

Key issues

Drawdown means withdrawing income from pension funds whilst leaving the remainder invested.

Flexible drawdown has no limit to the amount of the fund which can be taken as income, but the pensioner must be able to demonstrate a secure pension income of at least £20,000 pa in payment from other sources in the year that they opt for flexible drawdown.

Pensioners using drawdown are no longer forced to use their remaining fund to buy an annuity at age 75.

All drawdown income is taxed as pension income in the year in which it is received.

Flexible drawdown is likely to be particularly useful for those with significant pension assets.

What is drawdown?

Drawdown rules used to allow income (up to certain annual limits) to be 'drawn down' from pension funds whilst leaving the rest of the fund invested. At age 75, the remaining fund then had to be used to purchase a lifetime annuity. But the limit on annual income and the requirement to buy an annuity at age 75 placed unnecessary constraints on some pensioners.

Drawdown rules from April 2011

In April 2011, the drawdown rules were modified. In simple terms, the requirement to purchase an annuity at age 75 was removed, although the principles of drawdown are largely the same:

- When the pension benefits are first brought into payment (i.e. designated in a drawdown contract) the tax-free lump sum must be taken. Otherwise the entitlement will be lost.
- The remaining pension fund is invested and income is drawn from it. It's important that the invested fund performance continues to be closely monitored so that it will meet future income needs.
- The income drawn is limited, under HMRC rules, so that the fund is not depleted too quickly. Where these limits apply, the arrangement is called a "capped" drawdown.
- The income is taxed as pension income in the tax year it's received.
- On death, the remaining fund may be used to pay a dependant's pension or can be paid out as a taxed lump sum to a much wider range of recipients as designated by the pensioner. The tax rate is a sizeable 55% (special lump sum benefits tax charge) although this may still be far preferable to losing all of the fund in an annuity purchase.

Flexible drawdown

This concept was also introduced by the new rules in April 2011, allowing pensioners much more room for manoeuvre. Under these arrangements there's no limit to the annual drawdown. Indeed, the whole of a pension fund could be withdrawn in one go! But like capped drawdown, the income is taxed in the year it is taken, apart from any tax-free lump sum.

The catch is that the pensioner must be able to demonstrate a secure pension income of at least £20,000 pa in payment in the year they opt for flexible drawdown. This is to avoid someone depleting their pension assets and falling back on state benefits. This income can come from:

- **State pensions**
- **Lifetime annuities** under registered pension schemes
- **Scheme pensions** from registered pension schemes

What happens to drawdown funds on death?

Eliminating mandatory annuity purchase gives everyone in drawdown choices about what happens to their fund on death. For many with dependants the decision will be straightforward. But for many others the remaining fund can be distributed according to their wishes. And the introduction of flexible drawdown is a major step forward for people with significant pension assets. It offers quite different and imaginative retirement and inheritance planning options.