Quilter

Tax allowances and tax-efficient regular income – case study

With the face of retirement changing, an important part of the financial outlook for many individuals will be keeping control of the savings they have built up whilst being able to access them to deliver their retirement income needs for the foreseeable future.

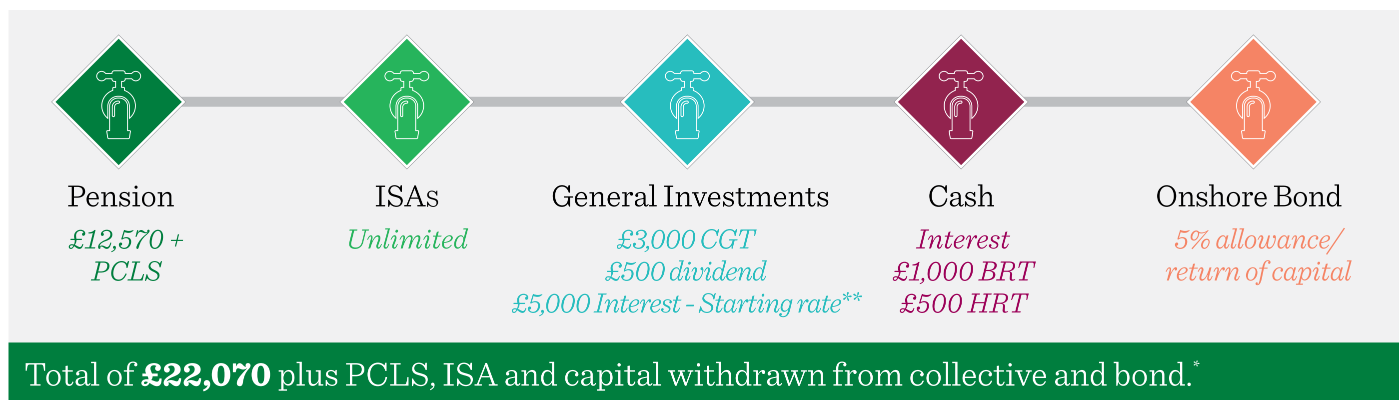
Proper use of the annual tax allowances provided by the Government will help clients seeking to receive a tax-efficient and sustainable income in retirement to achieve those objectives.

Depending on the make-up of their savings and the use of the options now available for money purchase pension savings, there is now an abundance of options to consider.

In simple terms an individual starting from a position of zero taxable income can draw across a range of investments up to a minimum of £22,070 (tax year 2024/25) a year before they pay a penny of income tax. In many cases the amount could be much more.

Being aware of, and making full use of, the allowances available gives clients real flexibility in managing their income needs, particularly across married couples or civil partners.

The tax allowances exist across a range of incomes and therefore tax wrappers:



Total of **£22,070** plus PCLS, ISA and capital withdrawn from collective and bond.*

* *The tax treatment and efficiency of these options will depend on the individual circumstances of each customer. Tax rules and their application may change in the future.*
** *Starting rate limit for savings income is available for up to £5,000 of savings income for those with income under £17,570.*

This tax-free income can be supplemented by a client's pension commencement lump sum (PCLS) from registered pension scheme savings, ISA savings, and capital withdrawn from collectives and bonds. Taking them in turn, these 'taps' provide:

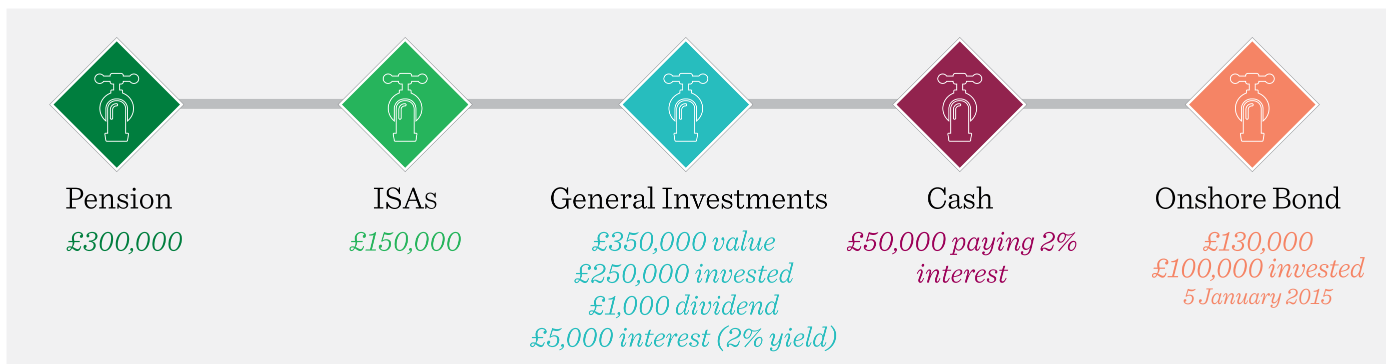
- pension income using the £12,570 personal income tax allowance
- sales from collectives using the £3,000 capital gains tax allowance
- distributions from equity-based collectives using the £500 tax-free dividend allowance
- distributions from fixed-interest based collectives using the £5,000 starting rate for savings
- interest from cash deposits using the £1,000 savings allowance for a basic rate taxpayer (£500 for a higher rate taxpayer)
- a withdrawal from an onshore bond within the 5% allowance (or potentially more than this utilising the 20% credit associated with onshore bond gains).

The planning opportunities these allowances create must be linked to the sustainability of income and other aims a client may have, for instance inheritance tax planning.

For financial advisers only

Case study: John

To consider these issues let's look at John. He has a broad portfolio across a range of tax wrappers:



Assuming John has zero taxable income how much could he draw without paying any tax?

Total of **£359,570** with no tax to pay. **But**... what is sustainable?****

* *Includes gain of £3,000*

** *Interest is taxed at 0% as interest is within the £5,000 starting rate limit for savings income.*

*** *It might be possible to take above this figure from the bond without any further income tax liability. Any excess above 5% is treated as income but carries a basic rate tax credit. There might be a liability to higher or additional rates where a larger sum is taken. 5% available for each complete policy year or part year.*

**** *The tax treatment and efficiency of these options will depend on the individual circumstances of each customer. Tax rules and their application may change in the future.*

John's primary goal is to draw a tax efficient income and 'use not lose' his available tax allowances. In looking at John's wider financial planning needs, his inheritance tax (IHT) position, and a desire to mitigate that, could mean that his pension fund is left untouched for longer and income is drawn firstly from other less IHT efficient tax wrappers.

What are the key elements to consider when looking at how to draw income from John's pension savings tax efficiently?

1. We can crystallise the whole of his pension savings taking the £75,000 pension commencement lump sum (PCLS) currently available and then draw £12,570 taxable income through the use of flexi-access drawdown.

But what does John do with the capital the PCLS provides that is surplus to his immediate needs? The money would form part of his estate and any future pension funding would be reduced to £10,000 a year. Would this course of action really work for him?

2. He can use the tax-efficient regular income options available via the Collective Retirement Account. These options can provide John with monthly income comprising PCLS with or without taxable income, so from funds that are **crystallised monthly** he could:

   Option 1. draw PCLS only with no taxable income being paid out

   Option 2. draw PCLS plus the taxable income generated by the crystallisation

   Option 3. draw PCLS plus a specified amount of income from the crystallised amount.

In John's situation, tax-efficient regular income options two and three look most appropriate as they allow him to draw a taxable income and, in doing so, use his £12,570 personal allowance. Option two is the most efficient method, based on crystallising the least amount of his pension savings each month and, in doing so, maximising the amount of PCLS that remains uncrystallised.

If John crystallised £1,396.67 per month this would provide £349.17 PCLS and £1,047.50 of taxable income. Over the course of the tax year this will provide £4,190.04 PCLS plus £12,570 of taxable income, giving John a total tax- free income of £16,760.04 from his pension savings that can be used to deliver part, or all, of his annual income needs.

Looking at this scenario, where £1,396.67 a month is crystallised, the three CRA income options would deliver monthly income as follows:

Client request	Monthly crystallisation amount	PCLS (always 25%)	Taxable income	Deferred income	Regular monthly income paid
Maximum deferred income	£1,396.67	£349.17	Nil	£1,047.50	£349.17
Maximum taxable income	£1,396.67	£349.17	£1,047.50	Nil	£1,396.67
Income split between taxable and deferred	£1,396.67	£349.17	£500 *(this amount is specified by the client)*	£547.50	£849.17

For advisers, using these tax-efficient regular income options under flexi-access drawdown increases the flexibility to structure PCLS and income payments in the most tax efficient way to meet a client's regular income needs. The facility becomes a valuable financial planning tool, retaining as much of a client's pension savings as possible for meeting future income needs and increasing the potential value that can be passed onto beneficiaries in the event of a client's death.

If John is also worried about the potential effect of IHT, especially when the pension becomes considered for IHT in 2027, then he may wish to consider drawing excess monies over the income amount that falls within the personal allowance. This may then be seen as excess income and as such, when gifted away would immediately be outside John's estate for IHT and will not be seen as a Potentially Exempt Transfer (PET). Further details on this process can be found here ***https://www.quilter.com/help-and-support/technical-insights/technical-insights-articles/iht-gifting-via-normal-expenditure/***.

For a step by step summary that explains how to set up tax-efficient regular income options (TRIO) on your client's Collective Retirement Account, please read our useful guide ***https://quilter.com/support-and-help/platform-training/how-do-i-set-up-tax-efficient-regular-income-from-a-pension/***

The following link provides more information on the full range of retirement income solutions provided by Collective Retirement Account, including the tax-efficient regular income options ***https://www.quilter.com/products/pensions/collective-retirement-account---flexible-withdrawals/***

Your clients' investments may fall or rise in value and they may not get back what they put in.

This document is based on Quilter's interpretation of the law and HM Revenue and Customs practice as at January 2025. We believe this interpretation is correct, but cannot guarantee it. Tax relief and the tax treatment of investment funds may change.

The value of any tax relief will depend on the investor's individual circumstances.

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Quilter is the trading name of Quilter Life & Pensions Limited which provides a Collective Retirement Account (CRA) and Collective Investment Bond (CIB).

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