Considerations for US citizens taking UK pension distributions

Pension freedoms were introduced in April 2015 in the UK allowing individuals aged 55 and over with a UK defined contribution pension to be able to drawdown their pension however they wish (though there are tax consequences). Prior to this change, there were prescribed options for drawdown limiting the way in which pension savings could be accessed today it is up to the individual to decide how they want to access retirement funds.

As an American living in the UK, there are several considerations when taking distributions from your UK pension. We discuss some of these options below in more detail.

There are four main distribution options to consider for UK pensions:

1) **Full lump sum distribution -** If you require significant liquidity or want control over your finances in the short-term you could decide to take your entire pension pot in one lump sum and invest/spend the funds as you wish. Certain taxation rules would apply which could significantly deplete your fund.
2) **Purchase an Annuity –** If you desire a more secure and regular income stream you could purchase an Annuity, either at retirement, or at a later chosen date. An Annuity is an insurance product that allows you to swap your pension pot for a guaranteed regular income which lasts for your lifetime or for a specified period. It should be noted that purchasing an Annuity is an irreversible decision.
3) **Flexi-access drawdown –** This option allows you to draw down different amounts over any period of time. It can be considered if you wish to keep your assets invested in the tax efficient pension wrapper for as long as possible and wish to access the funds over time. The amount of distribution can vary; the tax paid on the distribution will be determined by tax residency and amount of distribution.
4) **Uncrystallised funds pension lump sum (UFPLS) –** This option allows you to withdraw a single or series of lump sums from your pension without the need to move the funds into a drawdown product first. It can be considered if you would prefer to keep your assets invested in the tax efficient wrapper for as long as possible and wish to access the funds over time. If the entire pension fund is not withdrawn at once, then 25% of each lump sum may be taken tax-free with the balance taxed at your marginal rate of income tax. Not all pensions will offer this flexibility so, if this is something that you want to take advantage of, it is possible that you may need to transfer to a pension arrangement with more flexibility.

Individuals generally can choose one distribution option for their entire pension fund or choose different distribution options for segments of their pension fund. Up to 25% of the pension fund is generally available to be taken tax-free from a UK perspective.

Which drawdown strategy is right for you?

The ability to choose flexible drawdown over an Annuity offers increased control and flexibility on the use of your pension assets. It is important to note, that this option bears some risk as you do not have a secure Annuity and flexible drawdown requires careful management to ensure you do not deplete the account through excessive income drawdown.

To begin assessing which distribution strategy is right for you, you need to have a good understanding of your financial goals and objectives as well as your income needs from your pension and other assets. You should give some thought to the questions outlined below to frame your financial goals for the money:

- What does retirement mean to you? Will you stop work altogether or will you continue to earn a partial income stream?
- What lifestyle do you want in retirement? Regular holidays? How much income will you need your assets to generate; will that income be needed regularly or at reaching certain milestones?
- Where do you want to live in retirement? Will you live in the UK or in the US, or perhaps settle somewhere else?
- How much risk can you afford to take with your income? How much risk do you feel comfortable with? Will short-term volatility affect your ability to meet your everyday needs?
- Do you feel comfortable retaining an ongoing responsibility for managing your retirement income?
- Do you have dependents or other family members who will be reliant on monies from your pension when you die?
- Do you want to leave an inheritance to a specified individual? If so, do you have assets that you can draw upon before utilising your UK pension savings?

Additional considerations for a US person

Pension freedoms provide opportunities for US individuals to drawdown their pensions in a manner that can be both tax efficient and suitable for their individual situation. Individuals no longer face liquidity restrictions if accessing a large lump sum is a suitable drawdown strategy.

Distributions from a UK pension can be treated differently for tax purposes depending on the type of distribution, the tax residency of the pension owner and the application of the US-UK tax treaty. Generally, when it comes to periodic pension distributions, the primary taxing rights lie with the country of residence, not the country in which the pension is located. What this means is that if a US citizen who is UK resident begins taking periodic distributions from their UK pension, the UK will have primary taxing rights on the distribution. Despite this, the US will often require US citizens to report UK pension distributions in the US as well, albeit with foreign tax credits generally available to offset any US tax payable.

There are now many planning opportunities for Americans as they approach retirement and decide where their retirement years will be spent. The currency of your pension, the amount you should contribute to a pension, as well as your planned drawdown strategy should be a point of focus discussion with your tax adviser as well as your wealth manager as you near retirement.

The Legal Stuff

enquiries@masecopw.com
+44 (0) 207 043 0455 | +1-888-MASECO1

MASECOPRIVATEWEALTH.COM