R04 2020/2021
Decumulation Phase
Part 5 Phased retirement

This short part looks at how phased retirement works. There is usually one question on this in the R04 paper

The milestone is to understand:

- How to calculate how much needs to be crystallised to produce a given level of income using a lifetime annuity, drawdown and UPFLS.

There is no need or requirement to crystallise an entire fund in one go. Those who wish to stagger their retirement, particularly the self-employed, have often taken their funds in stages as they gradually run down their work.

With all crystallisation methods 25% of the crystallised amount is tax free either as a PCLS or simply 25% of the amount of a UPFLS. If this is not needed for capital, a tax efficient income can be produced by taking phased income. In R04 you may be asked how much needs to be crystallised to produce a set amount of net income.

There are different methods but generally the easiest is to calculate how much income crystallising £1,000 will produce. In all the following examples the target is £20,000 for a higher rate tax payer. The final answers have been rounded but in the exam you should work it out to two decimal places.

Lifetime Annuity

You will be given the annuity rate which we'll say is £65 per £1,000. Crystallising £1,000 gives £250 tax free cash and the remaining £750 would buy a lifetime annuity. At £65 per £1,000 this would produce £48.75 gross income but 40% tax is due so this is reduced to £29.25. Therefore £1,000 produces £279.25 net income.

Next divide the target income of £20,000 by £279.25 and multiply by 1,000 which will give you £71,620. The following year the tax free element would have been used up but the income from the annuity, £3,491 would remain.

FAD and UPFLS

If FAD is being used then designating £1,000 would give £250 tax free and £750 which would be taxed at 40% giving £450 and a total of £700. To produce £20,000 net income you would have to crystallise £28,571. You could of course also designate £80,000 into FAD taking the £20,000 as tax free income.

The calculation using UPFLS is the same and you would need to crystallise £28,571 since £7,142 would be tax free and the remainder subject to tax.

Capped Drawdown

The question would give you the GAD rate which we'll say is £65 per £1,000.

For each £1,000 £250 can be taken as tax free cash with the remaining £750 producing £48.75 as 100% of GAD. However, 150% can be taken which increases this to £73.12. Applying 40% tax reduces this to £43.87, a total of £293.87. Applying the same method as used previously crystallising £68,057 would produce £20,000 net income. £51,042 of this would have initially have been designated as a capped drawdown and £4,976 withdrawn leaving £46,066 in the drawdown account.

You should now understand:

- How to calculate how much needs to be crystallised to produce a given level of income using a lifetime annuity, drawdown and UFPLS.