Protected

pension access

Pension tax-free cash:

5 common pitfalls and how to avoid them

Stay **smart** when accessing your pension pot.

What’s included?

Important note: releasing pension money early is not right for everyone as it will leave you worse off in retirement.

What is pension tax-free cash?

Current government rules allow you to start withdrawing funds from your pension from the age of 55. And the first 25% is tax-free.

This means greater financial freedom when it comes to accessing your hard-earned savings. Many people have used their tax-free cash to:

- Fund home improvements
- Help a loved one onto the property ladder
- Pay off debts before retirement
- Clear a mortgage
- Fund a holiday
- Pay for a one-off expensive purchase

While accessing your tax-free cash sounds simple, pensions can actually be rather complicated. And, if you can't get your head around all the technical jargon, you could be making a decision now that will leave you worse off in the future.

That's why we have put together this guide to take you through the 5 most common pitfalls you could face when releasing your tax-free cash and how to avoid them.

In 2020/21, **596,080** people accessed their pensions for the first time[1].

[1]Retirement income market data, published by the FCA (Dec 21)

Pitfall 1: Leaving yourself short in retirement

Possibly the most important pitfall you might face is taking too much from your pension too soon and leaving yourself short in retirement. So, before you take any lump sums, regular income, or your whole pension, it's a good idea to understand any impact it may have.

This doesn't mean that taking your tax-free cash is a bad idea. It just means making sure it's right for you.

Top tip #1

With careful planning and preparation, you can make sure you are not impacting your future.

Top tip #2

Get help from a regulated financial adviser. Going straight to your pension provider means you won't receive authorised and regulated support when deciding what to do.

Top tip #3

Find a financial adviser that doesn't charge up front. This way you should get all the facts and figures you need to make a decision without having to pay a fee.

Pitfall 2: Getting an unexpected bill from the taxman

When withdrawing money from your pension, it's important to be aware of how and when tax will come into play.

Only the first 25% of your pension is tax-free, and any further withdrawals are taxable as income. So, withdrawing more than your tax-free amount can come with an unexpected bill.

Any money taken from your pension counts towards your annual income allowance. Exceeding this amount will affect your tax bracket and could mean having to pay a higher rate of tax. And no one wants to see the taxman take away their hard-earned cash.

Top tip #1

Know your annual income allowance and try to stay below this amount when making withdrawals.

Top tip #2

Ask a regulated financial adviser to assist you when making withdrawals to make sure you aren't lumped with a large bill.

In 2020 and 2021, **£9.6 billion** was withdrawn flexibly from pensions. The total value of flexible withdrawals since the introduction of pension freedoms exceeds **£45 billion**.[2]

[2]Commentary for Personal and Stakeholder Pension Statistics: September 2021 published by ONS (Oct 21)

Pitfall 3: Opting out of a defined benefit scheme

A defined benefit pension provides a guaranteed income from a set age. This means your retirement income is secure without having to worry about how your investments are performing.

These schemes generally have their own rules and limitations when it comes to accessing your cash. And these rules are there for good reason – to protect your future.

Like all regulated financial advisers, our starting point when it comes to this type of pension is to leave it as it is unless there is an urgent and immediate need for funds. This is because the benefits you get with the type of scheme are so valuable and almost impossible to recreate if you transfer out.

Top tip #1

Know what you will be giving up and assess what is more valuable to you.

Top tip #2

A financial adviser can help you know your options, making it easier to do what is right for you.

If your pension is worth **£30,000** or more, you will need to seek advice before you can access your pot.

Pitfall 4: Transferring your savings to an ISA or bank account

Before taking money from your pension, it's important to make sure you have a plan for the cash. This is because there are more benefits to keeping money in a pension than in a bank account.

Why it's better to save in a pension

1 Money in a bank account becomes vulnerable to inflation and low interest rates. Although, a bank account can be a lower-risk environment for your savings compared with a pension.

2 Any growth on your savings held in a pension isn't taxed.

3 The way pensions are set up puts you in a much stronger position to take advantage of compound interest. And Einstein called compound interest the eighth wonder of the world.

0.11%

The average interest rate for a standard instant access account[1].

9.80%

The average annualised investment return of our middle-risk portfolio[2]. Past performance is not an indicator of future results.

[1] Bank of England database (31 Jan 22)
[2] The performance figure is based on average annualised returns of our Prism 3 portfolio as of February 2023. Source: FE Analytics. The figures quoted above do not take into account the impact of any charges associated with bank accounts, pensions or advice.

Pitfall 5: Getting caught by a scam

So you've decided that releasing your tax-free cash is right for you, you've made sure it's affordable and you won't be losing out on any benefits. What is the final hurdle that might trip you up? Scammers.

When searching for a company to help, you might come across one that is offering something that no one else can. And there is a reason for that.

Pension scammers like to appear to be better than the rest, but you'll find that in using them your money could end up in dodgy investments, you get stuck with a high tax bill, or you lose all your money altogether.

When searching for a company, ask yourself these 5 questions:

- ✔ Is the company regulated by the FCA?
- ✔ Are they using unfamiliar language?
- ✔ Have they promised guaranteed returns?
- ✔ Have they said you can access your pension before 55?
- ✔ Does the company make you feel under pressure?

→ Find out more about avoiding pension scams here.

Who are Pension Access?

We are pension specialists, helping thousands of people to release tax-free cash each year. 97% of people who have reviewed us on reviews.co.uk recommend us. And we are authorised and regulated by the Financial Conduct Authority (company number 754580).

Thinking about getting pension advice?

Visit pensionaccess.co.uk

> I needed to release funds from my pension for some home improvements and they sorted the whole process quickly and professionally. Excellent service.
>
> \- J. Hodgetts

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