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Adviser factsheet

nucleus

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Pensions and age 75

Pension freedoms, introduced in April 2015, changed the way UK pensions savers could take their retirement income. A significant enhancement means it's no longer a requirement to buy a retirement income or use a different type of drawdown at age 75. Instead, it's possible to continue with the current accumulation or drawdown pension plan.

But reaching age 75 still acts as a watershed for your clients. This factsheet outlines the key changes that take place at age 75, impacting pension planning and highlights areas where a review and action may be suitable.

Ongoing contributions

It's possible to continue contributing to a pension plan after age 75 but there's no tax relief available on payments. Because of this, many pension plans (including the Nucleus Pension account) do not accept contributions from clients who are aged 75 or older.

Availability of choice after age 75

After the introduction of the pension freedoms, many 'new-style' pension plans updated their rules to introduce more flexibility at age 75. However, some 'old-style' pension plans have not done this and some barriers to choice may exist.

These barriers could include:

- Insisting clients have to take a pension commencement lump sum (PCLS) before age 75.
- Not offering flexi-access drawdown after age 75.
- Insisting on annuity purchase at age 75.

This provides an opportunity to review existing pension plans to identify where lack of choice could be an issue. Where there's barriers to choice, it may be suitable to recommend a transfer to a more flexible pension plan before age 75.

Change to death benefits

On death, it's possible to pass on any unused pension wealth to family members. If death happens before age 75 then the pension benefits are tax free. If death occurs at age 75 or over then any pension benefits taken will be taxed at the marginal rate of income tax.

So, at age 75, it may be prudent to review the nominated beneficiaries to make sure benefits can be passed on in the most tax efficient way. Any recommended changes may be driven by the beneficiaries' rates of income tax.

Example – James

James has a flexi-access drawdown fund worth £145,000. He has nominated his daughter Emily to receive the pension benefits if he dies. Emily is a higher rate taxpayer. If James dies before he is 75, then Emily can receive the benefits tax free. But if James is 75 or over, then Emily can receive the benefits tax free. But if James is aged 75 or over, Emily would have to pay income tax at her highest marginal rate on any pension benefits she takes.

On reaching his 75th birthday, following a meeting with his adviser, James changes his nomination form to name Emily's children, Kim and Kevin, to receive his pension benefits when he dies. Both Kim and Kevin are currently in full-time education and are non-taxpayers.

Benefit crystallisation event (BCE) at age 75

At age 75, where an individual has not taken a scheme pension (e.g. a defined benefit pension) or secured a lifetime annuity, then any uncrystallised funds or drawdown funds will be tested against the lifetime allowance.

There's a range of BCE tests at age 75, depending on the type of pension plan an individual has. The main categories are described below.

Name	Description	Amount crystallised
BCE 5	Where a client reaches age 75 under a defined benefit arrangement without having drawn all or part of their entitlement as a scheme pension and / or lump sum.	20 times the pension plus any separate lump sum, as if these benefits were taken at age 75.
BCE 5a	Where a member reaches age 75 with a drawdown pension fund or flexi-access drawdown fund.	The drawdown fund less the total amount crystallised previously under BCE 1*
BCE 5b	Where a client reaches age 75 with unused defined contribution pension funds.	Market value of the remaining unused funds.

*When funds are designated to provide a drawdown income

For those who have already designated drawdown, this means a second crystallisation event. This effectively tests any investment growth against the lifetime allowance by deducting the original amount designated for drawdown (not including any PCLS) from the current value of the drawdown plan.

The lifetime allowance charge at age 75 is 25% of the pension fund in excess of the relevant lifetime allowance, as it's not possible to take any benefits in excess of the lifetime allowance as a lifetime allowance excess lump sum.

Example – Stella

Stella has a Sipp worth £400,000.

She moves £200,000 into drawdown in March 2015 (when the lifetime allowance is £1.25 million). This uses up 16% of the lifetime allowance, leaving 84% unused. She takes her PCLS of £50,000.

In December 2020, Stella reaches her 75th birthday. Stella's drawdown fund is now worth £191,200, and her uncrystallised Sipp funds are valued at £236,900. The lifetime allowance is £1,073,100.

There are two BCEs at her 75th birthday:

- For BCE 5a the crystallisation amount is the current value of the drawdown less the amount originally designated for drawdown (not including the PCLS):
- £191,200 - £150,000 = £41,200
- This uses up nearly 4% of Stella's lifetime allowance (£41,200 / £1,073,100 = 3.8%).
- For BCE 5b there are unused funds worth £236,900, so 22% of the lifetime allowance is used up. (£236,900/£1,073,100 = 22%)
- Stella's final unused lifetime allowance is 58% (84% - 4% - 22%)

Merging drawdown accounts

There's no legislation preventing flexi-access drawdown accounts being merged but there's strong practical reasons why this is not possible.

At age 75, the scheme administrator has to be able to carry out a BCE 5a to test any increase in the drawdown funds against the available lifetime allowance, to calculate any tax. HMRC's view is that each tranche of drawdown has to be tested. If two drawdown accounts are merged, then it may not be possible to accurately complete the test. That's why most scheme administrators keep drawdown accounts separate.

Taking benefits after age 75

Where uncrystallised funds exist at age 75, these need to be tested against the lifetime allowance, either by carrying out the defined benefits (BCE 5) check or the money purchase (BCE 5a) test.

If benefits are then taken over age 75 there is no subsequent (BCE 5b) test, or possible lifetime allowance charge.

Example – Alison

In April 2017 Alison has a Sipp fund worth £990,000. She designates £490,000 into drawdown using up 49% of her standard lifetime allowance. The remaining £500,000 is still uncrystallised. She then begins to withdraw a regular £40,000 a year from her drawdown plan.

On reaching her 75th birthday in October 2020, her pension benefits have to be tested against the lifetime allowance:

- BCE 5a – Alison's current drawdown fund is now worth £480,000 and is lower in value than the original amount designated into drawdown. Therefore, no further lifetime allowance is used up.
- BCE 5b – Alison's uncrystallised pension fund is worth £515,000 and this crystallisation event uses up another 48% of her lifetime allowance (£515,000 / £1,073,100 = 48%)
- In December 2023, when she is 78, Alison finally designates the remaining pension funds into drawdown. Even though her funds are now worth £600,000 there is no further BCE test against the lifetime allowance.
- Even if a pension plan allows a delay in taking PCLS until after the age of 75, it may be more suitable to take this benefit sooner. If this doesn't happen and death occurs, the option of taking PCLS will not be available to any beneficiary inheriting pension funds, and this tax-efficient option is lost.

Managing the second drawdown crystallisation event

When the second drawdown crystallisation event (BCE 5a) means more than 100% of the lifetime allowance is exceeded resulting in an additional lifetime allowance charge, there are different mitigation options available.

Reducing a lifetime allowance charge

To help reduce any lifetime allowance charge, it may be prudent to take more drawdown income in the period before age 75. By doing this, the charge can be reduced or removed completely. But taking this action, especially if the income is not needed, may mean increasing the amount of money in other assets in an estate. Also, tax is payable on any drawdown income taken at the marginal rate.

Alternatively, it may be suitable to change the investment strategy to adopt a more cautious approach but may mean missing out on potential investment growth. Even if a lifetime allowance charge on growth in the drawdown fund applies, it means the remainder of growth is retained, so boosting the pension assets.

Retaining funds in the pension plan

Instead of withdrawing more income from the drawdown fund, it's possible to keep the pension fund intact. This may result in a lifetime allowance charge of 25% of the fund being applied at age 75 but the drawdown plan will benefit from tax-efficient growth after age 75, with no further checks against the lifetime allowance.

This allows funds to be retained in a pensions environment which should be free from inheritance tax (IHT). At death, the pension funds can be passed to family. Any funds withdrawn from the beneficiary's plan will be taxed at the beneficiary's marginal rate of income tax (which may be lower than the deceased's).

If you only read one thing

- Tax relief is not available on pension contributions after the age of 75.
- Many 'old-style' pension plans may still have barriers to choice at age 75.
- If death occurs at age 75 or older, then beneficiaries have to pay tax on any pension benefits taken, at the relevant marginal rate of income tax. This may influence the choice of beneficiaries.
- At age 75, there is a second benefit crystallisation event (BCE) test, and the scheme administrator (of the pension or drawdown plan) has to test any unused pension funds and any growth in drawdown funds against the available lifetime allowance.
- Several options are available to manage the second drawdown crystallisation event, depending on the agreed client objectives.

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