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RETIREMENT OPTIONS/BENEFITS – APRIL 2025

The way that pension benefits may be drawn changed significantly in April 2015. Following this, additional significant changes were made by the Chancellor, Jeremy Hunt MP, in March 2023. An inheritance tax change is also now planned for April 2027 by Rachel Reeves MP.

The way you draw your pension benefits remains topical and is important to ensure that you get real value from your pension arrangements. This is why it is important that you consider the notes in this document carefully

Legislation can and does change and you should check your individual position before taking any action

State Pension benefits do not fall under private pensions legislation

It should be clearly noted that the principle that a pension should provide you with income for the rest of your life does not change. We are all usually living longer, and this is illustrated by the way that the age from which you can draw your State Pension has gradually increased for those born on or after April 1960 and will reach 67 by 2028. Further increases are planned for those born on or after April 1977. Therefore, planning your pension benefits, along with other assets that you hold, for both your immediate and longer-term needs is important to take this potential longevity into account.

With this in mind, the key points that should be considered by each client before they make any important decisions are as follows:

- *Normally 25% of any undrawn money purchase pension fund can be drawn as tax free cash.*
- *There is now no restriction on income levels that you can draw from your money purchase pension(s).*
- *Income can be phased to meet your needs.*
- *Any income taken is still subject to income tax. You should be aware of higher rate income tax charges if you take significant sums from your plan.*
- *Under current legislation, there is normally no tax charge on your money purchase pension fund on your death before the age of 75.*
- *On your death after the age of 75, death benefits will be taxed at the recipient's highest marginal income tax rate, whether taken as a lump sum or as a regular income.*

This is not an exhaustive list. However, it provides a flavour of the opportunities to be considered.

Under current rules, pension benefits can (normally) be taken at any time after the minimum age of 55. This minimum age will increase to 57 from 06 April 2028 and thereafter is expected to be held at a level of 10 years below State Pension age. In addition, you no longer have to purchase an annuity at age 75 with your pension savings.

You will be able to draw your pension and continue working. This allows individuals to take their benefits whilst continuing to work, for example part time, as they move more gradually to retirement. You may want to consider any effects on your income tax if this is the case, as the combination of earned income and pension income may increase your overall tax liability, and on your ability to save further into a pension, as your annual allowance may be reduced if you draw pension income.

There is no limit on the taxable pension income in retirement that can be taken. For tax free cash, as described later, there are restrictions on the maximum that can be taken.



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The pension benefits that you will receive from your personal pension depend on the fund values finally available. The income provided by your pension fund in retirement is liable to taxation as earned income.

From an administration perspective, it should be noted that some older pension plans do not offer the flexibility noted above. This may mean that, if appropriate, changes to provider may be required if you do want to use the full flexibility available.

As a very approximate guide, it may take four to six weeks to access tax free cash and income from a pension fund. This is only an estimate.

YOUR RETIREMENT BENEFIT OPTIONS

You can choose the type of income/benefit you take. This could be:

- To draw tax free cash and take the balance, or a proportion, of the fund as cash, subject to your highest marginal income tax rate.
- To draw the tax-free cash and leave the remaining fund unchanged.
- To purchase an annuity (fixed term and whole of life options are available).
- To phase your retirement by purchasing annuities/taking income on a year-by-year basis using sections of the fund, while leaving the balance invested.
- To take income from the invested fund on a year by year or ad hoc basis ('flexible drawdown').
- Combination of the above (e.g., a mixture of annuity and income drawdown).

Below are more details on some of these options.

ANNUITY PURCHASE

Historically, the most common way to take retirement benefits under pension plans was to take the maximum tax-free cash sum available and use the balance of your fund to buy an annuity. An annuity is a level or increasing income for the rest of your life and is taxed in the same way as salary.

An annuity gives you payments at stated intervals (monthly as an example) until your death. You give your pension fund (in whole or in part) either to the insurance company that you have built up your funds with or to another on the open market to purchase as large a taxable income as possible, either for the rest of your life (sometimes called the Open Market Option / OMO), or for an agreed fixed term (as an example 5 years). There are several types of annuities, which can include guaranteed, value-protected, smoker and impaired life annuities.

Annuity rates have been historically low primarily because we are living longer; however, rates have risen significantly over recent years, owing to economic factors. Annuity rates will continue to change over time and may fall as well as rise. Please check current terms.

Guarantees & Dependants' Pensions

The cheapest annuity you can buy, i.e., one that will give you the highest starting income in return for your pension fund, is one that pays a level income for the rest of your life, with no additional benefits. However, when you die, no further income is payable even if you die after receiving only a few income payments.

At a cost, you can add extra benefits to your annuity at the outset, and these can include a guaranteed period of, say, five years, which will ensure that income payments continue for the fixed period after you buy the annuity, even if you die before then. You are also able to purchase an escalating annuity which will mean that your income increases in payment and may help keep pace with price increases and the effects of inflation.

Where married or in a civil partnership (or with a financial dependant), you may decide to build into the annuity a spouse's pension that will continue to be paid in the event of your death. Typically, the pension will reduce by one half or one third in this event.

Guaranteed annuities simply purchase an income based on the annuitant's age, normal life expectancy and the level of gilt yields (on which annuity rates are based). These guaranteed annuities may be improved upon for 'impaired lives', which are subject to medical evidence, because of reduced life expectancy, and this is an area where there could be an improvement in the basic annuity rate available at the time. This might be relevant for those who have past ill health situations, continuing health conditions, and/or are smokers / ex-smokers.

Advantages of an Annuity

- You have immediate access to part or all of your tax-free cash, as required.
- You can choose between a level or increasing income for life with the rest of your fund.
- The income is guaranteed to be payable for at least the rest of your life (this does not apply to investment linked annuities).
- Your pension income can be guaranteed for a certain period so that payments will continue for a fixed period after your death.
- Depending on how long you live you may get back more than the amount you used to buy the annuity in the first place.
- They are relatively simple plans and usually do not involve on-going planning.

Disadvantages of an Annuity

- Annuity rates may not be favourable when you buy your annuity.
- The levels of income and annuity features selected are fixed at the outset and cannot be changed even though your future income requirements, personal circumstances or health may change.
- It is possible that you may not get back the amount of money you used to buy the annuity if you die early.
- Options selected at the outset, which come at a cost, may not be used in practice. For example, if you choose a spouse's pension option and your spouse predeceases you, the cost of this benefit has been lost.

PENSION INCOME DRAWDOWN FACILITY

By using this type of facility, you can initially take the tax-free cash (again usually 25% of the fund) and the residual fund could be used to provide a taxable income if you choose.

Income drawdown is suitable for some clients who already have income or capital from other sources and do not need to maximise the income from their pension funds.

For most post-2015 plans, any annual withdrawal limit has been removed for defined contribution (money purchase) pension schemes. There is now normally no limit on the amount of income you can draw, noting that some income drawdown 'capped' plans are still in place. Usually, we would not recommend that the maximum income is taken, as one of the risks associated with income drawdown is that if the underlying fund does not perform well and the plan charges are high, the future income could be lower than if an annuity were purchased now. Indeed, the plan value could be extinguished in your lifetime.

If no income or minimum income is taken, there is a far greater opportunity for the fund to grow and, if you opt for an annuity in the future, it is likely that annuity income will be higher. However, you would have to bear in mind that you would not have enjoyed higher income in the previous years.

There are therefore risks involved in income drawdown.

- The fund may not grow as hoped and this could lead to an eventual shortfall in income in later years. The fund may run out of value in your lifetime.
- Annuity rates may fall further in the future and if an annuity is eventually purchased it could be lower than if one were purchased now.
- If maximum income is required, this route may well not be the most appropriate as the growth needed to maintain this income level could prove difficult to achieve. Normally to allow for realistic growth rates, you should be considering income in the region of 4.0% pa of the fund.
- A potential benefit of purchasing an annuity versus using income drawdown is the cross-subsidy from those annuitants dying early to those who live longer. 'Mortality drag' is the extra return that needs to be earned on investments within the drawdown contract to provide the same level of income as an annuity, as a result of this lack of cross subsidy.
- Any income provided will be taxed at your highest marginal income tax rate.

Death Benefits

One of the main attractions that income drawdown may have is the superior death benefits.

If you buy an annuity, then it is simply on your life / joint lives and there would usually be no return at all to your estate on your death beyond the guaranteed period that might be written into the contract. With income drawdown, the residual fund is available.

If you die before the age of 75 whilst taking income drawdown, or if the fund is uncrystallised (all still invested), your dependants will be able to receive the value of the remaining fund tax free. The person receiving the pension will normally pay no tax on the money they withdraw from that pension, whether it is taken as a single lump sum or accessed through income drawdown.

If you die over the age of 75 whilst taking income drawdown, or with uncrystallised pension funds, the beneficiary will be able to access the pension funds flexibly, at any age, and pay tax at their marginal rate of income tax.

Pension drawdown therefore gives you and your dependants far more flexibility in making use of the pension funds. However, this comes at a price and the price is that you lose the guarantee that is provided by a conventional annuity.

If you chose the income drawdown option, we would recommend that in the event of your death your fund should be nominated to financial dependants. This nomination can be updated, if needed, in the future.

Inheritance Tax

Currently, by concession, HMRC would not normally impose inheritance tax on pensions. However, from April 2027, inherited pensions will fall within the scope of inheritance tax. This may be important for your overall inheritance tax planning.

HMRC / OCCURRENCE OF DEATH WITHIN 2 YEARS OF DRAWING PENSION BENEFITS / POSSIBLE ADDITIONAL TAX CHARGES

We are aware that HMRC currently maintains a policy of investigating any pension transfers/withdrawals that occur within 2 years prior to death. HMRC will seek to ensure that the implemented transaction was not arranged to avoid any tax on the pension benefits affected. If, in their view, the transaction was to avoid tax, they may seek to apply an inheritance tax charge to the benefits drawn at a level of a further 40%.

You should be aware of this current position before proceeding.

OTHER ISSUES / TAX

HMRC LIFETIME ALLOWANCE / LUMP SUM AND DEATH BENEFIT ALLOWANCE: 2024/2025 CHANGES

Before the start of the tax year 2024/2025, there was an HMRC 'Lifetime Allowance' (LTA) for the maximum amount of all your pension savings. The LTA limit was £1,073,100 in the tax year 2023/2024, although the LTA tax penalty was removed, and has been abolished from the tax year 2024/2025 and replaced with the Lump Sum Allowance (LSA) of £268,275 and Lump Sum and Death Benefit Allowance (LSDBA) of £1,073,100. Those with HMRC protection may have had higher LTA limits applicable and these protections remain valid, providing they were in place prior to 15 March 2023.

Before the start of the tax year 2024/2025, testing of the LTA was carried out when benefits were drawn. How benefits were secured had an impact on how they were valued. Benefits were usually then tested again at age 75. From April 2024, only the non-taxable amounts of lump sums will be subject to a test against the LSA. Benefits above the LSA will be subject to tax at the individual's highest marginal rate.

For those who have drawn pension benefits prior to 06 April 2024, and therefore used part of their LTA, a standard calculation will be used to work out how much LSA remains. The LSA is reduced by 25% of the previously used LTA. This means that if 100% of the LTA was used prior to the tax year 2024/2025, the LSA is nil.

Importantly, however, where the actual amount of tax-free cash received was lower than the standard amount allowed, an individual may apply for a transitional tax-free amount certificate (TTFA). As an example, this may apply to those who have drawn benefits from a final salary/defined benefit plan that paid no, or minimal, tax-free cash. TTFA certification must be applied for and received before further pension benefits are crystallised.

SUMMARY

You can see from the above that planning to draw the benefits from your retirement plans can be a complicated subject. **Therefore, this text should not be treated as individual advice. Individual advice is only available based on your personal circumstances.**

The text above is based on our current understanding of legislation which, of course, can change. Please check that the rules detailed above are correct before making any financial decisions. Seek individual advice in your circumstances. No individual advice is provided in this document.

This document is based on our understanding as at April 2025.

Legislation can and does change and you should check your individual position before taking any action

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