WHIreland®
WEALTH MANAGEMENT

Case Study

Pension flexibility to fund balanced lifestyle

Many clients have both defined benefit ("DB") and defined contribution ("DC") pension pots. Whilst the rules on pension flexibility do not apply to defined benefits schemes, combining the more fixed benefits with the more flexible DC benefits can help clients wishing to 'slow down' rather than retire and give up working altogether.

Bob is 57 and has worked for the same company for 25 years. Throughout that time he has been a member of the company final salary pension scheme with a 1/60th accrual rate and a normal retirement date of 65. His current salary is £50,000 together with a generous benefits package.

For the last 15 years he has received annual bonuses, most of which he has used to make pension contributions into a personal pension plan. The fund is now worth around £80,000.

Bob feels 30 years in the office is enough, however, he believes it is too soon to retire but would like to work less hours doing something he enjoys. He plans to leave his current job in April 2016. He is a serious cyclist with coaching qualifications and has been using his contacts to find opportunities linked to his extensive experience of his sport. He has been offered a job working 25 hours a week at the new local velodrome opening in May 2016, which pays £15,000 a year. This will not be enough for him to live on comfortably but he hopes his pensions can be used to top this up. He could take his pension from his final salary scheme early, however, this would mean a substantial reduction in his benefits as his scheme has a 5% a year early retirement deduction.

He has heard about the new pension flexibility and his adviser says it may be useful to him. He can use his £80,000 fund to top up his lower earnings until he can start to receive his final salary benefits penalty free and his state pension. As he was born in 1958, he will be entitled to his state pension at age 66. Bob's adviser suggests a number of options.

Option 1

He can take 25% of the fund value as a tax free lump sum now and move the remainder of the funds into drawdown. He can then take as much or as little income from the plan each year as he requires and this will be taxed as income at his marginal rate.

Once he starts to take any income, the reduced money purchase annual allowance of £40,000 a year will apply to any further DC contributions. However, Bob has no plans to make any further substantial pension contributions so this should not be an issue.

The advantage of this option is that it will give him all his tax free cash up front and he will have full control of the income.

Option 2

As option 1 but take the benefits on a phased drawdown basis. He can take the tax free cash in smaller chunks and add more to the drawdown fund each time he does. So he could crystallise the funds in, for example four chunks of £20,000 (ignoring any growth). Each would give him tax free cash of £5,000. The remaining £15,000 could be used to provide any amount of income.

The advantage of this method is if he does not need the tax free cash for any capital expenditure, he can use it to help fund his income requirements. This would reduce his annual income tax bill.

The disadvantage is that Bob does not receive all his tax free cash as a one off lump sum. As with option 1, the reduced money purchase annual allowance will apply as soon as he takes any income.

Option 3

Take uncrystallised funds pension lump sums. With this option funds are drawn directly from Bob's pension funds. 25% of any amounts withdrawn would be tax free with the remainder taxable as income. So Bob could take £10,000 a year out of the plan and £2,500 would be tax free. The other £7,500 would be added to his other income and taxed at his marginal rate.

As with option 2, the advantage of this option is if the tax free cash isn't all required up front, he can use it to help fund his income requirements. This will reduce his annual income tax bill.

The disadvantage is the tax free cash is always directly linked to the income so it is not as flexible as option 2 above where he can take the tax free cash but doesn't have to take the income.

As with options 1 and 2, the reduced money purchase annual allowance will apply as soon as he takes his first uncrystallised funds pension lump sum.

Bob's Choice

After further discussions Bob and his adviser decides that option 1 is the most attractive. This is because when he leaves his current job he will need to give back his company car. The £20,000 immediate tax free lump sum will ensure that he can purchase a suitable replacement. He would also like to take his wife on a luxury cycling trip along the Californian coast before starting his new job.

The remainder of the funds will top up his reduced earnings. He thinks he needs around £8,000 a year and with reasonable growth the remaining funds should be able to provide that for the required time frame.

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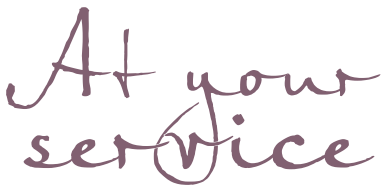

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