



7 min read

Helping you understand pensions

Many people find pensions easier when they understand the language that is sometimes used. As a result, we have prepared this guide to give you a helping hand.



We have split this guide into three sections:

1. When you make a withdrawal from a pension
2. The main types of withdrawals you can take from your pension
3. The main pension allowances

1. When you make a withdrawal from a pension

Tax-free cash	<p>When you take money from your pension pot, you're normally entitled to take up to 25% of it tax-free. You can take 25% of your pension pot value or 25% of your remaining lifetime allowance, whichever is lower. Some people with older pensions can take more than 25% tax-free. If you think you might have a higher entitlement, please contact us and we will be able to check for you.</p> <p>If your money is in a drawdown pot, it means that you have already had your chance to take tax-free cash and can't take it again.</p>
Taxable income	<p>When you take money from your drawdown pot it is classed as taxable income. It is taxed at your marginal rate of income tax, the same way as money you earn when working.</p> <p>When a pension provider pays you taxable income from your drawdown pot, they pay it through the pay as you earn (PAYE) system.</p> <p>When income tax is deducted it is calculated depending on your tax code. Unless the pensions provider has your correct tax code, it is likely an 'emergency' tax code will be used, and you may need to recover overpaid tax from HMRC.</p> <p>Income tax rates can vary across the UK depending on which country you live in. If you live outside of the UK, you will need to check with your tax authority whether you have to pay more tax in the country you live in.</p>
Marginal tax rate	The percentage of tax paid on earnings for the next pound earned.
Emergency tax	<p>If this is your first taxable income payment, your pension provider will put you on the emergency tax code until they are given an updated tax code from HMRC.</p> <p>The emergency tax code is designed so that you will be taxed by being given 1/12th of the standard personal allowance and 1/12th of each of the relevant tax bands until you reach the highest tax band. This will ignore any other income you have from other sources.</p> <p>For example, If you take monthly payments or a one-off payment, you will receive only one month's worth of your annual personal allowance (1/12th), and HMRC will assess the remaining payment against 1/12th of each of the relevant income tax bands.</p>
Disqualifying pension credit	Normally you can take 25% from your pension pot tax free. However, if you have received a pension sharing order (divorce) where your ex-spouse has already taken tax-free cash, you will have a pension pot that cannot pay you tax-free cash. You can only take taxable income.





2. The main types of withdrawals you can take from your pension

<p>Drawdown</p>	<p>You can choose to move some or all your pension pot into drawdown. This means after you take tax-free cash the pension money you moved into drawdown will remain invested (ringfenced) and you can take income from it a bit at a time. This is known as drawing down an income or withdrawing your capital.</p> <p>Unlike an annuity, drawdown does not provide a guaranteed income. That means if you withdraw all the money in your pension, you will no longer be able to use it to provide an income.</p> <p>There are two types of drawdown:</p> <ul style="list-style-type: none"> - Capped drawdown - Flexi-access drawdown
<p>Capped Drawdown</p>	<p>If you moved some or all your pension pot into drawdown before 6 April 2015, you'll have capped drawdown. It's 'capped' because the amount of income you can take is limited at a maximum amount. The cap, or limit, is reviewed every 3 years until you're 75, and then every year after that.</p> <p>As long as you don't take out more than your capped limit, you can put up to the annual allowance into any pension in the future.</p> <p>If you take more than the capped limit, your plan will convert to a flexi-access drawdown. This still allows you to take your pension income from drawdown. However, once you move to flexi-access drawdown the amount you can save into some pensions in future could be limited. This is called the money purchase annual allowance.</p> <p>You can also choose to convert your capped drawdown to flexi-access drawdown.</p>
<p>Flexi-access drawdown</p>	<p>If you move some or all your pension pot into drawdown now or in the future, you'll have flexi-access drawdown. Flexi-access means there's no limit on how much you can take from your pension pot every year. You could take it all, you could take a little, or you could leave it all invested. For instance, you might just have taken a tax-free cash lump sum, so you might not need any money from your drawdown for a while.</p> <p>However, as soon as you start taking money using flexi-access drawdown you'll be limited to how much you can save into some types of pension pots in the future. This limit is called the money purchase annual allowance.</p>
<p>Annuity</p>	<p>You can use some or all your money to buy a guaranteed, regular income from an insurance company. This is called an annuity.</p> <p>Annuities will pay you an income for life. They can be helpful if you're looking for security, and don't want the hassle of managing your money throughout retirement yourself.</p> <p>However, once you buy an annuity you can't usually change your mind and switch to another product.</p> <p>An annuity won't leave any money to your loved ones when you die, unless you choose a specific annuity product that does this. Look out for 'joint life' annuities if you want to choose something that will pay money toward someone else after you die. There are also different types of annuity. Some will always pay the same level of income. Over time, this may mean that your spending power declines as inflation leads to high prices in the future.</p> <p>Other annuities pay an income that rises in line with inflation, protecting your spending power in future. But they will pay you less when you first buy the annuity.</p>

3. The main pension allowances

Annual allowance	<p>There's a limit on how much money you can save or build up in all your pension savings each year without having a tax charge.</p> <p>This is called the Annual Allowance. Normally the Annual Allowance is £60,000 but it could be a lower amount if you take your pension income in a way that is considered 'flexible' or if you have a large taxable 'income'. These lower Annual Allowances and how they work are briefly explained below.</p> <p>If you go over your limit, you'll have to pay extra tax. You'll need to think about this if you're putting money in at the same time as taking it out, which might be the case if you're continuing to work while taking some of your pension.</p>
The money purchase annual allowance	<p>A money purchase pension is a pension pot where the money that is saved into it is invested and the value depends on what those investments are worth. Your pension with us is a money purchase pension.</p> <p>When you take income from your flexi-access drawdown, take an uncrystallised funds pension lump sum or an investment linked annuity you are considered to have flexibly accessed your pension. At this point the amount you can save into your money purchase pension without having a tax charge is £10,000. You may still be able to build up more savings than £10,000 without a tax charge if you have a defined benefit pension.</p> <p>A defined benefit pension provides a pension income for life, based on your earnings and the amount of time you have worked for the employer who offers that pension.</p>
The tapered annual allowance	<p>If you have a high taxable 'income' your annual allowance might be reduced depending on the amount of 'income' you have. The 'income' for this purpose considers taxable income for the year and the amount of pension savings made in the same tax year. Working out where it applies to you can be complicated so you should speak to us if you are not sure.</p>
Lifetime allowance	<p>This is a limit on the amount you can build up in all your pension savings put together. If the money in all your pensions adds up to more than this limit, you might have to pay tax when you use the money. This limit doesn't include your state pension though.</p> <p>For the 2023/24 tax year, the lifetime allowance is £1,073,100 however if you have previously applied for it, you might have a protected lifetime allowance. Whenever you use money in your pension pot – to take a tax-free lump sum, to move money into drawdown, or to buy an annuity, you use up a bit of your allowance. If you still have uncrystallised funds at age 75 these will be tested at this time.</p> <p>If the amount of money you take out is over your remaining lifetime allowance limit, and paid out as a lump sum, marginal rate income tax will be deducted.</p> <p>If your savings aren't checked against the lifetime allowance when you're alive, they'll be checked as they're passed on to your beneficiaries on death before age 75.</p>

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