



Income Drawdown and Income Recycling

Case Study

What is Income Recycling?

Pension's legislation offers a great degree of flexibility in retirement planning. An example of this is the ability for your clients to 'recycle' the income from their Income Drawdown plan back into their Personal Pension plan, instead of taking their Pension Commencement Lump Sum (PCLS) and nil income. This gives the following benefits:

➤ Maximising Death benefits

If your client chooses to take their PCLS with nil income, the fund that remains would be liable to a 55% tax charge on death. However if the client takes the maximum available income from the drawdown plan and recycles the income back into a personal pension pot, the fund accrued by the reinvested income payments would not be liable to the same tax charge on death.

➤ Allows a second Pension Commencement Lump Sum

The income that is taken from the drawdown plan is re-invested back into your client's Personal Pension plan. Your client would continue to benefit from tax efficient growth and would have access to a further PCLS at the point they take benefits from the plan.

Case study



Mr Smith, who is still working, is aged 55 and has a selected retirement age of 65. He wants to inject around £100k of capital into his business. He has a Personal Pension (PP) with fund value of £400k.

What are his options?

Option 1

- Move full fund from personal pension into drawdown
- Take 25% PCLS
- Rest of fund remains invested for future income

Potential issue

Lump sum death benefits under drawdown will be return of fund less 55% tax charge

Option 2

- As option 1 but take maximum allowable income
- Reinvest income each year into Personal Pension
- Mr Smith is still working so he has the relevant earnings to support his pension contributions
- The reinvested income creates a fund that will allow him to take additional PCLS in future
- Lump sum death benefit will grow each year with any growth in the Pension i.e. less of Mr Smith's pension fund will be liable to new 55% tax charge

The examples on the following pages show how Mr. Smith could benefit from choosing Income Recycling as an option. Please note that Income Recycling isn't a suitable option for everyone and will be dependent on the clients individual circumstances.

Death benefits – if client dies on day 1 (Age 55)

Before PCLS invested into business, PP death benefit = return fund = **£400,000**

Option 1

Mr Smith moves full fund into drawdown and takes £100,000 (PCLS) so is left with £300,000

If Mr Smith dies on day 1 then lump sum death benefit payable is fund value less 55% tax charge = £300,000 – £165,000

£135,000 Net death benefit

Option 2

Mr Smith moves full fund into drawdown and takes £100,000 (PCLS) so is left with £300,000

Mr Smith takes maximum income of £20,880 p.a.* and recycles into FRP personal pension

Income Drawdown Pot

Day 1 fund value
= £300,000 – £20,880
= £279,120

£279,120 – £153,516
(55% tax) =
£125,604
Day 1 lump sum death benefit

Personal Pension Pot

Day 1 fund value
= £20,880

Death Benefit =
£20,880
(return of fund)

£146,484 Net death benefit

**Increase to Day 1
Death Benefit = £11,484**

* All income and contribution figures are gross of tax

Assumptions:

- 7% pa growth before charges
- FRP charging structure applies
- Nil Commission
- Income payments & pension contributions remain constant
- Income payments & pension contributions – paid annually in advance
- The value of an investment may go down as well as up and your clients fund value in future may be less than the payments they have made
- The above is based on our understanding, as at February 2010, of current taxation, legislation and HM Revenue & Customs practice, all of which are liable to change without notice. The impact of taxation (and any tax reliefs) depends on individual circumstances. This does not take into account the more complex situations eg where Protection applies. Income will be subject to PAYE tax.

Death benefits – If client dies 10 years later (age 65)

Option 1

10 yrs later on Nil income, Income Drawdown Fund is now worth **£551,000**

If Mr Smith dies at year 10 the death benefit will be **£551,000 – £303,050 (55% tax charge)**

£247,950 Net death benefit

Option 2

Assuming income of £20,880* p.a. paid into Mr Smith's personal pension

Income Drawdown Pot

Year 10 drawdown fund value = **£250,000**

Death Benefit = **£250,000 – £137,500 (55% tax charge)**

Net Death Benefit = **£112,500**

Personal Pension Pot

Year 10 personal pension fund value = **£295,000**

If Mr Smith dies at year 10 benefit is calculated as **£112,500 + £295,000**

= £407,500 Net death benefit

Increase to Year 10 Death Benefit = **£159,550**

If Mr Smith survives to age 65 he will have a personal pension fund worth **£295,000**

The fund could generate a further PCLS of **£73,750** for Mr Smith.

Assumptions:

- 7% pa growth before charges
- FRP charging structure applies
- Nil Commission
- Income payments & pension contributions remain constant
- Income payments & pension contributions – paid annually in advance
- The value of an investment may go down as well as up and your clients fund value in future may be less than the payments they have made
- The above is based on our understanding, as at February 2011, of current taxation, legislation and HM Revenue & Customs practice, all of which are liable to change without notice. The impact of taxation (and any tax reliefs) depends on individual circumstances. This does not take into account the more complex situations eg where Protection applies. Income will be subject to PAYE tax.



www.pruadviser.co.uk

Prudential" is a trading name of The Prudential Assurance Company Limited, which is registered in England and Wales. This name is also used by other companies within the Prudential Group, which between them provide a range of financial products including life assurance, pensions, savings and investment products. Registered Office at Laurence Pountney Hill, London EC4R 0HH. Registered number 15454. Authorised and regulated by the Financial Services Authority.