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INDEPENDENT FINANCIAL SERVICES

An introduction to Phased Drawdown

What is Phased Drawdown?

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When you get to retirement, your pension fund can be used to provide an income in different ways and Phased Drawdown is a tax efficient way to access your pension without having to take the full 25% tax free lump sum. This leaves some of your pension completely untouched which also reduces the potential exposure of the funds to inheritance tax.

For example, if you want to retire gradually by reducing the hours you work, you can use your pension to ‘top up’ your income until you decide to stop work completely. This enables you to take your benefits over a number of years leaving some of your pension untouched.

Using Phased Drawdown you can target a specific level of net ‘income’ which consists of part tax free lump sum and part income (less tax at your highest rate). You can have a tax free lump sum of 25% of the amount you decide to take, with the remaining 75% moved into drawdown to provide you with the income. Alternatively, you could take the income via a Lifetime Annuity or Flexible Drawdown.

To illustrate how this works, consider the following example:

> John is a basic rate taxpayer with a fund of £200,000 and needs a net ‘income’ of £10,000. Following advice from his IFA it is decided that £30,000 of the pension fund needs to be ‘crystallised’ in order to realise this £10,000 net income.
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> Firstly a tax free lump sum of £7,500 is generated (25% of £30,000) with the remaining balance of £22,500 moved into drawdown to provide an income. After allowing for basic rate tax, the drawdown funds generate an income of £2,500 per annum. This results in the desired ‘net’ income of £10,000 (i.e. £7,500 + £2,500).
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> If John still needs an income of £10,000 the following year, he will need to crystallise another lump sum in order to provide him with £7,500 net which, added to his £2,500 drawdown income, would provide him with the £10,000 total.

This approach enables you to crystalise the minimum amount each year to provide your required income level.

What death benefits are payable?

As Phased Drawdown consists of two elements, i.e. the funds that are in drawdown, plus the remaining, uncrystallised funds, the death benefits payable would be:

- 100% of the uncrystallised pension fund paid as a lump sum, tax free, up to age 75. (In John’s case this would be £170,000 if he dies in the first year). After age 75, the lump would be subject to tax (currently 55%).
- 100% of the funds in drawdown paid as a lump sum less tax (currently 55%). In John’s case this would be £12,375 (£22,500 less 55%).

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To provide some flexibility for the lump sum payment, a Trust arrangement could be used to provide an income to your dependant(s) or even a combination of lump sum and income.

There are of course potential advantages and disadvantages to Phased Drawdown which are listed below and we strongly advise you to take professional advice before making a decision.

Advantages	Disadvantages
You do not have to take all your benefits at the same time.	If you require all your tax free lump sum.
A tax free lump sum can still be taken from the uncrystallised fund at a later date.	It is complex and requires regular reviews which incur costs
On death, the uncrystallised fund can pay a lump sum of 100% of the fund up to age 75.	The Lump Sum death benefits from the crystallised fund will be taxed at 55%
You can target an amount of net income required consisting of tax free lump sum and taxable income.	The fund is subject to investment risk
The pension fund still remains invested.	Annuity rates may decrease in the future
	Pre April 2006 protected tax free lump sums require all benefits under the scheme to come into payment at the same time.

For help and advice on Phased Drawdown or other ways to access your pension, please call us on: 01789 263257 or email: justask@jjfsltd.com