

**SCOTTISH WIDOWS**

*official pensions and investment provider*



# Case Study: Income Recycling with Retirement Account

Generating more Tax Free Cash in Retirement  
using post 'A' day pension rules



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## The background

James Anderson just turned 55. He's been prudent throughout his life and has made regular contributions into his personal pension plan which he stopped a couple of months ago. He heard from a colleague that the rules on taking pension benefits changed a few years ago allowing him more flexibility on how he can plan for his eventual retirement. James is keen to pay off the outstanding balance of his mortgage, and would like to buy a new car for his forthcoming vacation in Europe. He has other savings and investments but doesn't want to touch these right now. James approached his Financial Adviser, Mervyn Smyth, to help him figure out his options. Based on James having a non-protected rights pension fund of £300,000, Mervyn advises that:

- On transferring his personal pension to an income drawdown plan, he can take a tax free cash sum of 25% of the fund – currently £75,000.
- He doesn't need to draw any income from the drawdown plan.
- At age 75, he'd have to start taking an income, either by buying an annuity, or moving to an alternatively secured pension.

James explains to Mervyn that he intends to fully retire at age 70 as his work is a massive part of his life. In view of this, James will have continued earned income from his employment, all things being well, up to age 70. His current salary is £35,000.

## The solution

While James likes the idea of taking £75,000 as tax free cash, Mervyn suggests an alternative to this plan.

He explains that although James can start to draw from his pension now, he can also continue to contribute to his personal pension plan while he remains working. This is a good example of Income Recycling. So Mervyn advises James to consider:

- Paying regular contributions into his personal pension plan from his employment income, on which he'd enjoy tax relief, and
- Withdrawing a sustainable amount of income from his drawdown plan until age 70, to supplement his employment income. Naturally Mervyn explains that the income would be subject to tax in the normal way.

Mervyn suggests that Income Recycling would work well for James by allowing him to take his £75,000 tax-free lump sum now and, potentially, an additional tax free cash lump sum when he eventually retires at age 70.

James likes Mervyn's suggestion, but feels having a personal pension plan and an income drawdown plan sounds overly complex – after all he already has enough other investments to keep track of.

Mervyn explains that there are new products on the market that combine “retirement planning” and “retirement income” in the one arrangement.

He suggests that the Scottish Widows Retirement Account offers the full flexibility required to take advantage of his suggested approach, and so recommends that James transfers his existing personal pension plan to a new Retirement Account.

In addition to providing James' tax free cash and income, Mervyn explains that the Retirement Account can also accept on-going contributions, allowing James to recycle his income by starting to build up another “pre retirement” pension pot. He also points out that the Retirement Account is easier to administer than James' existing plan, offering on-line access, and that the charging structure is designed to reward consolidation.

Using the on-line Retirement Account new business functionality, Mervyn draws up the following table of calculations to help illustrate the benefits of his suggestion. He explains that while the figures are based on James circumstances, they are only examples and are not guaranteed.

	Option 1 Retirement Income part only, taking no income	Option 2 Retirement Income part, taking an income, and contributing to Retirement Planning part
Tax Free Cash at age 55	£75,000	£75,000
Retirement Income gross pa, from age 55 to age 70	0	£15,376
Retirement Planning contribution gross pa from age 55 to age 70	0	£15,376
Retirement Income fund at age 70	£524,000	£150,000
Retirement Planning fund at age 70	0	£361,000
Total Retirement Account fund at age 70	£524,000	£511,000
Additional Tax Free Cash at age 70	0	£90,250
Total Tax Free Cash from Retirement Account	£75,000	£165,250

Mervyn confirms that the calculations assume:

- An initial £300,000 investment, with tax free cash of £75,000 taken at outset.
- A sustainable\* income of £15,376 is taken each year until age 70, payable monthly in advance.
- Regular monthly contributions equal to the income taken are paid until age 70.
- The Account is invested wholly in the SW Consensus Fund, with an annual fund charge of 0.100%.
- Administration charges are deducted each month based on the standard Retirement Account service charge table.
- Investments grow each year at 7%.
- Mervyn takes adviser remuneration of 3% flexible plus 0.5% fund based commission on the Retirement Income part, and for the first 12 months 20% flexible commission plus 0.5% fund based commission on the Retirement Planning part.

\* Mervyn calculates an amount of income that, based on the assumptions detailed above, the Retirement Income part of the Account can continue to provide until age 70, allowing for five year GAD reviews at age 60 and age 65.

Under Option One, if James were to take his tax free cash of £75,000 and leave the remaining fund untouched without taking income, his fund could grow to £524,000 at age 70, if Mervyn's assumptions are met. He could then recycle his income by drawing down an income from the fund, or use it purchase an annuity. However, he wouldn't be able to obtain any more tax free cash, meaning his total tax free cash from his Retirement Account would be £75,000.

On death, the money held in the Retirement Income part would be liable to a 35% tax charge, if the benefits are paid as a lump sum.

Under Option Two, if James were to pay contributions equal to the income he receives from his Retirement Account until age 70, and Mervyn's assumptions are met, the Retirement Planning part of his Account could be worth £361,000 at age 70.

Mervyn explains that James could draw 25% of that amount as tax free cash, giving him an additional tax free cash sum of £90,250 over and above the £75,000 he could take now. He could then draw an income from the residual fund plus the existing Retirement Income fund, or use these funds to buy an annuity.

In the meantime, the death benefits could also be improved, as any lump sum payment from the Retirement Planning part of the Account would be paid free of tax, provided James has sufficient unused Lifetime Allowance. And, as James will be withdrawing money from the Retirement Income part, causing its value to diminish over time, the value of the 35% tax charge described above should also diminish.

By age 70, Mervyn explains the position on death could be improved by £117,900, if his assumptions are met. He proves this with the following calculations:

#### **Option 1**

- £524,000 @ 35% tax charge (all held in Retirement Income)

#### **Option 2**

- £150,000 @ 35% tax charge (held in Retirement Income)
- £361,000 @ 0% tax charge (held in Retirement Planning)

#### **Overall death benefits could be improved by £117,900**

Mervyn tells James that he must have employment income at least equal to the contributions to be paid (i.e. the level of income to be withdrawn) until age 70 for the proposed arrangement to work effectively. So, even if James scales back his working hours in the run-up to age 70, as long as his earnings are not less than the contributions being made, the arrangement will still work.

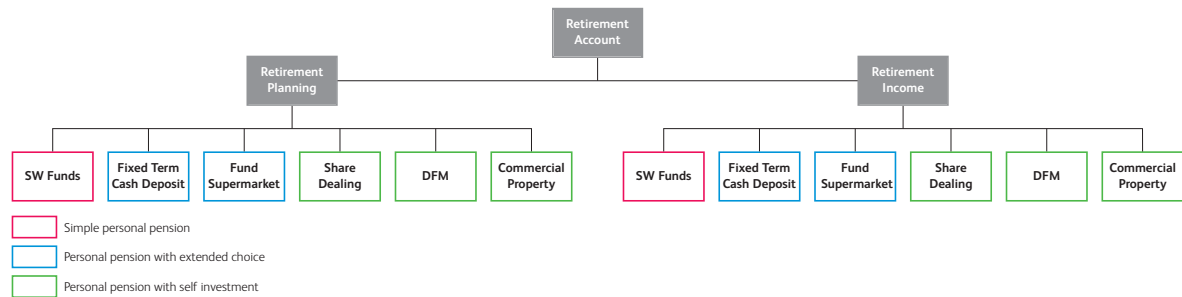
## In summary

Mervyn summarises the benefits of his suggested approach:

1. James can start taking income from the Retirement Income part of his Account now, but also build up value in the Retirement Planning part, meaning more tax free cash will be available at a later date. He must take the additional tax free cash by his 75th birthday or he'd lose it.
2. The lump sum death benefit position could be improved.
3. The immediate tax free cash sum of £75,000 can be used to help James with his current aims of paying off his mortgage balance, and purchasing a new car.



## Why the Scottish Widows Retirement Account?



- Product for Life – all aspects in one plan
  - Accepts Protected Rights – today
  - Straightforward to administer
  - Consolidated valuation encompassing both Retirement Planning and Income
- Service charge structure rewards consolidation
- Fund Based Commission paid on all assets
- Regular Premium Commission has no term relation
  - Initial commission paid on regular premiums regardless of age
- No administration charge for designating funds

The information presented in this case study is based on Scottish Widows understanding of current pensions law and tax rules. These can change in future.

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