Drawdown has been available since 1995. Immediately prior to April 2015 there were two methods:

- Capped Drawdown
- Flexi Drawdown.

Both ceased to be available for new arrangements after 5 April 2015. What happened to any existing cases can be summarised as follows:

- Flexible Drawdown arrangements automatically became FADs on April 6 2015.
- Capped Drawdown arrangements could continue and it's possible to transfer new uncrystallised funds into an existing arrangement provided the new provider allows this. The member can however elect to convert it to a FAD and this will occur automatically if more than the maximum amount is withdrawn.

The mechanics of capped drawdown

Capped Drawdown limits the maximum that can be taken in a plan year. This is calculated using the Government's Actuary's Department or GAD rate. The GAD table is a grid with the vertical axis showing the individual's age and the horizontal axis medium term Gilt Yields

The cross-over point shows the income for a £1,000 lump sum. For a 60 year old and 2.5% yield the rate would be £49 per £1,000. If the amount going into CD was £200,000 this would produce £9,800. However, the maximum is 150% of the GAD rate so in this case it would be £14,700.

The administrator calculates and informs the member of the maximum amount. The member is then free to take any amount between nothing and the maximum. The administrator must recalculate the maximum amount every three years up to age 75 and then annually.

As mentioned earlier a member in Capped Drawdown arrangement can transfer further uncrystallised funds into it. This will trigger an immediate review which will usually increase the maximum amount. This can be taken immediately but the date of the next three year review will stay the same.

If part of the fund was used to buy a lifetime annuity or is subject to a pension sharing order this will also trigger an immediate review. As funds have been withdrawn the maximum

withdrawal will reduce but this will only take place at the next plan anniversary date. The date of the next three year review will remain the same.

Someone in CD who wishes to convert to Flex Access has to complete an application form and this must contain a warning that by doing this the Money Purchase Annual Allowance will apply.

Small Pots

There is one final way of taking benefits and that is under the small pots rule. This is designed to allow those with small uncrystallised funds to access all their benefits without using FAD or UFPLS.

The advantage of using this method is that it does not use up any of the individual's Lifetime Allowance

For a non-occupational scheme, the maximum amount to qualify for this is £10,000 and this can be done on three separate occasions. This means that someone with a Personal Pension with a fund of up to £30,000 could split this into three separate plans and take it all as cash. The first 25% is tax free and the remainder will be taxed as non-savings income.

For occupational schemes the limit is again £10,000 and there is no limit on the number of times this can be done. The tax rules are the same.

Prior to the 15/16 tax year trivial commutation could also be used if the total value of all benefits was less than £30,000. This has been superseded by UPFLS so if someone had a fund of £24,000 and could not use the small pots rule, this could all be withdrawn using UPFLS.

Money Purchase Annual Allowance

Taking benefits flexibly can trigger the Money Purchase Annual Allowance. This reduces the Annual Allowance to £4,000 for any future MP input.

The following events will trigger the MPAA:

- Taking a withdrawal from a flexi access drawdown fund
- The automatic conversion of a pre April 2015 Flexible Drawdown fund to a FAD
- Converting a capped drawdown fund to a FAD either because it was requested by the member or because more than the maximum amount was withdrawn
- The payment of a UFPLS
- Purchase of a **flexible** annuity
- The payment of a stand-alone lump sum from a money purchase arrangement to a member who has primary protection with a protected lump sum of more than £375,000.

MPAA is only triggered by the action of a member. The actions of a beneficiary taking benefits on the death of the member will never result in the MPAA being applied

MPAA will not be triggered by the member:

- Purchasing a lifetime annuity
- Taking a pension from a defined benefit scheme
- Taking payments from capped drawdown that are less than the maximum permitted.
- Taking benefits under the small or stranded pots rules.

Note that moving into Flexi access does not in itself trigger the MPAA so if the member takes a PCLS, puts the remainder into FAD but takes nothing they won't be subject to the MPAA. This only happens when the first withdrawal is taken.

The MPAA comes into effect the day after the trigger event takes place except when the former flexible drawdown was converted to FAD on 6 April 2015. The MPAA for that individual came into immediate effect on April 6 2015.

Being subject to the MPAA means that the TPI to money purchase arrangements is limited to £4,000 This is for life unless legislation is changed. A further restriction is that carry forward is not available.

Karen is subject to the MPAA for the whole of 19/20 and had a TPI of £1,000. In 20/21 she cannot carry forward the unused amount of £3,000.

Prior to the MPAA coming into effect the individual has the standard Annual Allowance plus any available carry forward.

Tim had an input into a Personal Pension of £25,000 on September 1 2020. At that point he is not subject to the MPAA. On October 31 he takes a UFPLS and the following day, November 1 2020 becomes subject to the MPAA. Between that date and April 5 2021 he can have a further input of £4,000 into a money purchase pension without incurring an annual allowance charge.

That concludes this chapter so you should now know:

- The difference between drawdown and annuities.
- The principles of flexi access drawdown
- How UFPLS works
- The principle issues in managing a flexible income.
- The options with pre April 2015 drawdown arrangements
- When benefits can be taken under small pots rule
- When the Money Purchase Annual Allowance will be triggered