Access pension money, make contributions and maintain PCLS growth potential using small pots

Case study

***Eddie**, 63, has worked hard all his life and is now easing into retirement by undertaking consultancy work after taking redundancy.*

Eddie's consultancy work means that his income is not regular. He usually does three or six month contracts with gaps in-between. These contracts can be very lucrative so he wants to keep going as a consultant for as long as he can. While doing so, he wants to keep topping up his pension with one-off contributions.

He has saved into pensions for most of his working life and has a fund value of £300,000. He lives with his wife Elaine, 58, who is still in full time employment with the NHS. They have used Eddie's redundancy to pay off their outstanding mortgage.

When Eddie and Elaine fully retire, they plan to use the pension commencement lump sum (PCLS) from both of their pensions to buy a flat on the south coast for long weekend breaks and summer holidays. That's their retirement dream.

Eddie has always had a passion for cars and feels it's the right time to treat himself to a new BMW 3 series. He has £4,500 remaining from his last work contract and he's looking to use that towards the purchase. Having done lots of research and scoured the car market for the best deal, he's negotiated a cash purchase price for his dream car of £30,000. The deal is only valid if he completes the purchase by the end of the month. Therefore, he needs £25,500 promptly.

Eddie's really proud to have paid off his mortgage and he doesn't want to be taking on more debt. Therefore, he's looking to his pension as a source of finance. He understands that pension rules allow him to cash in some, or all, of this benefits and he feels it's the right time to start to do this. As well as buying the car today, he's also got one eye on being able to use his pension to buy the holiday flat he and Elaine want in the future. He wants financial advice to make sure he can do everything he wants to do.

What's the best way for eddie to structure the purchase?

Before purchase

Uncrystallised fund value	£300,000
Crystallised fund value	£0
Total fund value	£300,000

After purchase

	Options		
	Pension Commencement Lump Sum (PCLS) only	Uncrystallised funds pension Lump sum (UFPLS) or PCLS & Flexi-access Drawdown (FAD) income	Small pots
Uncrystallised fund value	£198,000	£264,113	£270,000
Crystallised fund value	£76,500	£0	£0
Total fund value	£274,500	£264,113	£270,000
Gross payment	£25,500	£35,887	£30,000
Income tax (at source)	£0	£10,387*	£4,500**
Net payment	£25,500	£25,500	£25,500

** Taxed on an emergency tax basis of M1 code 1250L for the 2023/2024 tax year. A tax refund may be applicable if there has been an overpayment.*

*** Taxed at the basic savings rate of 20%. Use of the basic savings rate assumes we do not hold a income tax code for Eddie. A tax refund may be applicable if there has been an overpayment, or more tax may be due if there has been an underpayment.*

PCLS only

This option results in a tax-free payment that does not trigger the money purchase annual allowance (MPAA). However, it does result in the loss of a future PCLS payment which could potentially grow over time due to investment returns. This is unlikely to help meet Eddie's plan to purchase a flat on the south coast in the future.

Tax efficient (in the short term)?	Yes	✓
Avoids MPAA trigger?	Yes	✓
Maintains PCLS potential?	No	✗

UFPLS or PCLS and FAD income

This option does help maintain the potential for a future PCLS. However, it suffers from the emergency tax code problem which more than likely results in too much income tax being paid. This tax can be claimed back but it cannot be returned directly to the pension. The payment also triggers the MPAA. This is unlikely to meet Eddie's plan to make further one-off pension contributions going forward.

Tax efficient?	No	✗
Avoids MPAA trigger?	No	✗
Maintains PCLS potential?	Yes	✓

Small pots

This option has the most potential to maintain a future PCLS and does not trigger the MPAA. This helps meet Eddie's needs of a future flat purchase and future one-off pension contributions. This option means that 75% of the gross payment is taxed at 20%. If Eddie becomes a higher rate taxpayer in the tax year, this could mean that a further tax payment is due.

Tax efficient (in the long term)?	Maybe	?
Avoids MPAA trigger?	Yes	✓
Maintains PCLS potential?	Yes	✓

Conclusion

With the help of his adviser, Eddie decides that the small pots payment is the best option and completes the car purchase without delay. Eddie wants to keep growing his pension with one-off contributions and stick to his and Elaine's plan of buying a flat on the south coast in the future.

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