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How to Access in Excess of 25% of Your Pension Fund Today

Many people often ask about **"cashing in their pension plans"**. Unfortunately many people seem to believe for one reason or another that you can take all your money out of a personal pension plan n in one go - this simply isn't the case.

Under current legislation, an investor with a personal pension plan in the UK **can access 25% of fund value tax-free** between ages 50 and 75 (minimum retirement age is rising to 55 from 6th April 2010 - anyone aged between 50 and 55 before 6th April 2010 needs to act in the next 11 months if they want to avoid being unable to access pension benefits until age 55). This tax-free cash as it is commonly known was renamed "pension commencement lump sum" following A Day on 6th April 2006 - I wonder why they changed the name???

Many people wish to access as much of their pension funds as possible, as soon as possible, effectively bringing the money back into their estate now, rather than waiting until later.

There is an option which can be pursued to maximise income from your personal pension plan by combining tax-free cash with income drawdown and annuity purchase.

This is how it works

Let's assume that you are a male now aged 50 and looking to take the maximum possible amount out of your pension plan in the current tax year - there are three steps you would need to take to achieve this -

1. Take maximum tax-free cash at commencement

It does exactly what it says on the tin - **normally this will give you 25% of the current fund value** - on some older pension plans you may be able to get in excess of 25%.

2. Move to an income drawdown arrangement and take "maximum GAD" from day one

Income drawdown is a flexible arrangement which allows you to draw an income from your pension fund whilst still allowing your pension plan to remain invested. It's normally an option taken up by people with a medium to adventurous attitude to investment risk - since your money remains invested there is a possibility that investment performance could move against you, and the level of withdrawals you are taking from your pension fund could exceed the growth you are enjoying, thereby reducing the size of your pension fund. You could in theory use up your entire pension fund BEFORE you die - this is the risk you are running - with an annuity you pass this risk to the pension provider - in exchange for your pension fund they provide you with an "income for life".

Maximum GAD refers to the amount of your fund which the regulations will allow you to drawdown from your pension pot - GAD stands for the "Government Actuaries Department" and they set the rate that can be drawn down for each age group.

For a 50 year old male, the current GAD rate (April 2009) is £49/£1,000 invested based on a Gilt Yield of 3.75%. This gives a GAD percentage of 4.9% (this figure will differ depending on your age - in simple terms the older you are, the higher the GAD rate will be)

The regulations allow the pensioner in this scenario to take 120% of this amount from their pension plan - which in this case amounts to 5.88% gross.

(Important Note: Some personal pension plans provide what is known as a "guaranteed annuity" - this can be as high as 9%-10% - you MUST check with your pension provider before moving to an income drawdown arrangement that you are not entitled to any higher "guaranteed annuity" rates - please consult an IFA before taking pension benefits)

3. Take an annuity with the remaining vested drawdown fund.

Under income drawdown rules it is normal for investors to take an annuity before they reach age 75. An annuity is an "income for life" - in exchange for your remaining pension pot a life insurance company will pay you an income for the rest of your life - however long this might be.

There are different options which can be added to an annuity, such as a widows pension, indexation (to protect the pension income against rises in the cost of living), and guarantees whereby the pension will continue paying out for 5 or 10 years if you die early during the annuity period - remember that generally income from an annuity stops when you die.

To maximise your annuity you need to opt for a simple annuity which contains none of these add-ons

(WARNING - not including some of these add-ons, such as a widows pension, could lead to financial hardship for your family in the event of your death - I cannot emphasis how strongly you should take independent financial advice in respect of accessing your pension benefits in this way.)

For a non-smoking male, age 50, the current best annuity rate available is 5.4% gross per annum - pension income is taxable - you might be liable for tax on this income depending on the other sources of income you may have.

To see what annuity rates are available in the market for your particular circumstances go here - http://www.moneymadeclear.fsa.gov.uk/tools/compare_products.html

We have therefore identified the three steps which can be used to take maximum cash out of your personal pension plan at this moment in time. Let's now look at the monetary implications of this.

Let's assume you have a pension pot today of £50,000. We will now consider the effect on your pot of each of these steps.

1. Take 25% tax-free cash (**cash in hand of £12,500 tax free**) - remaining pension fund of £37,500.

2. Take income drawdown of 5.88% gross immediately (£37,500 x 5.88% gross = £2,205.00 - less 20% income tax - **£1,764.00 cash in hand after tax**) - pension pot remaining of £35,295.00.

3. Purchase an annuity after taking income drawdown - based on a pension pot remaining after taking maximum drawdown of £35,295.00 and annuity rate of 5.4% the investor would receive £1,905.93 gross (**£1,524.74 cash in hand after tax**).

Summary

Having carried out these three actions in quick succession the investor has been able to access £15,788.74 of their pension fund after payment of income tax - amounting to 31.58% (nearly a third of their pension plan).

The remaining fund can then be used to provide an income for the remainder of the pensioners' life in line with the annuity options chosen at stage 3 above.

Warning

We can't emphasis enough the need to consult an Independent Financial Adviser before embarking on the course of action outlined in this article. It may be that this course of action is totally unsuitable for your particular circumstances. We accept no responsibility for your actions - you have been warned!!!

E & OE

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