MES PENSIONS

Things to Consider Before Taking Your Pension Benefits

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Most people look forward to the time they can access the money they have saved into their pension. It is common for the first decision to be accessing the tax-free cash lump sum. However, before making this decision, there are things you may want to think about before taking any of your pension savings.

Making decisions about your pension based on short-term events and circumstances can have long-term consequences for your financial wellbeing and retirement. Do you understand this risk and are you happy that now is the right time to access your pension.

Pros and cons of taking full tax-free cash
Many people choose to take their tax-free cash as soon as they receive the minimum pension age of 55 (rising to 57 from 2028).

Money has certain tax advantages so you may want to consider if you need to take the money now or if you should consider leaving your pension savings invested. This would mean that your savings could continue to grow, potentially providing a larger cash sum at a later date.

You may need to access the cash for good reason such as to pay off a debt, but you may not need to access the full 25%. You can just take the amount you need and leave the remainder invested to take later.

Will it affect your future income?
Your pension savings are designed to provide an income for you for the whole of your retirement. If you take some or all of your pension savings, you're immediately reducing the amount of money available to you throughout your retirement. You're also removing the potential for those monies to grow through returns on investments.

For example, if your pension was worth £80,000 you could take a maximum tax-free cash sum of £20,000. However, if you left it invested and it grew at a rate of 5% per year for the next 10 years, your pension savings could be worth £124,000 meaning you could take a tax-free cash sum of £31,000.

Please note that this is an example for illustration purposes only. The amount you receive will depend on the value of your pension savings at retirement.

Tax considerations
Pension withdrawals are subject to income tax. Any withdrawals will be added to any other income you receive in that tax year, which means taking large withdrawals could push you into a higher tax bracket. It's also likely that emergency tax will be deducted from the first taxable withdrawal you make. Do you understand the impact this could have on your retirement/situation, and are you happy to continue knowing there may be instances where the tax you pay could be higher or lower than owed?

Have some of your investments lost money?
Your pension is invested in funds which means the value can go down as well as up. Thus is a normal part of investing. If the funds in your pension have suffered a heavy loss, you don't need to take the money right away and have flexibility when you access your pension savings.

You may wish to consider waiting to allow your pension savings time to recover. If you are unsure of what to do, you should seek the advice of an authorised financial adviser or contact Money Helper at www.moneyhelper.org.uk.

Are you in debt?
Any money in a pension may be protected from your creditors if you're in debt (e.g. loans, mortgages, credit cards) if they act against you. This protection could be lost once you withdraw money from your pension. Do you understand this risk, and are you happy knowing the effect this could have on your current and future finances?

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Lump sum allowance
If you have a large amount of pension savings, the lump sum you can take could be subject to the Lump Sum Allowance (LSA). This is the maximum amount of lump sum you can take in your lifetime. You can normally take 25% of your pension savings as long as the amount is not greater than the current LSA (currently £268,275 for the 2024/25 tax year).

Money Purchase Annual Allowance (MPAA)
Once you start taking money from your pension savings, you may become subject to the Money Purchase Annual Allowance (MPAA). Thus reduces the amount you can pay into your pension pot, is permanent and commences in the tax year you trigger it.

Pensions and Inheritance Tax (IHT)
Pensions will become subject to Inheritance Tax (IHT) from April 2027.

How does IHT currently work?
Pensions are generally not currently included when working out the value of your estate. This means that pensions are not currently subject to IHT.

Instead, a different tax regime applies. How much your loved ones pay depends on the age you are when you die.

Before age 75 – if you die before aged 75, your pension could be inherited tax free.

After age 75 – if you die after age 75, your loved ones will pay income tax on the amount that they inherit at their marginal rate of tax.

How will IHT work after April 2027?
With effect from April 2027, any unspent pension will be included in the value of your estate and potentially subject to IHT.

This means the value of your pension savings when you die will be added together with your assets to calculate if your estate will need to pay IHT. If the value of your estate is about £325,000 or £500,000 if you're leaving your house to a direct dependent, any pension funds above the threshold will be liable for IHT.

You could pay IHT and Income Tax on inherited pensions
Under the current rules, the age you die determines whether or not your loved ones pay income tax on any pension funds they inherit from you. The Government has kept these age rules in place which means that:

- If you die under age 75 – your loved ones will pay no income tax on any inherited pension after IHT has been deducted.
- If you die after age 75 – your loved ones will pay income tax on any inherited pension at their marginal rate of tax after IHT has been deducted.

If you inherit a pension that's subject to IHT, it will be taxed at source.

The information in this document is based on our understanding of legislation and HMRC guidance at the time of print. It should not be relied on as a statement of law or for advice purposes. Whilst every effort has been omission in this document. made to ensure the information is accurate, we will not accept responsibility or liability for any inaccuracy or omission in this document.

Contact

MES Financial Services Limited
First Floor, 31 College Green,
Bristol, BS1 5TB

info@mespensions.com
+44 3303 202091