To crystallise or not to crystallise?

That is the question for clients with pension savings above £1,073,100.

How has clients' tax-free cash been frozen?

From 6 April 2024, the lifetime allowance was abolished and as a consequence the amount of tax-free cash clients can take (otherwise known as their pension commencement lump sum or PCLS) will be frozen at £268,275 for those clients with no protection. This new limit is called the lump sum allowance and it includes the client's PCLS as well as other tax-free lump sums during the client's lifetime.

This means clients who accrue pension savings above £1,073,100 have their tax-free cash limited to £268,275. There is no inflation-proofing of this amount, and it is safe to say that the frozen PCLS amount could remain unchanged for some time.

There will be clients who hold legacy lifetime allowance protections and who will enjoy higher protected PCLS amounts than £268,275. Similar principles to this case study could apply for these clients.

Tom
Age: 57
Gross pension pot:
£1,073,100

Tom is 57 and is married to Barbara, 47. He's about to start a new highly paid job and will join his new employer's auto-enrolment pension scheme.

He has a defined contribution pension pot of £1,073,100.

Barbara has a part-time job earning £22,000 and has very little in the way of pension savings.

They've paid off their mortgage and have about £37,000 in cash savings earning a small amount of interest.

They both want to retire in 10 years and are looking for an income of around £1,130 after tax each week* to live a comfortable life. Tom is therefore likely to be a higher rate taxpayer.

Tom doesn't currently need his pension commencement lump sum (PCLS).

Because tax-year end is approaching, he feels it's a good time to look at his financial position. He speaks to his financial adviser as he has read in the Daily Telegraph that PCLS limits have been frozen and this is really concerning him.

*£1,130 per week is the amount required by a couple to live a comfortable retirement.
Source: PLSA Retirement Livings Standards https://www.retirementlivingstandards.org.uk/

As Tom doesn't currently need his PCLS he could wait until he retires at 67. This might seem the natural choice, but is it the best strategy for Tom and Barbara to achieve their comfortable retirement?

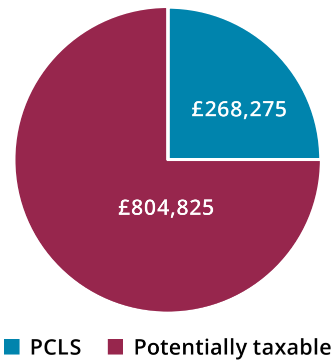
Option 1 – what would happen if Tom leaves his PCLS in his pension until age 67?

- As he doesn't need his PCLS, Tom decides not to take it until he retires at 67.
- Over the next 10 years his pension grows at 4% gross in real terms, allowing for 2% inflation, to £1,588,450.
- With his PCLS frozen, the maximum tax-free cash Tom can take at age 67 is still £268,275, even though his pension pot has grown significantly. Because of this, his effective PCLS entitlement has shrunk from 25% to 17%.

Tom's pension today

Total gross pension wealth at age 57:

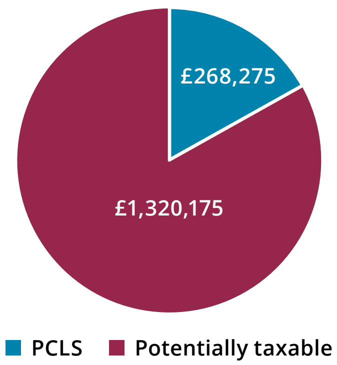
£1,073,100 gross



Position in 10 years

Total gross pension wealth at age 67:

£1,588,450 gross



Because the PCLS remains frozen, it now makes up just 17% of Tom's pension fund value.

Total net pension wealth at age 67 after Tom takes his PCLS and designates the rest to drawdown:

This is made up of:

- Tom's PCLS of £268,275, plus
- the remaining fund net of tax: £792,105 (£1,320,175 – 40%).

As you can see, under this option, Tom's total net wealth at age 67 is **£1,060,380.**

Option 2 – what would happen if Tom crystallised his pension now and reinvested his PCLS into a new tax wrapper?

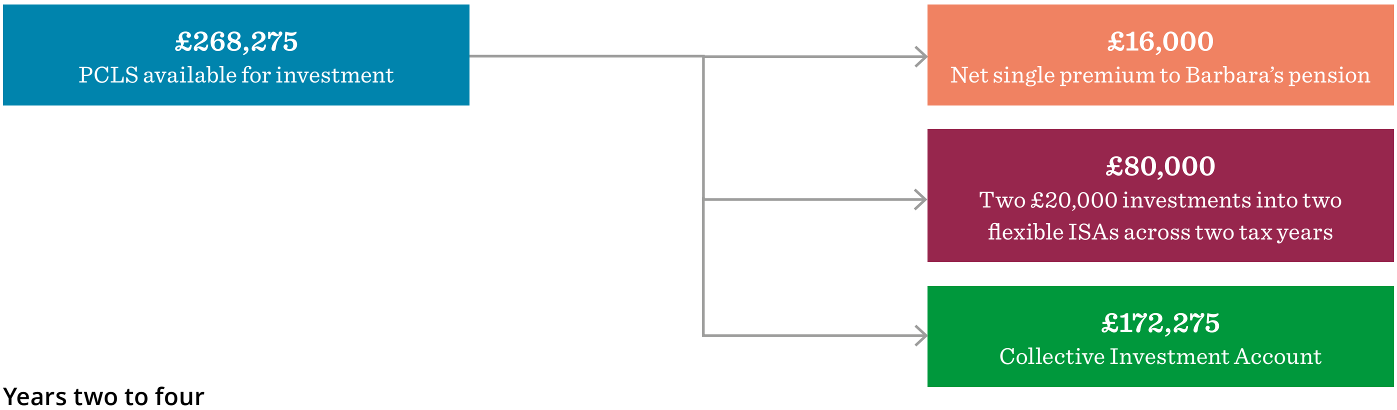
Tom's adviser could recommend crystallising the pension and taking the PCLS at age 57. The PCLS can then be reinvested over the next four years in a variety of tax wrappers to maximise overall tax efficiency. Importantly, Tom's adviser also recommends using Barbara's tax allowances both when paying money in (accumulation) and taking money out (decumulation).

Tom's adviser recommends that using the £268,275 tax-free cash he has withdrawn from his pension, he should:

- invest £80,000 into flexible ISAs across two tax years - £40,000 for Tom and £40,000 for Barbara
- invest a net single premium of £16,000 into the Quilter CRA for Barbara (£20,000 gross with immediate tax relief)
- invest the balance of £172,275 in a Quilter Collective Investment Account (CIA). The CIA will then be used in subsequent years to fund contributions to Barbara's pension and the couple's ISAs for the next three years, until it is completely exhausted.

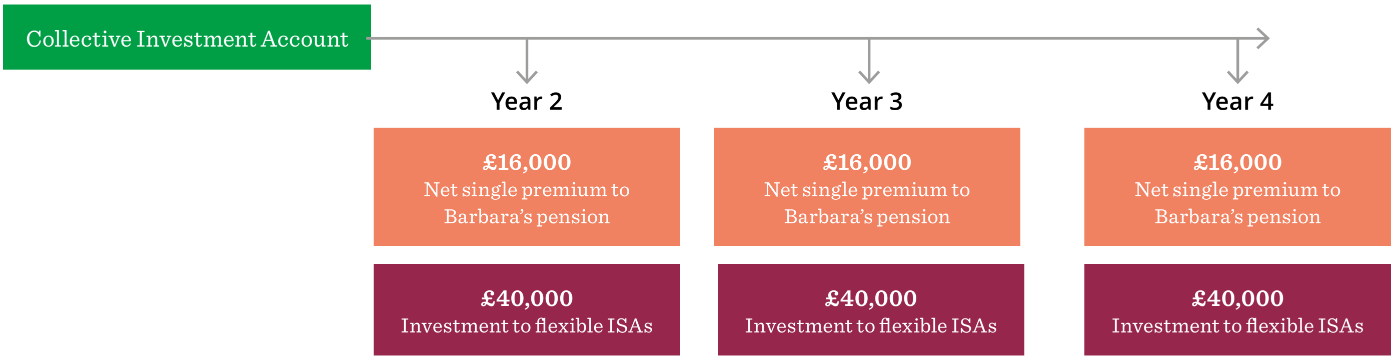
Year one

The PCLS is taken and is immediately reinvested.



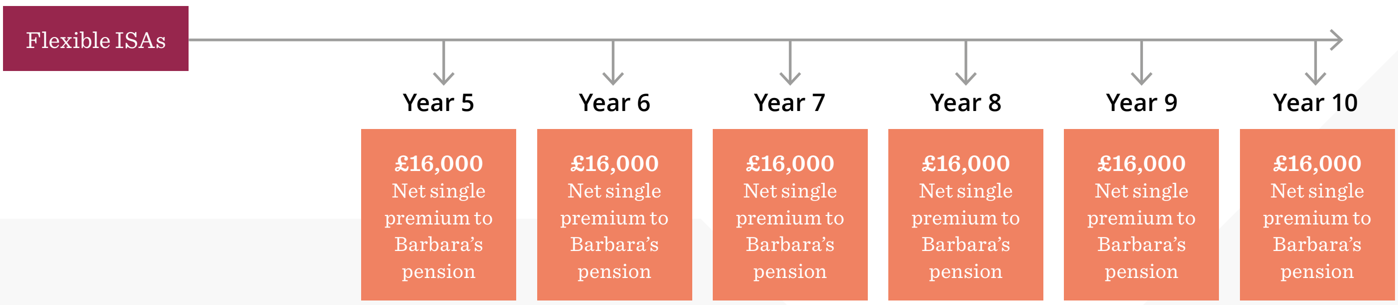
Years two to four

In the next three years, £56,000 is moved each year from the CIA into Barbara's pension and the couple's flexible ISAs, until the CIA is completely exhausted.



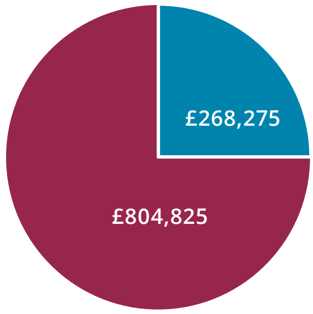
Years five to 10

In the final six years, Tom's adviser uses the funds accrued in the flexible ISAs to continue funding Barbara's pension, again at £16,000 net per annum.



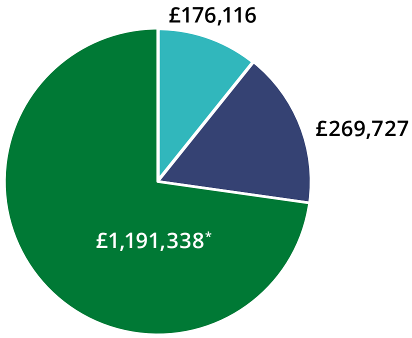
Tom's pension today

Total gross pension wealth at age 57:
£1,073,100 gross



Position in 10 years

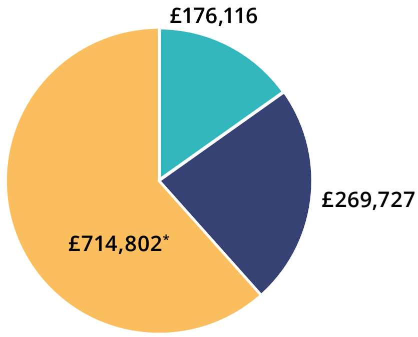
Couple's total gross wealth at age 67:
£1,637,181 gross



- Barbara's pension is uncrystallised, so her PCLS is still available.
- Tom's pension no longer contains his PCLS but his crystallised fund has grown*.

**£1,073,100 - £268,275 = £804,825 x 4% gross real return over 10 years = £1,191,338*

Couple's total net wealth at age 67:
£1,160,645 net



- Barbara uses Quilter's TRIO options to withdraw an income with no tax exposure until state pension age.
- The ISAs are free of income tax.
- Tom pays 40% tax on his pension, as a higher rate taxpayer*.

**(£1,191,338 – 40%)*

As you can see, under this option, the couple's total net wealth when Tom reaches age 67 is **£1,160,645.**

Option two allows the couple's adviser to add considerable value to their financial plans

As you can see, compared to option one – doing nothing and leaving the PCLS to languish within Tom's pension – rewrapping offers significant benefits.

Investment worth more	Fund increase over 10 years	Delta per annum
£100,265	9.5%	91bps

By taking the PCLS at 57 and reinvesting it in a new tax wrapper:

- more wealth is accumulated as each contribution to Barbara's pension receives tax relief and an instant uplift in value, along with the contributions to the flexible ISAs where money can grow tax free in a gross environment
- less tax will be paid in retirement as there are now double the personal allowances that can be used along with tax-efficient retirement income options for Barbara (until state pension age), coupled with their flexible ISAs.

What about IHT?

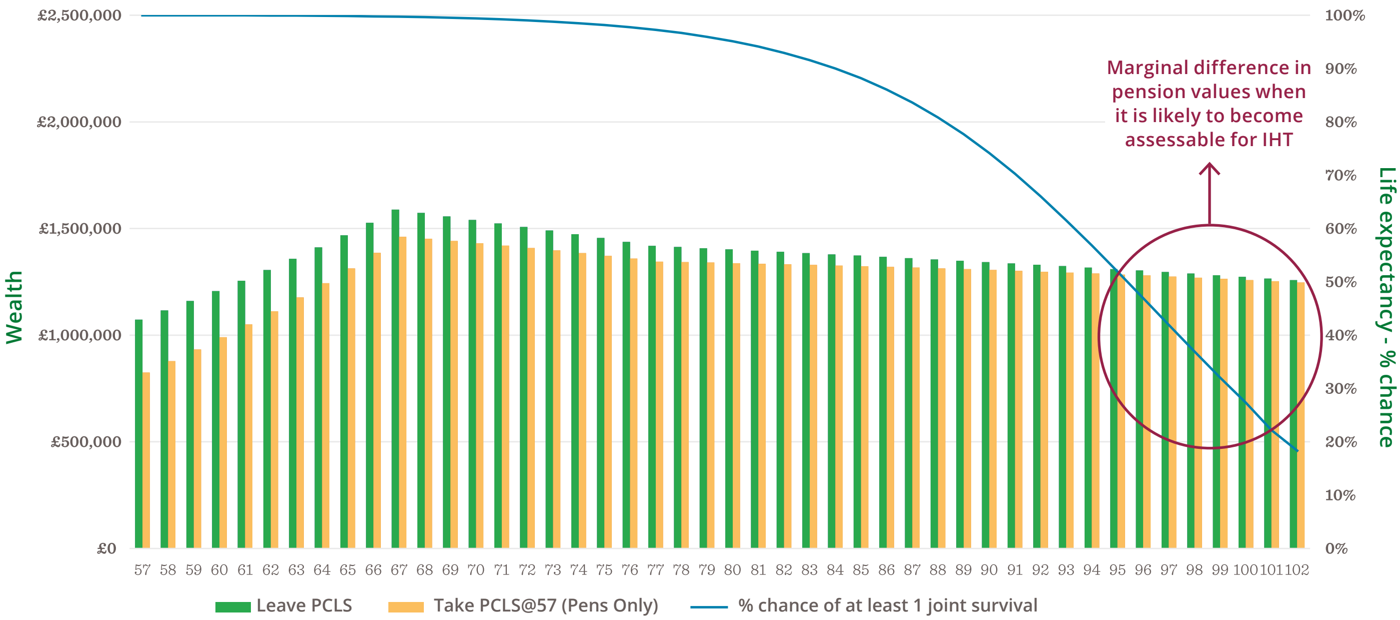
From 6 April 2027, it is the Government's intention to bring all unused pension funds into the inheritance tax framework.

Prior to this announcement, some advisers were concerned about the IHT efficiency of taking the PCLS out of the pension wrapper. However, as supported by the figures in the graph below, taking the PCLS out of a pension and using it to invest in other tax-efficient wrappers does not have a negative IHT impact longer-term.

This is because the other wrappers can help provide valuable additional sources of tax-efficient income in retirement, so the remaining pension doesn't need to be drawn-down as quickly as it would otherwise need to if it was the only source of income.

What the graph shows:

- The green bar is the value of Tom's pension including the PCLS.
- The yellow bar is the value of Tom's remaining pension after taking his PCLS out and reinvesting it into a pension for Barbara and into flexible ISAs over the 10-year period.
- Tom retires at age 67 and starts to take an income.
- In drawdown the green bar drops quicker than the yellow bar as the green bar is Tom's only source of pension income. The yellow bar doesn't drop as quickly as there are other sources of tax efficient income.
- Statistically, based on the ages of Tom (57) and Barbara (47) today, there is a 50% chance of at least one of them surviving to the age of 95. At which point, there will be minimal difference in value between Tom's pension if he leaves the PCLS or takes it out (the difference between the green and yellow bars is minimal by that point).



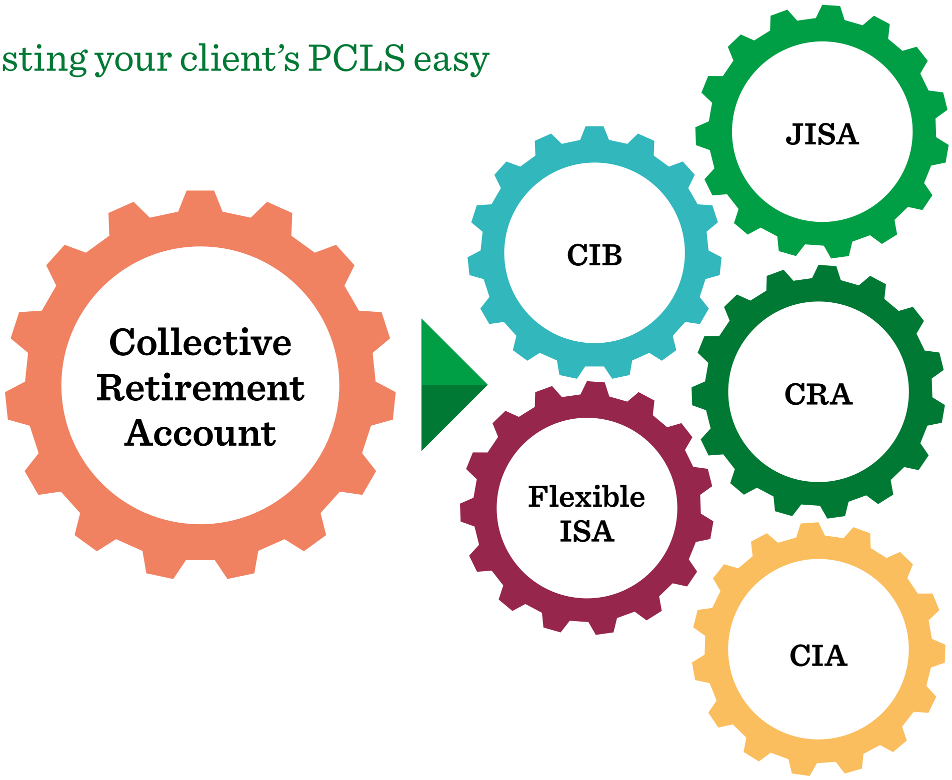
In conclusion, not taking action early and leaving the PCLS to dwell in the original scheme could create a poor outcome, due to the freezing of the lump sum allowance. Your advice on alternative approaches could turn that around and ensure good outcomes for clients.

At Quilter we make reinvesting your client's PCLS easy

Our platform makes it easy to reinvest your client's PCLS directly into other Quilter tax wrappers. Transfers can be made directly to an account in the investor's name, a joint account, or another investor who is eligible under Family Linking.

Our simple process means:

- no unnecessary bank transfers between you, your client or us – we'll take care of it
- all transactions are linked across multiple products
- reduced time out of the market.



You can find more information on reinvesting your client's PCLS in our flyer ***here***.

Or by opening your phone camera and scanning this QR code:

Tom case study assumptions: fund values within all tax wrappers grow at 4% gross real - in today's terms after accounting for 2% inflation for pensions and flexible ISAs. For the Collective Investment account, we assume a 3% net real return in today's terms accounting for 2% inflation. At 67, Tom will be a higher rate taxpayer and Barbara will be a non-taxpayer from 57 when she stops work through to her State Pension age. Barbara uses Quilter TRIO in her CRA to take retirement income without triggering income tax until her state pension age.

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 December 2024. 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.

quilter.com

QIP 23389/161/9543/December 2024