

TAXABLE LUMP SUM OPTION – THE IMPACT OF TAXATION

The way pensions are taxed can be complicated, therefore we have tried to explain it simply below. However, the easiest way to calculate what tax you may have to pay when taking the whole of your pension fund as a taxable lump sum is to visit the Pension Wise website at www.pensionwise.gov.uk.

How to calculate the tax you will pay if you choose to take the whole of your pension as a taxable lump sum:

Small Pot Lump Sum

A small pot lump sum will be taxed at the basic rate of income tax on settlement.

Taxable Lump Sum (other than Small Pot Lump Sum)

A taxable lump sum will be taxed at an Emergency Tax rate on settlement.

It is important to understand that ultimately your cash lump sum will be taxed on your marginal rate. However, initially you may be under or over taxed. Shortly after the end of the tax year, HM Revenue and Customs (HMRC) will automatically assess the tax you have paid on the lump sum along with any other sources of income you may have. HMRC will contact you directly regarding any under or over payment.

We have provided an example based on a customer taking all of their pension savings as a taxable lump sum. Please note that the same principles will also apply to any taxable lump sum taken as part of a combination of benefits.

The information below explains the basis of the tax amount due using the Emergency Tax Rate.

Under the Emergency Tax Rate your provider will apply one month's (1/12th) amount of each of the following allowance/bands to your taxable lump sum amount.

Basic Personal Allowance - £12,570 per annum

- You will not pay tax on the first £1,047 (£12,570/12) of your lump sum amount

Basic Tax Rate Band - £50,450 per annum

- The next part of your lump sum amount between £1,047 and £4,204.16 (£50,450/12) will be taxed at 20%

Higher Tax Rate - £50,450 to £150,000 per annum

- The next part of your lump sum amount between £4,204.16 and £12,500 (£150,000/12) will be taxed at 40%

Additional Tax Rate Band - Greater than £150,000 per annum

- Any amount remaining from your lump sum will be taxed at 45%

Please see the example overleaf – figures rounded down.

Example:

Joan has pension savings worth £50,000. The example below explains the tax-free element and the amount of tax deductible. This will be the initial amount of tax applied to Joan's taxable lump sum. However, Joan's final tax year end position will be determined by HMRC.

Pension Fund value: £50,000

- 25% tax-free amount: £12,500
- Basic Personal Allowance tax-free amount: £1,047
- Total amount liable for taxation = £50,000 - £12,500 - £1,047 = £36,453

The £36,453 will be taxed as follows:

- £3,157.16 of the £36,453 @ 20% = £631.43
- £8,295.84 of the £36,453 @ 40% = £3,318.33
- £25,00 of the £36,453 @ 45% = £11,250

Total tax on the taxable lump sum of £50,000 will be £15,199.76

The actual lump sum amount payable to Joan will be **£34,800.24**

Additional Information

- Please be aware that this is not your final tax year end position and does not take into account any other income, savings or benefits you may have and/or any details held with regard to your personal tax code.
- If you wish to gauge the tax that may be applicable if you were to take the whole of your pension savings as a taxable lump sum, please visit the Pension Wise website at www.pensionwise.gov.uk. You can also call us using the contact details set out below.
- The calculations are based upon tax allowances for tax year 2022/2023 and our interpretation of Pension Legislation as at February 2015.
- Please be aware that by taking a taxable lump sum payment this may impact your entitlement to means-tested state benefits.

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