

# BENEFICIARY FLEXI-ACCESS DRAWDOWN

## What is it?

Flexi-access drawdown for a beneficiary works in a similar way to flexi-access drawdown for a member but without the age restrictions in relation to access. The beneficiary can take anything between 0% and 100% of the drawdown fund.

If a beneficiary chooses to move into drawdown then the money remains within the pension environment. This means that on the death of the beneficiary, the funds can pass onto the beneficiary of the original beneficiary and so on.

Dependant's drawdown was available before 6 April 2015 but it was not possible for anyone apart from a dependant to benefit. If a dependant was in capped drawdown on 5 April 2015 then they can remain in capped drawdown but all the rules of capped drawdown will still apply. They can also choose to convert to flexi-access drawdown.

If a dependant was in flexible drawdown immediately before 6 April 2015 then from that date it is automatically treated as a flexi-access drawdown fund.

If a dependant child first designated funds into drawdown (flexi-access or capped) before age 23 and then reached age 23 after the 16 September 2016, they can continue to receive dependant's drawdown, regardless of the fact that they have passed age 23.

## What is flexi access drawdown?

Drawdown pension is a method of withdrawing benefits from a money purchase pension fund without purchasing a lifetime annuity.

Those who inherit a money purchase pension plan, as an alternative to purchasing a guaranteed lifetime income (an annuity) can instead make withdrawals directly from the pension fund. This will first require the funds to be moved into a dependant's, nominee's or successor's flexi-access drawdown plan.

The main purposes of drawdown pension can be summarised as follows:

- Deferral of annuity purchase, thus avoiding being locked into low annuity rates which may apply at the time of retirement or at the time the fund is inherited.
- The drawdown pension option enables the policy holder to buy an annuity at a time that is best suited to them and hopefully when annuity rates are more favourable or provides an opportunity to avoid purchasing an annuity altogether where appropriate.
- The option enables investors to retain control over their pension investments and allows them to continue to be invested in the markets.
- It postpones the decision of deciding which type of annuity to lock into, for example selecting a level or increasing pension.
- With flexi-access drawdown the amount of income that can be taken from the fund is not subject to any specific limits therefore this method offers great flexibility. This can be useful for tax planning or where other sources of income are available.

## Critical yield

The critical yield calculation is an attempt to show the investment returns required from a drawdown pension arrangement to match the income that could be provided by a traditional annuity. The critical yield takes into account mortality drag and the additional costs involved in a drawdown pension plan. Crucially, it assumes that throughout the period of withdrawal the underlying annuity interest rate and mortality basis will not change.

The critical yield is an important consideration in deciding whether or not drawdown pension is an appropriate investment vehicle or not. Once established it is then necessary to decide how the funds will be invested to achieve the critical yield. Generally, if long term income is the requirement, the drawdown pension route will only prove to be more effective in total income terms if the investment return generated is sufficient to cover:

- The investment return on current annuity rates, plus
- Mortality drag, plus
- The additional costs involved in a drawdown pension arrangement as opposed to an annuity.

## Mortality drag

Annuity providers know that not all annuitants will live as long as expected. The providers use this 'mortality gain' to subsidise current annuity rates. Therefore those clients who die earlier than expected subsidise the remaining annuitants. If you choose an alternative to annuity purchase, such as drawdown pension then you do not benefit from this cross subsidy and effectively take on the 'mortality risk' yourself. The longer you delay annuity purchase, the less you will benefit from the cross subsidy when you eventually buy an annuity. This is known as 'mortality drag'.

## Main features of beneficiary flexi access drawdown pension

Age and health	<p>The beneficiary can choose how much income they want to withdraw without reference to any rates or limits other than the size of the beneficiary's flexi-access drawdown fund.</p> <p>If you are relatively young, a secured pension (lifetime annuity or scheme pension) would be less attractive due to the lower mortality factor and, in addition, there is a longer timescale to take advantage of the potential investment rewards and risks of Drawdown Pension. You can delay purchasing a Lifetime Annuity if you think annuity rates will improve.</p>												
Beneficiary Flexi-Access Drawdown	<p>Investing in relatively safe areas such as cash and gilts is unlikely to enable a higher lifetime income to be achieved than with a secured pension therefore investing in the type of assets that might achieve the extra returns necessary will involve risk. The shorter the term to the intended date of purchasing a secured pension, the greater the risk.</p> <p>The value of your pension fund may go down as well as up and investment returns may be less than those shown in the illustrations.</p> <p>Taking withdrawals may erode the capital value of the fund, especially if investment returns are poor and a high level of income is being taken. This could result in a lower income if/when an annuity is eventually purchased. If investment returns do not at least match the critical yield (in simple terms, the value of growth required to provide an equivalent income at the age you intend to purchase an annuity), your eventual income is likely to be less than that which could have been available via the annuity route.</p> <p>Please be aware that there may be occasions when an individual fund or funds may have a higher risk rating than your overall stated attitude to risk. If this is the case, then the overall risk rating applied to all of the combined funds being recommended is still designed to meet your stated tolerance.</p>												
Other risks	<p>Annuity rates may be at a lower level if/when annuity purchase takes place and there is no guarantee that your income will be as high as that offered under the other options referred to earlier.</p> <p>There is no guarantee that annuity rates will improve in the future. They could be lower if/when you decide to purchase an annuity than they are currently. Your pension may be lower than if you bought a lifetime annuity now. High levels of drawdown pension may not be sustainable in the longer term. If you intend to invest some or all of your pension fund there may be charges involved with the new investment.</p> <p>If you withdraw large amounts of capital from your drawdown fund these may impact on any means tested benefits you are in receipt of.</p> <p>Any monies drawn down from an existing Flexi-access drawdown plan and not spent as intended, could create an Inheritance Tax issue.</p>												
Flexibility	<p>You will be able to plan in advance the level of income that you wish to take each year, so that you can take into account any other sources of income which may become available to you.</p> <p>There are products available which offer a level of guaranteed income which is paid regardless of the performance of the investments in your pension fund thereby removing some of the risk involved with Drawdown Pension (albeit at a price and subject to specified conditions being met).</p> <p>If the Drawdown Pension product is set up within a Self Invested Personal Pension (SIPP) wrapper, this will permit access to a wide range of investments and enable the investments to be rearranged easily if required (and usually more cost effectively than switching between product providers).</p>												
Taxation	<p>If you inherited the pension fund from a person who died before the age of 75 the benefits can be paid to you tax free as long as certain conditions are complied with. If you inherited from a person who died aged 75 or over any benefits taken will be taxed on you in the same way as earned income.</p> <p>If your benefits are taxable, the provider of your pension plan will deduct tax from any withdrawals you take through the PAYE system and you should be aware that if they do not hold your correct tax code, an emergency code will be used and you may need to reclaim or pay additional tax through your self-assessment tax return or by way of a separate claim.</p> <p>If taxable, the income you draw will be taxed as earned / pension income, with tax deducted at source in the tax year in which it is withdrawn. This could mean income tax of up to 45% (48% in Scotland) depending on your circumstances.</p> <p>You can structure your income to mitigate liability to personal income tax. By reducing your income in some years you may be able to avoid a higher rate tax liability.</p> <p>If in flexi-access drawdown you may withdraw an unlimited amount from your pension fund, although, if subject to tax, all amounts withdrawn will be taxed as income at your marginal income tax rate(s).</p> <p>All statements concerning the tax treatment of products and their benefits are based on our understanding of current tax law and HM Revenue and Customs' practice. Levels and bases of tax relief are subject to change.</p>												
Transfers & withdrawals	<p>It is possible to transfer your drawdown plan from one provider to another.</p> <p>You can make ad hoc withdrawals instead of, or in addition to, taking a regular income from your fund.</p> <p>The flexibility over income levels offered by flexi-access drawdown pension can be useful for tax planning purposes. You can decide at any time to buy a lifetime annuity with all or part of your fund.</p> <p>Having entered flexi-access drawdown there will be no restriction on the income you are able to draw – anything from zero income to the entire fund in one go is allowable. If you inherited from a person who died after age 75, all income taken is taxable as earned / pension income.</p>												
Availability	<p>There are many drawdown providers in the market and you should ensure you consider costs, service standards and investment choice before selecting a provider.</p>												
Long term care	<p>Your income payments will be taken into consideration should you require long term care in the future. Once you reach state pension age, if greater than the actual income being taken, an income in line with that available from an annuity based on your age at that time will be taken into account.</p>												
Treatment after death	<p>Your beneficiaries can continue to take withdrawals from any remaining drawdown fund on your death (annuity purchase is also an option) or take the remaining fund as a lump sum. If you die before age 75 any income or lump sums taken by your beneficiaries will be tax free (as long as any lump sum death benefit payment doesn't exceed your available Lump Sum and Death Benefit Allowance – if it does, the excess will be subject to income tax on your beneficiaries).</p> <p>If you die after age 75, any income or lump sums taken by your beneficiaries will be taxed at the recipient's marginal income tax rate(s).</p> <p>The tax treatment of these payments are shown below:</p> <table><tr><th>Type of benefit</th><th>Death occurs before age 75</th><th>Death occurs on or after age 75</th></tr><tr><td>Lump sum</td><td>Payment tax-free if within Lump Sum and Death Benefit Allowance (any excess is taxable).</td><td>Payments will be subject to tax at the beneficiaries' income tax rate.</td></tr><tr><td>Beneficiary flexi-access drawdown</td><td>Income payments are tax free for the lifetime of the beneficiary.</td><td>Income payments are subject to income tax payable by the beneficiary.</td></tr><tr><td>Beneficiary's annuity</td><td>Income payments are tax free for the lifetime of the beneficiary.</td><td>Annuity payments are subject to income tax payable by the beneficiary.</td></tr></table>	Type of benefit	Death occurs before age 75	Death occurs on or after age 75	Lump sum	Payment tax-free if within Lump Sum and Death Benefit Allowance (any excess is taxable).	Payments will be subject to tax at the beneficiaries' income tax rate.	Beneficiary flexi-access drawdown	Income payments are tax free for the lifetime of the beneficiary.	Income payments are subject to income tax payable by the beneficiary.	Beneficiary's annuity	Income payments are tax free for the lifetime of the beneficiary.	Annuity payments are subject to income tax payable by the beneficiary.
Type of benefit	Death occurs before age 75	Death occurs on or after age 75											
Lump sum	Payment tax-free if within Lump Sum and Death Benefit Allowance (any excess is taxable).	Payments will be subject to tax at the beneficiaries' income tax rate.											
Beneficiary flexi-access drawdown	Income payments are tax free for the lifetime of the beneficiary.	Income payments are subject to income tax payable by the beneficiary.											
Beneficiary's annuity	Income payments are tax free for the lifetime of the beneficiary.	Annuity payments are subject to income tax payable by the beneficiary.											
Type of charges	<p>Drawdown Pension products tend to have higher charges than Secured Pension products due to the greater amount of administration and advisory input they involve.</p>												
Future planning issues	<p>If you decide to move abroad after inheriting the funds, you can arrange to have your withdrawals paid to an overseas bank account if you wish to.</p> <p>If your health / circumstances change, you may change the amount of income you are drawing and/or purchase an annuity.</p> <p>If you have taken some income from your own flexi-access drawdown plan (not inherited) or withdrawn an Uncrystallised Funds Pension Lump Sum under a different arrangement of your own (not inherited) you will be subject to the £10,000 money purchase annual allowance (MPAA).</p> <p>When you first flexibly access your own pension (not inherited), the scheme administrator has to provide a statement to you within 31 days. You must then notify any other schemes that you are an active member of (i.e. where contributions are being paid to a money purchase scheme or you are accruing benefits under a cash balance or hybrid scheme) within 91 days of receiving their statement, so that they're also aware that the £10,000 MPAA will apply.</p>												