October 2023

ONE STOP Finance Ltd

# 7 useful questions if you plan to take **a flexible income** from your pension

020 8441 2605 | 01442 232272

infolondon@osfg.co.uk | infohemel@osfg.co.uk

When you start to access your pension, how will you take an income? One of your options may be to withdraw a flexible income that suits your needs through flexi-access drawdown.

A flexible income puts you in control and means you can adjust how much you withdraw from your pension if you need to. However, you also need to consider what income is the "right" amount to balance your short- and long-term needs.

There is a risk that you could withdraw too much too soon and face financial insecurity in your later years.

In fact, according to a report from think tank World Economic Forum, the average UK man faces outliving his pension by more than 10 years. For women, it's more than 12 years.

As well as spending too much, worrying about your long-term financial security could lead to you being overly frugal in retirement. It may mean that despite working hard and saving diligently, your retirement falls short of expectations, even if you have the pension savings you'd need to reach your goals.

Deciding how much to withdraw from your pension can seem like a balancing act, and there are often many factors you need to consider.

In a Legal & General survey, 94% of people said their most important retirement dream is to feel financially secure. With that in mind, here are seven questions you may want to consider if you'll be accessing your pension flexibly.

### 1. How could taking a lump sum from your pension affect your income?

Usually, when you access your pension, you can take up to 25% tax-free. It could help fund exciting plans to start your retirement.

You might be tempted to withdraw the money to travel, renovate your home, or indulge your hobbies. However, withdrawing a lump sum at the start of retirement could have implications for your long-term finances.

So, understanding how taking a lump sum out of your retirement savings may be important. Could it mean you may run out of money in your later years?

In addition to reducing the value of your pension, it could also affect investment returns. Typically, your pension will remain invested. By withdrawing a lump sum, potential returns could be lower than you expect, which may affect your income.

You don't have to take a lump sum at the start of retirement to benefit from the tax-free money – you may spread it out over several withdrawals.

## 2. How long does your pension need to provide an income?

One of the challenges of creating a sustainable income in retirement is that you don't know how long your pension will need to last.

Research from Canada Life suggests people nearing retirement underestimate how long they'll live, which could lead to them spending their retirement savings too quickly.

The study found both men and women think they'll live until they're 80.

According to the Office for National Statistics, a 65-year-old man has an average life expectancy of 85. So, you may think taking an income that will be sustainable for 20 years is enough. Yet, 1 in 4 men will celebrate their 92nd birthday.

If you calculated your pension withdrawals based on the average life expectancy, there's a reasonable chance you could live longer and face a shortfall.

Women are likely to spend even longer in retirement. A 65-year-old woman has an average life expectancy of 87 and a 1 in 4 chance of reaching their 94th birthday.

While thinking about life expectancy can be difficult, it's often a crucial factor when you're understanding how to use your assets sustainably.

### Consider how you'll spend a lump sum before you withdraw it

If you decide to take a lump sum from your pension at the start of retirement, it could be useful to consider how you'll use the money.

According to a Standard Life survey, retirees who withdrew a lump sum spent or expect to spend a third of the money within six months. While having the money in your account can be reassuring, remember that money that remains in your pension is often invested, so has the potential to grow further.

## 3. Could lifestyle changes affect your income needs throughout retirement?

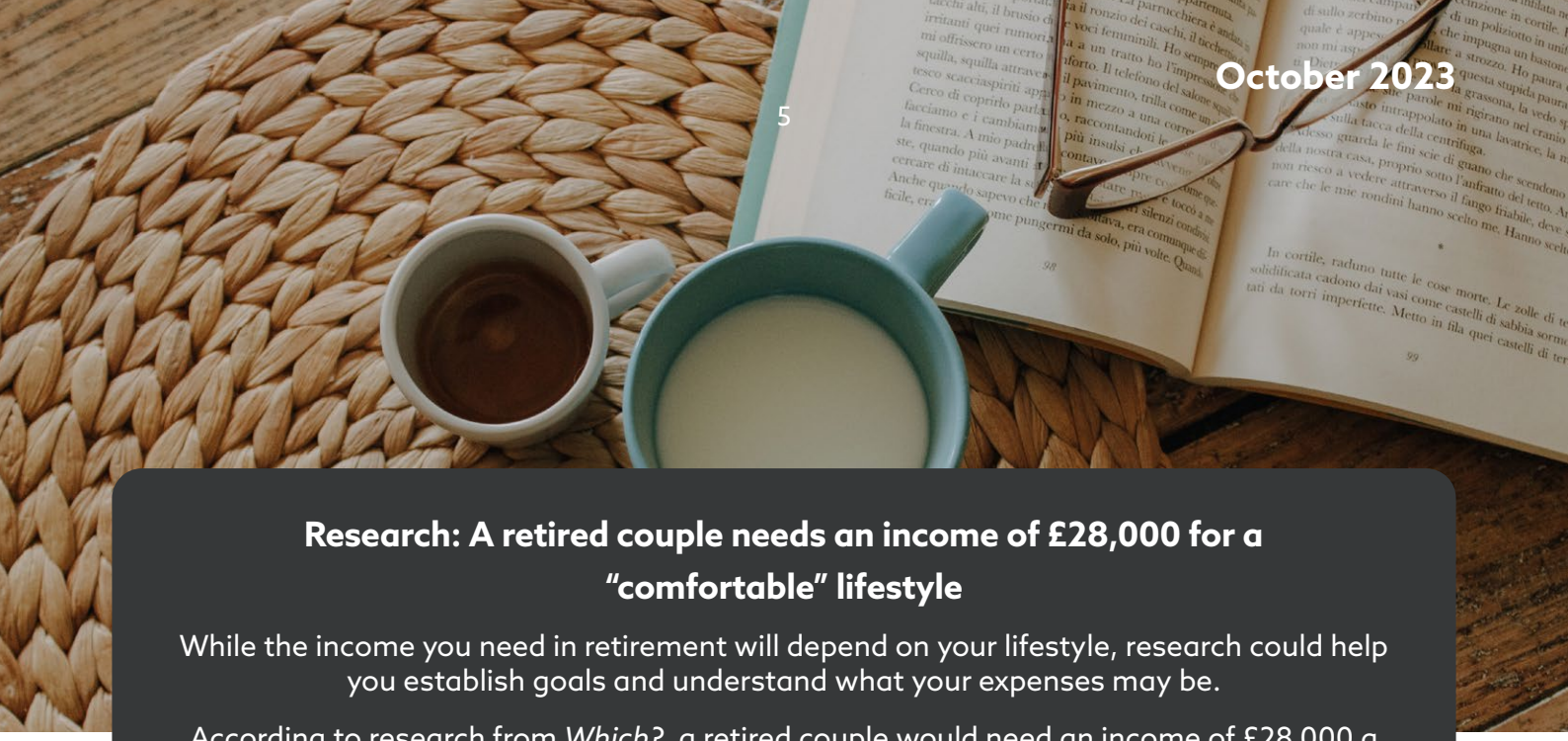
One of the benefits of taking a flexible income is that you can adjust it to suit your needs.

While there may be unexpected changes in the future, it might be worthwhile to set out how your income needs could change throughout retirement.

Many retirees find they spend more at the start of retirement as they enjoy their new freedom and tick off bucket list experiences. That said, your income needs may still be lower than when you were working as you won't be commuting, for example, or because you may have paid off your mortgage.

Once early retirement has passed, your spending may settle down, but you might also want to prepare for higher costs in your later years in case you need to pay for care.

Setting out your retirement goals could help you understand how to create an income that suits your lifestyle at different points.



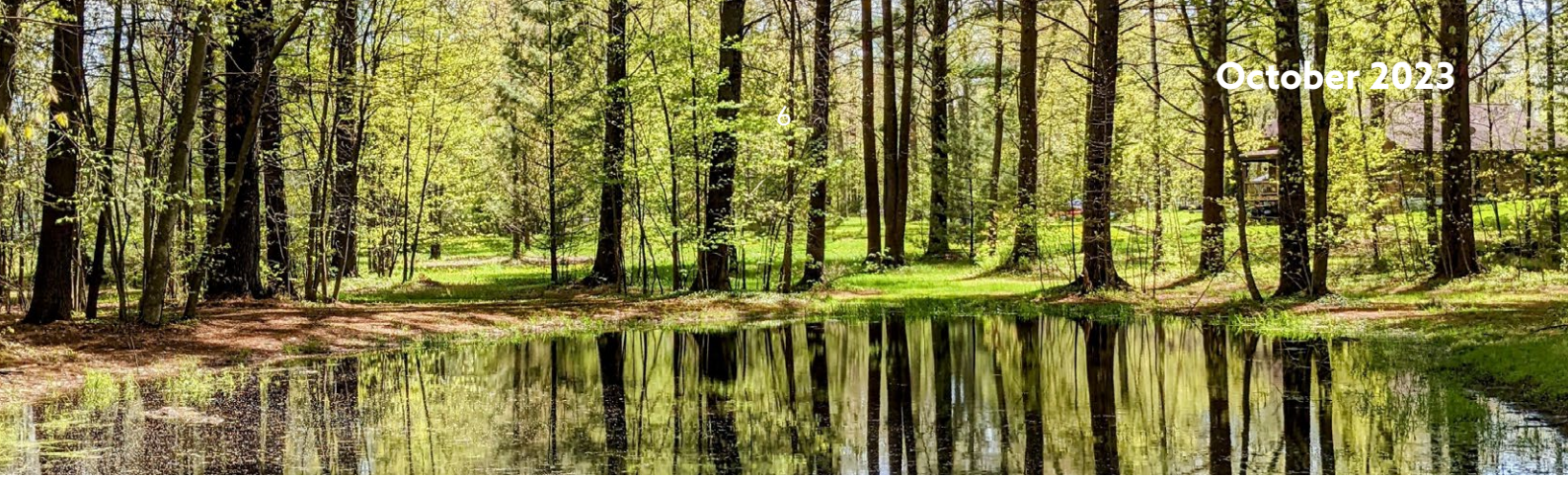
## Research: A retired couple needs an income of £28,000 for a "comfortable" lifestyle

While the income you need in retirement will depend on your lifestyle, research could help you establish goals and understand what your expenses may be.

According to research from *Which?*, a retired couple would need an income of £28,000 a year to live a "comfortable" lifestyle. A comfortable lifestyle includes an annual holiday budget of almost £4,000 and more than £1,200 to spend on recreational and leisure activities.

If you want to enjoy a "luxury" lifestyle, such as long-haul holidays and a new car every five years, the annual income needed rises to £44,000 for a two-person household.

**Source**: *Which?*



### 4. How could inflation affect your income needs?

Lifestyle changes could affect how much income you need, but so could factors outside of your control, such as inflation.

The last two years have highlighted how a period of high inflation can affect short- and long-term finances.

Let's say you retired in 2021 with an income of £30,000 a year. According to the Bank of England inflation calculator, just to maintain your lifestyle, your income would need to be more than £35,200 a year in July 2023 because of the rising cost of living.

Even when inflation is lower, the effect over a retirement that spans decades could add up.

Retirees who didn't consider inflation when calculating what a sustainable income would be for them may now find their standard of living has fallen or they could run out of money in the future.

In fact, a report from interactive investor found the rising cost of living was the top financial concern among retirees in 2022. Almost 3 in 5 retirees said it was a "big worry".

So, when you're calculating your income needs for the future, it may be wise to consider the effect the potential rising cost of goods or services could have.

There may be steps you can take to reduce the effect of inflation on your assets. For example, by leaving your pension invested, your savings have an opportunity to grow in real terms. However, investment returns cannot be guaranteed, and market volatility could present another retirement challenge.

### 5. How could investment volatility affect the value of your pension?

Typically, the money you don't withdraw from your pension will remain invested.

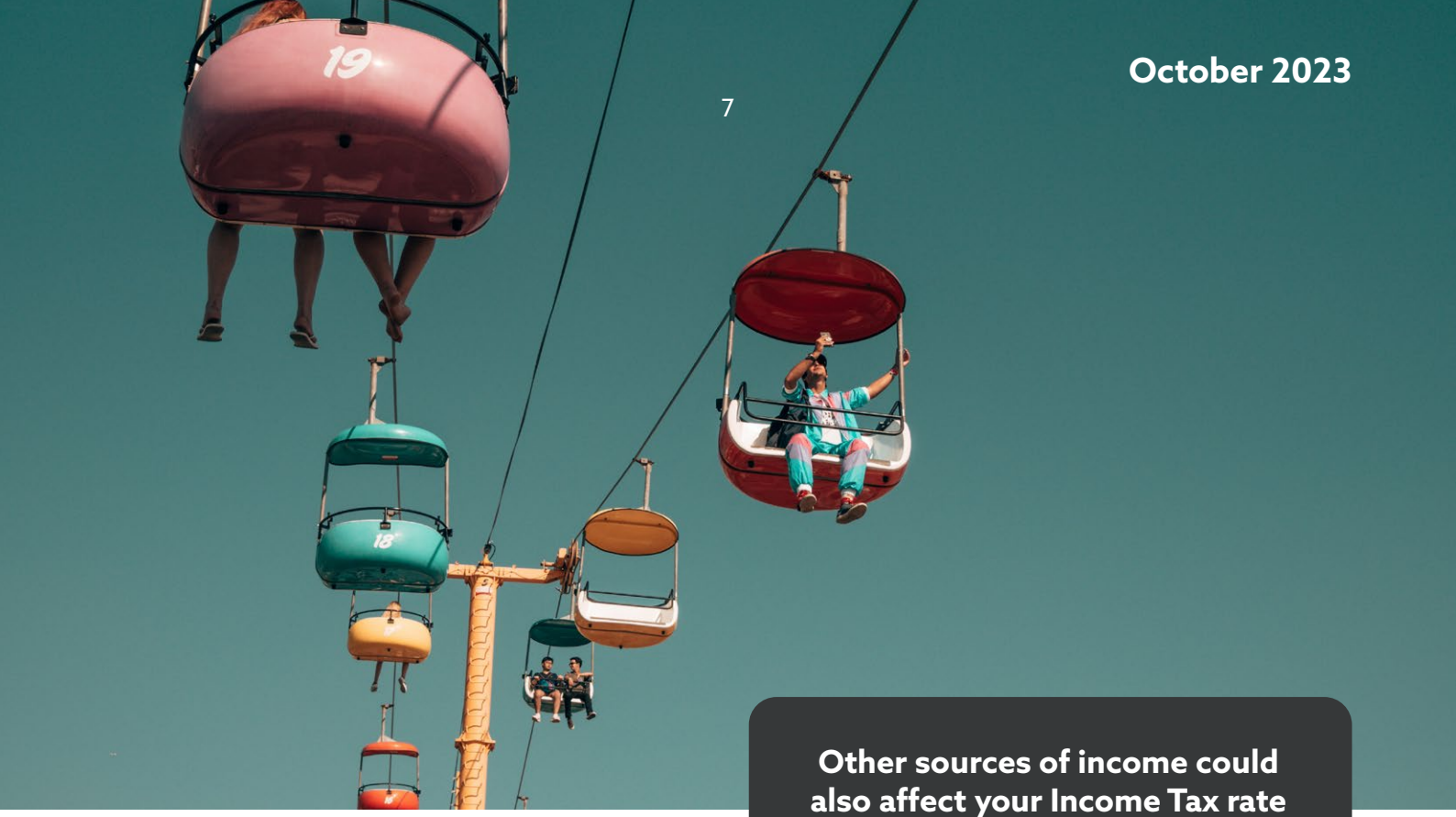
Over the long term, this could help the value of your pension grow and may help your savings keep pace with inflation. However, volatility is also part of investing and, at times, the value of your investments may fall.

When you're using investments to create a regular income this could create a challenge. During points when the value of investments has fallen, you'd need to sell more assets to deliver the same income. So, a period of volatility might mean you deplete your pension quicker than expected.

There are things you can do to manage investment volatility, including:

- Adjusting or pausing your flexible income so you take a lower amount when the market dips
- Having an emergency fund you can fall back on to cover expenses if you reduce or stop pension withdrawals
- Understanding how your other assets could be used to provide an income during a downturn.

Frequent reviews of your pension, other assets, and retirement plans could help you manage investment risks and help you maintain a sustainable income.



## 6. What tax could your pension withdrawals be liable for?

You might need to pay tax when accessing your pension. As you'll be in control of your income, considering how to make withdrawals tax-efficient may be useful.

If your total income exceeds the Personal Allowance, which is £12,570 in 2023/24, your pension withdrawals will likely be liable for Income Tax.

You should also keep the thresholds for the higher- and additional-rate of Income Tax in mind. Unwittingly exceeding these thresholds could mean you're taxed at a higher rate than you anticipated.

For the 2023/24 tax year, the thresholds are:

- Higher-rate of Income Tax: £50,270
- Additional-rate of Income Tax: £125,140

The Personal Allowance and Income Tax thresholds are frozen until April 2028.

### Other sources of income could also affect your Income Tax rate

Don't forget that other sources of income will also count towards your Personal Allowance. This could mean that you may end up paying a higher rate of Income Tax.

In retirement, you may receive a regular income from the State Pension, a final salary pension, or an annuity. If you've opted to phase into retirement, you might be earning an income through work too.

If you're nearing a threshold, delaying a withdrawal until a new tax year starts could reduce your tax liability and help you get more out of your pension.

If you're married or in a civil partnership, retirement planning with your partner might reduce your overall tax bill as a couple.

The Marriage Allowance may allow your partner to transfer £1,260 of unused Personal Allowance to you, which could reduce your Income Tax bill by up to £252. To use the Marriage Allowance, the partner with the higher income must be a basic-rate taxpayer.

### 7. Do you want to pass on your pension benefits?

You might be planning your retirement, but it could be worthwhile to consider your estate plan too.

A pension could provide a tax-efficient way to pass on wealth to your loved ones if your estate could be liable for Inheritance Tax (IHT).

The portion of your estate that exceeds IHT thresholds could be taxed at a standard rate of 40%. If you passed on wealth held in your pension, the tax charge could be lower.

The tax charged will depend on when you pass away and how your beneficiary accesses the money. In 2023/24:

- If you pass away before the age of 75, your beneficiary will usually inherit your pension tax-free.
- If you pass away after the age of 75, your beneficiary could be liable for Income Tax when they access your pension and the rate will depend on the other income they receive.

Your pension isn't covered by your will, so you'll need to complete an expression of wishes for each pension to let your provider know who you'd like to receive your pension benefits when you pass away. However, keep in mind that an expression of wishes isn't legally binding.

### If the value of your estate exceeds £325,000, you may want to consider Inheritance Tax

For the 2023/24 tax year, the nil-rate band is £325,000. If the value of your estate is below this threshold, your estate won't be liable for Inheritance Tax (IHT) when you pass away.

Many estates can also make use of the residence nil-rate band, which is £175,000 in 2023/24. To use this allowance, you'd need to leave your main home to direct descendants.

Both the nil-rate band and residence nil-rate band are frozen until 2028.

You can also pass on unused allowances to your spouse or civil partner. So, when planning as a couple, you could leave up to £1 million to loved ones before IHT is due.

If your estate could be liable for IHT, there might be ways you can reduce a potential bill. Please contact us to talk about your estate plan and IHT.

## Contact us to talk about your income in retirement

We're here to offer support and advice if you want to understand how to create a sustainable income in retirement. As well as flexi-access drawdown, we can explain your other options so you can make a decision that's right for you.

Working with a financial planner to create a retirement plan could mean you feel more confident about your finances and help you get the most out of retirement.

To arrange a meeting, please contact us.

020 8441 2605 | 01442 232272

infolondon@osfg.co.uk | infohemel@osfg.co.uk

**Please note:** This guide is for general information only and does not constitute advice. The information is aimed at retail clients only.

A pension is a long-term investment. The fund value may fluctuate and can go down, which would have an impact on the level of pension benefits available. Your pension income could also be affected by the interest rates at the time you take your benefits.

This article is for information only. Please do not act based on anything you might read in this article. All contents are based on our understanding of HMRC legislation, which is subject to change.

The Financial Conduct Authority does not regulate estate or tax planning. Tax treatment varies according to individual circumstances and is subject to change.

**Approver Quilter Financial Services Limited & Quilter Mortgage Planning Limited October 2023.**

---

One Stop Finance Ltd is an appointed representative of Quilter Mortgage Planning Limited and Quilter Financial Services Limited, which are authorised and regulated by the Financial Conduct Authority. Registered office: Aston House, Cornwall Avenue, London, N3 1LF. Registered in England and Wales: 6876390