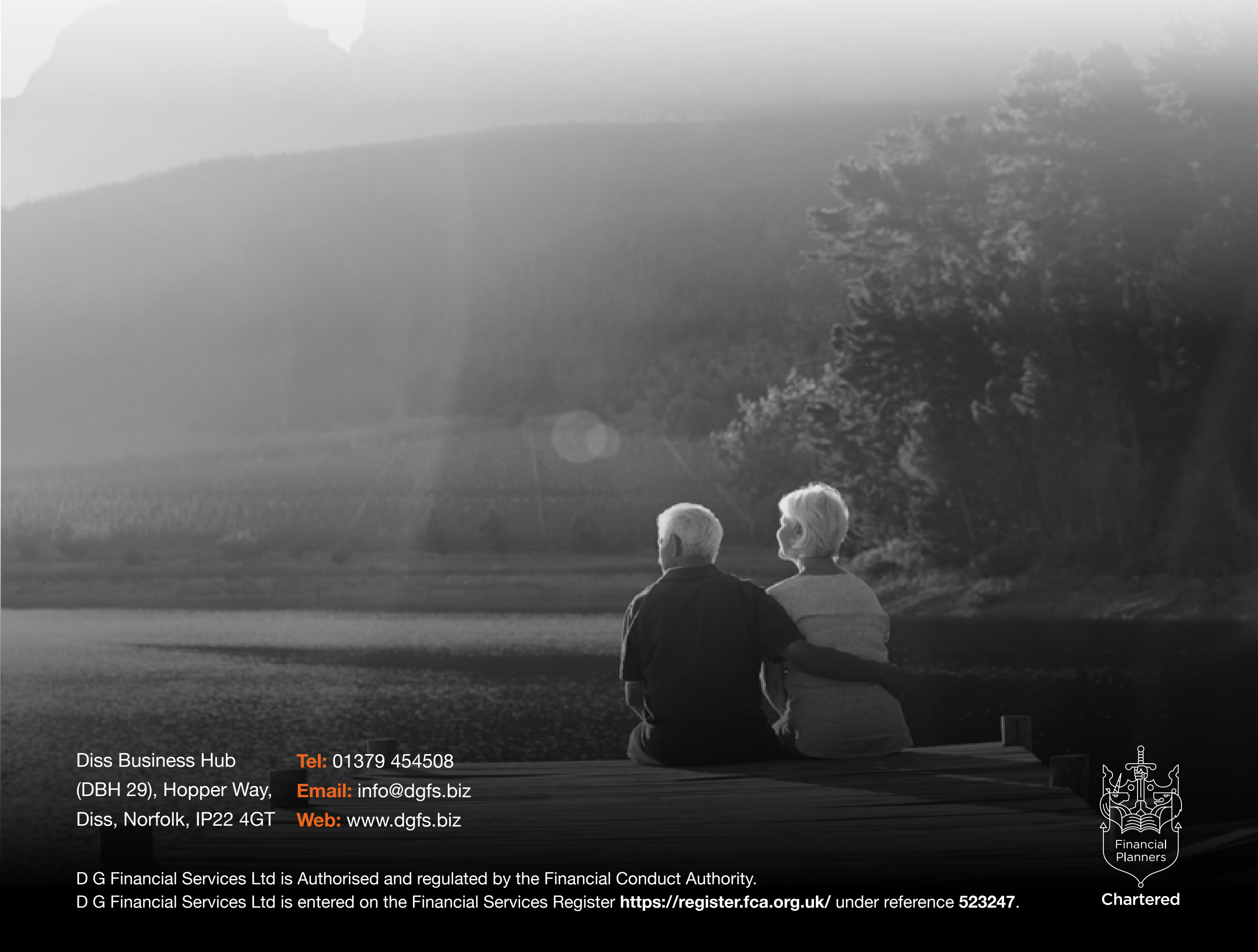
TAKING CONTROL OF YOUR PENSION INCOME

Pension Drawdown: Income, flexibility and tax



Diss Business Hub
(DBH 29), Hopper Way,
Diss, Norfolk, IP22 4GT

Tel: 01379 454508
Email: info@dgfs.biz
Web: www.dgfs.biz

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Building a pension is only one part of retirement planning. The next challenge is deciding how that money should support your lifestyle once you stop working, reduce your hours, or move gradually into retirement.

Pension drawdown can offer a flexible way to access retirement income. Instead of using your pension pot to buy a guaranteed income, drawdown allows you to keep some or all of it invested while you take withdrawals as required.

This flexibility can be valuable, but it also places greater responsibility on the individual. Income is not guaranteed, the pension remains exposed to investment risk, and the level and timing of withdrawals can significantly affect how long the fund lasts.

At DG Financial Services, we help clients assess whether pension drawdown is suitable for their circumstances. The appropriate strategy depends on factors such as expenditure, sustainable income requirements, tax position, investment risk, capacity for loss, other assets, family circumstances, health, longevity and long-term retirement objectives.

WHAT IS PENSION DRAWDOWN?

Pension drawdown, usually called flexi-access drawdown, is a way to take benefits from a defined contribution pension while leaving the remaining funds invested.

The value of the pension available for future withdrawals will depend on contributions, investment performance, charges, withdrawals, and the length of time the fund remains invested. Unlike a defined benefit pension or an annuity, there is generally no contractual guarantee that a particular level of income will continue for life.

With flexi-access drawdown, you can normally take regular income, make occasional withdrawals, or vary the amount taken from year to year. This can be particularly useful when expenditure changes throughout retirement, or when pension income needs to be coordinated with other sources of income, such as the State Pension, ISAs, savings, investments, rental income, or earnings from part-time work.

The technical distinction between crystallised and uncrystallised pension funds is also important. Pension benefits can be designated for drawdown, with the relevant funds becoming crystallised, while other pension funds can remain uncrystallised for future use. The timing and method of crystallisation can therefore be an important part of retirement and tax planning.

Drawdown differs from an annuity. An annuity normally converts some or all of a pension fund into a guaranteed income, subject to the terms of the contract. Drawdown retains greater flexibility and investment exposure, but the income is not guaranteed.

This means drawdown should be regarded as a retirement income strategy rather than simply a method of accessing pension savings.

HOW PENSION BENEFITS ARE TAXED

Tax is central to pension drawdown planning. Under current rules, you can usually take up to 25% of your pension benefits as tax-free cash, subject to applicable allowances and any protections. The standard Lump Sum Allowance (LSA) for 2026/27 is £268,275.

Individuals with certain forms of transitional or historic pension protection may have a higher available allowance. The remaining pension benefits are generally taxable as income upon withdrawal. Pension income is added to other taxable income for the year and taxed at the individual's marginal rate.

The standard Personal Allowance for 2026/27 is £12,570. The basic-rate band is £37,700, giving a standard higher-rate threshold of £50,270, while the additional-rate threshold is £125,140. The Personal Allowance is gradually withdrawn when adjusted net income exceeds £100,000 and is fully withdrawn once income reaches £125,140.

This means the effective tax cost of a pension withdrawal can depend heavily on the individual's overall income position.

For example, a large pension withdrawal could move income from the basic-rate band into the higher-rate band, or from the higher-rate band into the additional-rate band. It could also cause some or all of the Personal Allowance to be lost.

The timing of withdrawals can therefore be as important as the amount withdrawn. Phased withdrawals across tax years may help manage marginal tax rates, although the appropriate approach depends on the individual's wider circumstances.

Tax-free cash does not normally count as taxable income and does not use the Personal Allowance. However, taking taxable pension income can have wider consequences, including potentially triggering the Money Purchase Annual Allowance.

PENSION COMMENCEMENT AND CRYSTALLISATION

When pension benefits are accessed, it is important to distinguish between the amount withdrawn and the amount crystallised.

For example, an individual might designate £100,000 of pension funds for drawdown. Subject to the available Lump Sum Allowance and the individual's circumstances, up to £25,000 could be taken as tax-free cash, with the remaining £75,000 allocated to the drawdown fund.

Alternatively, an individual may use phased crystallisation, designating smaller portions of the pension over a number of years. This can allow tax-free cash and taxable income to be taken progressively rather than crystallising the entire pension at once.

Phased crystallisation can be particularly relevant where an individual has variable expenditure or seeks to manage taxable income around employment income, State Pension commencement, or other sources of retirement income.

However, pension tax planning should take into account the individual's total remaining Lump Sum Allowance and Lump Sum and Death Benefit Allowance, rather than assuming that 25% of every future pension withdrawal will automatically be tax-free.

STATE PENSION AND TAX PLANNING

The State Pension should normally be considered alongside private pension withdrawals rather than in isolation.

For 2026/27, the full new State Pension is £241.30 per week, equivalent to approximately £12,547.60 a year. The actual amount received depends on the individual's National Insurance record and other factors.

Because the full new State Pension is close to the £12,570 Personal Allowance, someone receiving the full amount may have very little Personal Allowance available for additional taxable pension income or other taxable income.

This can make the period immediately before and after State Pension age particularly important for retirement income planning. A person may choose to draw more or less from a private pension before the State Pension begins, depending on their income requirements and tax position.

State Pension deferral can also be considered as part of the wider strategy. The new State Pension increases when it is deferred, although the financial value of deferral depends on factors including longevity, tax and the individual's alternative uses for the money.

WHY FLEXIBILITY CAN BE USEFUL

One of the main advantages of pension drawdown is control. Retirement spending rarely follows a fixed pattern. Expenditure may be higher in the early years of retirement because of travel, hobbies, home improvements, or financial support for family members. Spending may then decline before potentially increasing again if care or health needs arise later in life.

Drawdown allows income to be adjusted to reflect these changing requirements. An individual might take a relatively modest income in one year, increase withdrawals for a major expenditure in another year, and reduce them again later.

Drawdown can also serve as a bridge between employment and the State Pension. For example, someone reducing their working hours may supplement their employment income with their pension rather than immediately stopping work altogether.

However, flexibility should not be confused with unlimited sustainability. Each withdrawal reduces the capital available for future growth and heightens the importance of investment returns, inflation and longevity assumptions.

SUSTAINABLE WITHDRAWALS AND SEQUENCE-OF-RETURNS RISK

One of the key technical risks associated with drawdown is sequence-of-returns risk. Two retirees could experience the same average investment return over a 20-year period but achieve very different outcomes, depending on when positive and negative returns occur.

A significant market fall during the early years of retirement, combined with ongoing withdrawals, can permanently reduce the capital available to participate in a subsequent market recovery.

This is sometimes described as the interaction between investment returns and withdrawals. When a portfolio falls significantly while withdrawals continue, the investor may need to sell more units to maintain the same level of income. Fewer units then remain available for future growth.

For this reason, a sustainable withdrawal strategy should not be based solely on an assumed average investment return.

It should consider:

- the size and composition of the pension fund;
- expected retirement expenditure;
- inflation and changing spending patterns;
- the timing and amount of withdrawals;
- investment volatility and asset allocation;
- other guaranteed income;
- the expected duration of retirement;
- taxation;
- charges and adviser or platform costs; and
- the individual's capacity to reduce expenditure if investment returns are poor.

Cashflow modelling is very useful because it allows different assumptions and scenarios to be tested, including adverse investment returns, higher inflation, increased expenditure and longer-than-expected life expectancy.

MANAGING INVESTMENT RISK IN RETIREMENT

With pension drawdown, the remaining pension fund is generally left invested. This offers the potential for long-term growth but also means the fund can rise and fall in value.

Investment risk is particularly important once withdrawals begin. A portfolio designed solely for accumulation may not be appropriate once it is also required to generate regular income.

Some retirement strategies therefore use a combination of asset classes and time horizons. Money required for near-term spending may be held in lower-volatility assets, while funds unlikely to be needed for many years can remain invested for longer-term growth.

However, holding excessive amounts in cash also carries risks. Inflation can erode the real purchasing power of cash over a long retirement, meaning that avoiding investment volatility altogether may itself create a significant risk of falling behind the cost of living.

The appropriate asset allocation should therefore reflect attitude to risk, capacity

for loss, investment horizon and the individual's ability to adjust withdrawals if markets perform poorly.

DRAWDOWN OR GUARANTEED INCOME?

Pension drawdown is not the only retirement income option. An annuity can provide a guaranteed income, potentially for life, depending on the type of annuity selected. This can be useful for covering essential expenditure, such as household bills, utilities, food and insurance.

Annuity rates are influenced by factors such as age, interest rates, the size of the pension fund and the selected terms. Some annuities can also include features such as inflation-linked increases, guarantee periods or continuing benefits for a spouse or civil partner, although additional guarantees or increases will generally reduce the starting income available.

Drawdown offers greater flexibility and ongoing investment exposure, but it does not provide the same level of income certainty. It can also leave a pension fund available for beneficiaries, subject to the pension scheme's rules and the tax treatment at the time of death.

For some individuals, a blended approach may be appropriate. Essential expenditure could be covered by guaranteed income, while discretionary spending is funded from drawdown and other investments.

There is no universally correct balance. The decision should take account of health, life expectancy, essential and discretionary expenditure, other guaranteed income, investment risk, tax, family circumstances, and the importance placed on leaving assets to beneficiaries.

PENSION DEATH BENEFITS AND INHERITANCE PLANNING

The treatment of pension funds on death is an increasingly important part of retirement planning. Under current rules, pension death benefits can receive favourable tax treatment, particularly where death occurs before or after age 75, depending on the type of benefit and the beneficiary. The age at death can therefore influence the Income Tax treatment of benefits received by beneficiaries.

However, the Inheritance Tax treatment of pensions is changing. From 6 April 2027, most unused pension funds and pension death benefits will be included in an individual's estate for Inheritance Tax purposes. The reforms apply broadly to unused pension funds and death benefits, subject to specific exclusions, including certain death-in-service benefits. Personal representatives will generally be responsible for reporting and paying any IHT arising on the pension element of the estate.

This means that the traditional assumption that retaining pension funds until death will always be the most tax-efficient way of passing wealth to beneficiaries needs to be reconsidered.

The interaction between Income Tax, Inheritance Tax, pension withdrawals, other assets, and the individual's available nil-rate bands will become increasingly important. Retirement income planning and estate planning should therefore be considered together rather than as separate decisions.

PLANNING AROUND FUTURE PENSION CONTRIBUTIONS

Accessing pension benefits can affect the ability to make future pension contributions. If an individual flexibly accesses certain defined contribution pension benefits, the Money Purchase Annual Allowance (MPAA) may be triggered. For 2026/27, the MPAA is £10,000. This is particularly important for anyone who plans to continue working, return to employment, or make substantial pension contributions after retirement has begun.

Not every pension withdrawal triggers the MPAA. The rules depend on how benefits are accessed. For example, taking pension benefits through certain methods may constitute a flexible-access trigger event, whereas some forms of tax-free cash or other permitted payments may not. The precise circumstances therefore need to be established before benefits are taken.

Once the MPAA applies, the £10,000 limit generally applies to relevant money purchase pension savings. There is also an alternative annual allowance for other pension savings in certain circumstances. The standard Annual Allowance for 2026/27 is £60,000, though it can be reduced for higher earners, and its interaction with the MPAA can be complex.

This makes it important to consider future pension contributions before taking taxable flexible income.

OTHER ASSETS AND THE ORDER OF WITHDRAWALS

A retirement income strategy should not necessarily focus on the pension in isolation. Individuals may have a mix of pensions, ISAs, taxable investment accounts, cash deposits, property and other assets. The tax treatment of each asset differs, so the order in which assets are used can affect the overall tax position and the portfolio's longevity.

For example, an ISA can generally provide tax-free withdrawals, whereas pension withdrawals exceeding the available tax-free amount are normally subject to Income Tax. A taxable investment portfolio may give rise to dividend or capital gains tax considerations.

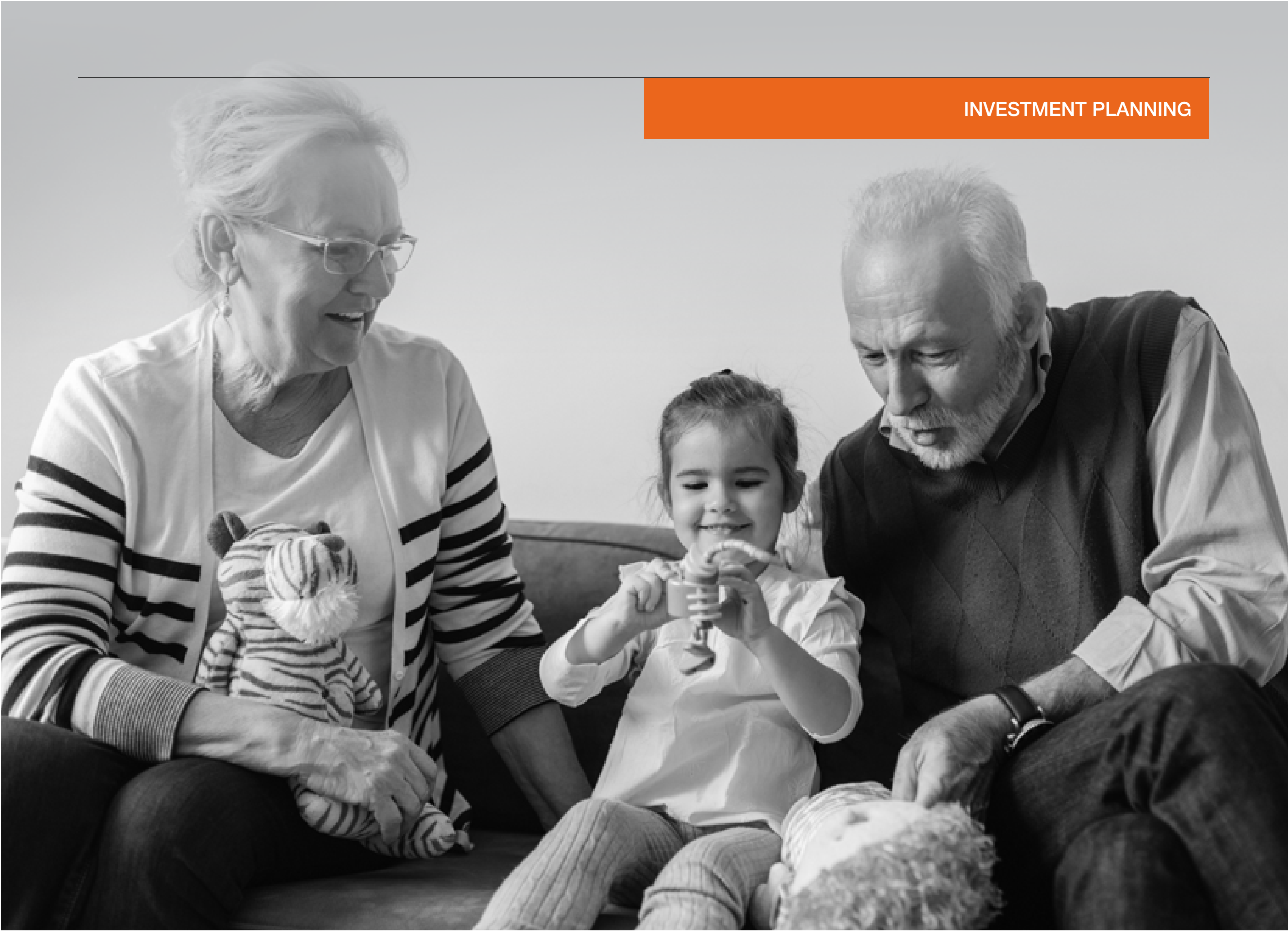
There can therefore be circumstances in which drawing from one asset first, or using several assets together, produces a more efficient outcome than simply taking the maximum available pension income.

However, the most tax-efficient strategy is not necessarily the most appropriate overall. Liquidity, investment risk, future expenditure, inheritance objectives and the need for emergency capital also need to be considered.

IS PENSION DRAWDOWN RIGHT FOR YOU?

Pension drawdown can offer flexibility, control and continued investment exposure. It may be suitable for individuals who want to vary their retirement income, manage taxable income across tax years, bridge periods before other income begins, or retain flexibility over how their pension is invested and distributed.

However, drawdown is not right for everyone. There is no guarantee that a particular income can be sustained for life. Investment losses can reduce the available



fund, inflation can erode spending power, and excessive withdrawals can increase the risk of running out of money. The decision should therefore be based on a structured retirement income plan rather than on simply selecting a percentage withdrawal rate.

At DG Financial Services, we will help you review your pension options and assess whether drawdown aligns with your broader retirement objectives. This may include reviewing your pension arrangements, tax position, investment strategy, other sources of income, expenditure requirements, risk tolerance, future contributions and estate-planning objectives.

Taking control of pension income is about more than choosing a withdrawal method. It is about building a retirement income strategy that provides sufficient income today while preserving resilience and flexibility for the years ahead. ■

Need help planning your pension income?

Pension drawdown can offer significant flexibility, but it also requires careful management of investment risk, withdrawals, taxation and longevity. Contact DG Financial Services to review your pension options, understand the tax implications and develop a retirement income strategy tailored to your circumstances and long-term objectives.

DG FINANCIAL
SERVICES LIMITED

Diss Business Hub
(DBH 29), Hopper Way,
Diss, Norfolk, IP22 4GT

Tel: 01379 454508
Email: info@dgfs.biz
Web: www.dgfs.biz

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Registered office: 47 Butt Road, Colchester, Essex, CO3 3BZ.

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If you wish to register a complaint, please write to **russell.golledge@dgfs.biz** or telephone **01379 454508**

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