New Pension Freedoms

Case Study – Withdrawing lump sum funds.

Mrs Cash is currently aged 57 and has accumulated a single pension fund presently valued at £500,000. She consolidated several smaller plans from different employments into a self-invested personal pension – a SIPP, several years ago. Mrs Cash works part time and earns an annual salary of £22,000 and continues to make her regular pension contributions of £250 monthly. Her daughter wishes to buy a flat but doesn't have a large enough deposit, so Mrs Cash has offered to help her out by giving her £25,000 from her pension fund. As Mrs Cash is still working, she does not want to take any additional income at this time.

Mrs Cash has two options:

1) Take a tax-free pension commencement lump sum (PCLS) of £25,000.

Once she has taken the cash she will have £75,000 crystallised funds left in her pension which she will be able to start taking income from under flexi-access drawdown rules whenever she likes. She also has £400,000 left uncrystallised to use for a lump sum and/or income in the future.

2) Take a lump sum that is part tax-free and part taxed of £29,412

The first 25% of the lump sum crystallised will be tax free and the balance will be taxed at her marginal rate of 20%. The net figure she will receive is £25,000.20 (£7,353 tax free plus £17,647.20 net/£22,059 gross). It is important for Mrs Cash to arrange for HMRC to provide the pension provider with her current Tax Code *prior* to drawing a taxable income from her pension otherwise they may well use an emergency tax code which would result in far more tax being deducted at source and Mrs Cash having to wait on a tax refund from HMRC. This would not suit her daughter who requires the full funds for her property deposit now.

She will be left with £470,588 in her pension fund. This is all uncrystallised and she can take further lump sum payments at a later date, or use the fund to take PCLS and an income under flexi-access drawdown.

The second option is more 'expensive' in that more of the pension fund is withdrawn initially, but it is worth considering that as all the remaining funds are uncrystallised there is likely to be a larger entitlement to a tax-free lump sum in the future and that by leaving it in the pension, it will benefit from virtually tax-free growth until the money is required.

On the other hand, if Mrs Cash was a higher rate tax payer whilst she was working, but was likely to be a basic rate tax payer once she retires, she may prefer to take the sum now wholly as PCLS, so that any taxable income generated in the future would be taxed at the lower rate.

It is of course possible to use a combination of these approaches; the key is to obtain professional advice based upon personal circumstances and then make a judgment accordingly.