Puzzled By Pensions?

Pensions And Tax Guide 2024/2025

Guidance for Usdaw members

USDAW PENSIONS

Introduction

The Finance Act 2004, which became law in April 2006, made far-reaching changes to the tax treatment of pensions.

A pension is basically a long-term savings plan with tax relief.

Your regular contributions are invested so that they grow throughout your career and then provide you with an income in retirement.

Generally, you can access the money in your pension pot from the age of 55.

Once your income is over a certain level, the Government takes tax from your earnings.

You can see this on your payslip. If you put money into a personal pension scheme, it qualifies for tax relief. This means that as well as the money you're putting in, some of your money that would have gone to the Government as tax now goes into your pension pot instead.

You can usually take up to a quarter of your pension savings as a tax-free lump sum.

If you've built up your own pension pot in a defined contribution scheme (as opposed to a salary-related pension scheme) you can then use the rest of your pot as you choose from age 55 onwards.

This guide will provide further information about how Income Tax interacts with your pension.

Paddy Lillis
General Secretary

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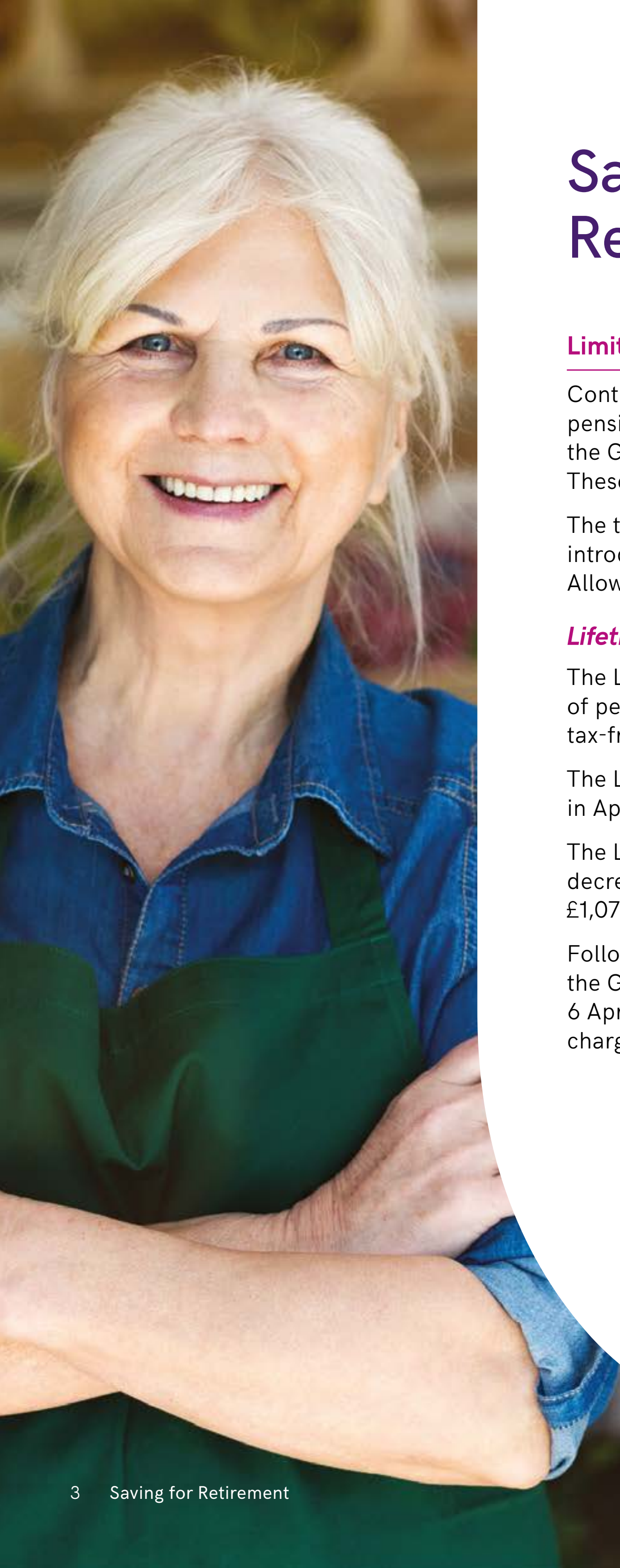


Saving for Retirement

Limits to Tax Relief

Contributions paid to a registered pension scheme receive tax relief from the Government up to certain limits. These are known as Taxable Allowances.

The two main taxable allowances introduced in 2006 were the Lifetime Allowance and the Annual Allowance.

Lifetime Allowance

The Lifetime Allowance was the amount of pension benefits that you could build tax-free over your working life.

The Lifetime Allowance was introduced in April 2006 at a limit of £1.5 million.

The Lifetime Allowance steadily decreased over a number of years to £1,073,100 for the tax year 2022/23.

Following the Spring budget in 2023, the Government announced that from 6 April 2023 the lifetime allowance charge would be removed altogether.

Annual Allowance

If you're a UK taxpayer the standard rule is that you'll get tax relief on pension contributions of up to 100% of your earnings or a £60,000 (2024/25) annual allowance, whichever is lower.

Any contributions you make over this limit will be subject to Income Tax at the highest rate you pay.

However, you can carry forward unused allowances from the previous three years, as long as you were a member of a pension scheme during those years.

The £60,000 Annual Allowance is also reduced if you have an income of over £260,000, including pension contributions (2024/25).

Your own workplace pension scheme may have limits on the amount you can pay in that it is more restrictive than the above allowances.

These allowances only really affect very high earners.

Money Purchase Annual Allowance (MPAA)

There is an exception to the standard Annual Allowance rule.

This will only affect you if you have a Defined Contribution (DC) pension.

These types of pensions are not linked to your salary and years of membership in the scheme. DC pensions are where you and your employer pay fixed contributions each month, which are typically invested in your individual pension pot.

This will only affect you if you are 55 or over, access more than the tax-free lump sum in a Defined Contribution pension pot and you continue to contribute to your current pension at the same time.

In this instance, the maximum amount you can pay into your current arrangement will reduce from £60,000 each year to £10,000 each year (2024/25). If you exceed this allowance you could be subject to taxation.

The reason for this restricted allowance is to prevent people withdrawing money from their pension pot and gaining tax relief for a second time, when they've already benefited from tax relief on what they paid into their pension over the years.

Whether the MPAA applies depends on how you access your pension pot and there are some complicated rules around this.

As a basic guide though, the main situations when you'll trigger the MPAA are:

- If you take your entire pension pot as a lump sum or start to take ad-hoc lump sums from your pension pot.
- If you put your pension pot money into a flexi-access drawdown scheme and start to take income.
- If you buy an investment-linked or flexible annuity where your income could go down.
- If you have a pre-April 2015 capped drawdown plan and start to take payments that exceed the cap.

And you won't normally trigger it if:

- You take a tax-free cash lump sum and buy a lifetime annuity that provides a guaranteed income for life that either stays level or increases.
- You take a tax-free cash lump sum and put your pensions pot into a flexi-access drawdown scheme but don't take any income from it.

- You cash in any small pension pots valued under £10,000.
- You started taking income under capped drawdown before 6 April 2015.

Finally, be aware that you can't carry over any unused MPAA to another tax year.

For more information about this please refer to Usdaw's factsheet Money Purchase Annual Allowance Explained: **www.usdaw.org.uk/MPAA**

Contributions paid to a registered pension scheme receive tax relief from the Government up to certain limits. These are known as Taxable Allowances.

The two main taxable allowances are a Lifetime Allowance and an Annual Allowance.

How Tax Relief is Applied to Your Pension

The Government will usually add money to your workplace pension in the form of tax relief if both of the following apply:

- You pay Income Tax.
- You pay into a personal pension or workplace pension.

Even if you don't pay Income Tax, you'll still get an additional payment if your pension scheme uses 'relief at source' (see later) to add money to your pension pot.

This applies to most private pension schemes, for example:

- Workplace pensions.
- Personal and stakeholder pensions.
- Overseas pension schemes that qualify for UK tax relief; ask your provider if it's a qualifying recognised overseas pension scheme (QROPS).

You get the tax relief automatically if your:

- Employer takes workplace pension contributions out of your pay before deducting Income Tax ('net pay scheme') or
- Pension provider claims tax relief for you at a rate of 20% and adds it to your pension pot ('relief at source').

You get relief at source in all personal and stakeholder pensions, and some workplace pensions.

Workplace Pension Schemes

Putting money in

How does tax relief work on your contributions?

Net Pay Scheme

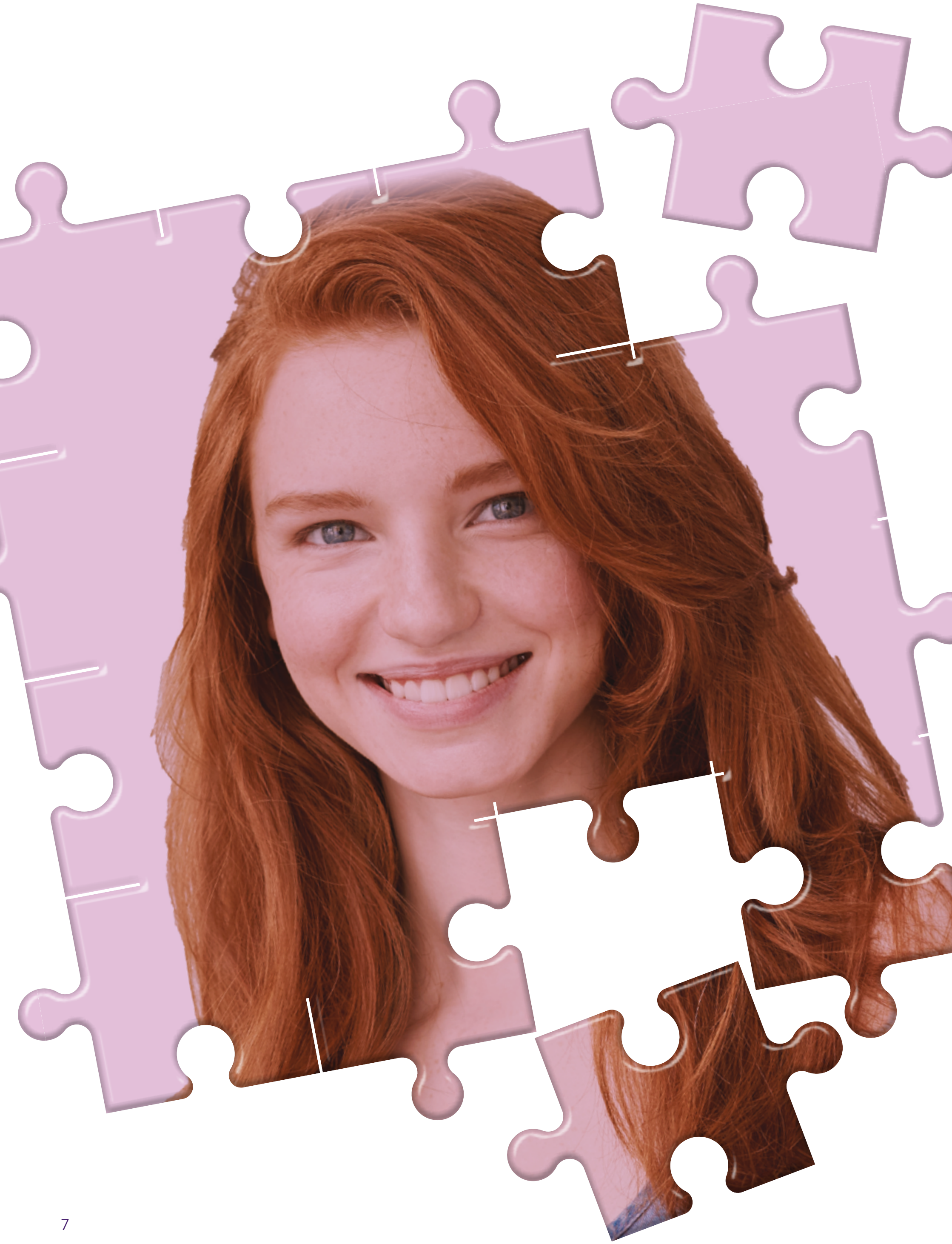
Your contributions are taken out of your gross pay*

*Gross pay = your total pay before Income Tax and National Insurance are taken off

Relief at Source

Your contributions are taken out of your net pay*

*Net pay = your pay after Income Tax and National Insurance deductions and then your pension provider reclaims the tax



Pensions in Payment and Income Tax

How Income Tax is Applied

You will pay tax if your total annual income adds up to more than your Personal Allowance.

The standard Personal Allowance is £12,570 (2024/25), which is the amount of income you don't have to pay tax on.

Your total income could include:

- The State Pension.
- A private pension (workplace or personal) – you can take some of this tax-free (see below).
- Self-employment.
- Any taxable benefits you get (eg. Jobseeker's Allowance and Carer's Allowance).
- Any other income, such as money from investments, property or savings.

Normally, any pension paid to you is treated as earned income and may be liable to Income Tax.

Pensions and Income Tax

Pension income paid to you is normally treated as earned income for Income Tax purposes, although you don't pay any National Insurance contributions on your pension income.

You will pay tax if your total annual income adds up to more than your Personal Allowance.

The standard Personal Allowance is £12,570 (2024/25), which is the amount of income you don't have to pay tax on.

Normally, any pension paid to you is treated as earned income and may be liable to Income Tax, although you don't pay any National Insurance contributions on your pension income.

You will normally be able to take some of your pension benefits (typically up to 25% of the value of your pension) as a tax-free lump sum.

Tax-Free Lump Sum Payments

You will normally be able to take some of your pension benefits (typically up to 25% of the value of your pension) as a tax-free lump sum at outset (sometimes called a Pension Commencement Lump Sum). The maximum tax-free lump sum is normally restricted to 25% of £1,073,100 (£268,275).

State Pensions

Any State Pension you receive is liable to Income Tax but it's paid to you gross (without any tax deducted).

State Pensions that you receive are treated as earned income for Income Tax purposes, (although you are no longer liable to pay any further National Insurance contributions once you have reached State Pension age). The State Pension age is the earliest age you can claim your State Pension. Your State Pension age depends on when you were born.

The amount of Income Tax that you pay depends on your gross income (the total amount of income potentially liable to tax that you receive from all sources, including other pensions and bank or building society interest).

You don't pay any Income Tax on your gross income up to your Personal Allowance (the standard Personal Allowance). Your Personal Allowance may be more or less than the standard figure due to a number of other factors. HM Revenue and Customs (HMRC) should tell you how much your Personal Allowance is each time it changes.

If your gross income is more than your Personal Allowance, you're liable to pay Income Tax on the amount that exceeds the Personal Allowance. Different rates of Income Tax apply depending on the type of income and how much it is.

Other Incomes

If you have other income as well as the State Pension you receive, such as a job or income from other pensions, your employer and/or pension provider will deduct Income Tax from the amount they pay you and pay this across to HMRC on your behalf. They'll also deduct tax due on your State Pension.

If you continue to work, your employer will take any tax due off your earnings and your State Pension. This is called Pay-As-You-Earn (PAYE).

If you do not work, but get pensions from more than one provider, for example if you have a workplace pension and a personal pension, HM Revenue and Customs (HMRC) will ask one of your providers to take the tax off your State Pension.

Check Your Income Tax

You should check each year that the correct amount of Income Tax has been deducted from the State Pension payments and other income you receive, especially if you have other sources of income, such as a part-time or full-time job, bank or building society interest and/or dividends or distributions from investments.

You should also check if you have a change in circumstances that affects the income that you receive, for example retiring from work and having lower income.

If you have had more tax deducted than you should have paid, you can reclaim the difference from HMRC using Repayment Claim Form P50. Similarly, you may also have to pay any tax that has been underpaid.

Tax Relief if You're a Non Taxpayer

If you're not earning enough to pay Income Tax, you'll still qualify to have tax relief added to your pension contributions up to a certain amount.

The maximum you can pay is £2,880 a year or 100% of your earnings – subject to your annual allowance.

Tax relief is added to your contribution so if you pay £2,880, a total of £3,600 a year will be paid into your pension scheme, even if you earn less than this.

However, this tax relief is only available where the pension scheme operates on a relief-at-source basis; it is not available for schemes that operate a net pay arrangement, which are the majority of pension funds in the market.

If you are a member of a pension scheme which operates a net pay arrangement, a low earner and you are owed tax relief, you will need to contact HMRC to claim the tax relief.

Understanding Your Tax Code

Tax Codes

When you retire, if you receive an income from several different sources; for example:

- Savings.
- Income.
- Earnings from a job.
- More than one pension.

You might be given more than one tax code.

Make sure you check the tax code(s) so you know the right amount of tax is deducted.

You can still claim back tax you might have paid on your savings in previous years when you should not have done.

To claim a repayment if you think you've paid too much tax on your savings, you can either:

- Use the online form service (sign into, or set up a Government Gateway account).
- Print the postal form, fill it in by hand and post it to HM Revenue and Customs (HMRC).

Personal Allowance

- You can earn a certain amount of income each year, called your Personal Allowance, before you need to pay any Income Tax.
- In general, everyone gets the same Personal Allowance of £12,570 (2024/25).
- However, you might get less if your income is over £100,000, if you owe tax from a previous tax year or more if you have overpaid tax from a previous tax year.

Gross and Net Pay

If you're an employee, the money you earn (your salary or hourly wage) is called your gross pay.

When deductions from gross pay like tax and National Insurance have been taken off, the amount you receive is called your net pay.

You can see what your gross pay was and how much has been taken off (if anything) on your payslip.

You can earn a certain amount of income each year, called your Personal Allowance, before you need to pay any Income Tax.

In general, everyone gets the same Personal Allowance of £12,570 (2024/25).

How Tax and National Insurance is Paid

If your income is more than your Personal Allowance in a year, you have to pay tax.

In general, your Personal Allowance is spread evenly across your pay packets for the year and your employer will take out tax before giving you your pay.

They know how much to take out through a system called PAYE (Pay-As-You-Earn). If it turns out at the end of the year you have paid too much tax, you can get a refund; too little and you will have to pay extra.

Your employer will also make National Insurance deductions from your pay.

This is worked out on a weekly or monthly basis, or however frequently you get paid. Unless there has been a mistake, you cannot get back any of the National Insurance you pay, even if your earnings fall later in the year.

How PAYE Works

When you start work, you'll either need to hand in a P45 form from your last job, or complete HMRC's new starter checklist: **www.gov.uk/government/publications/paye-starter-checklist**, which you get from your employer (if you are in receipt of a pension and your pension provider has your P45 form).

These forms both tell HMRC you've started work and will be used to create a tax code.

Your tax code then tells your employer how much tax to take off your pay.

How a Tax Code Works

The amount of tax you pay depends on:

- How much income you have;
- How much tax you've already paid in the year; and
- Your Personal Allowance.

Different people have different tax codes, depending on their circumstances.

Every year, HMRC sends out a Coding Notice telling you what your tax code is and how much tax you've paid.

You can also find your tax code on your payslip. It's usually made up of a few numbers and a letter.

Working Out Your Tax Code

Your tax code is normally the amount you can earn without paying tax, divided by 10, with a letter added.

For example:

Tax code: 1257L

1257 becomes £12,570 earned before tax.

Check You Have the Right Tax Code

Sometimes your tax code isn't right for your circumstances.

For example, if you started work recently and your correct tax code hasn't been worked out before your first payday, you might be on an 'emergency tax code'.

This means you might not be given the right Personal Allowance for you.

Incorrect Tax Codes

To make sure you're on the right tax code, check your code matches the Personal Allowance you should be getting.

Changing an Incorrect Tax Code

If you think your tax code is wrong, or if you're in any doubt, contact HMRC.

It's important you give HMRC all the information they ask for so you don't end up on the wrong tax code and pay too much or too little tax.

Overpayment of Tax

It's worth checking how much tax you've paid on your wages.

Remember to check your payslip regularly and check it shows the same tax code as your latest tax invoice.

Other Considerations

One of the main incentives to start and continue saving for a retirement pension is that by doing so you can get tax relief and reduce your tax bill.

For basic rate taxpayers this means that for every £1 you pay into your pension it will only cost you 80 pence.

Different people have different tax codes, depending on their circumstances.

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You can also find your tax code on your payslip. It's usually made up of a few numbers and a letter (normally the amount you can earn without paying tax, divided by 10, with a letter added).

If you think your tax code is wrong, or if you're in any doubt, contact HMRC.

Reclaiming Overpaid Tax

Emergency Tax Codes

Since April 2015 the pension freedoms allow people to access their defined contribution pension funds from the age of 55 and take as much of their money when and how they want to. However, tax is one of the main things you need to consider when taking money out of your pension.

If you take out a large, one-off lump sum (other than the first 25% which is tax-free) or your entire pension as cash, you may pay too much Income Tax.

This is because if you haven't taken money out of your pension savings before, your pension provider won't have your up-to-date PAYE tax code.

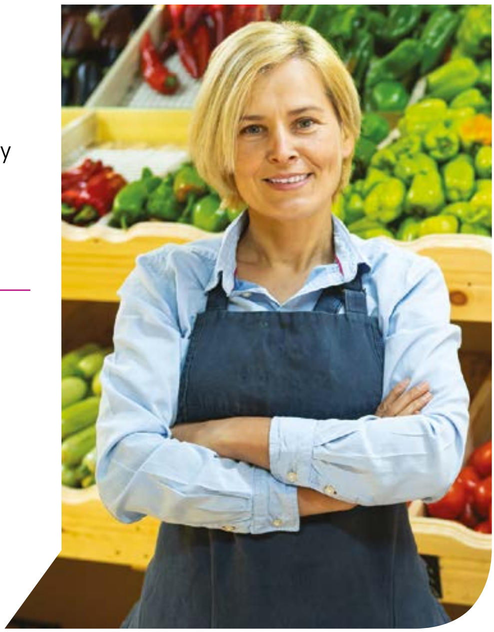
This means they have to follow HM Revenue and Customs' rules and apply an emergency tax code.

Understanding the Emergency Tax Code

The standard tax-free Personal Allowance for tax year 2024/25 is £12,570 but when the emergency tax code applies only one-twelfth of the Personal Allowance is applied to the money you receive. The assumption is that the payment you are getting is the first of a monthly series over that tax year.

When you make a one-off withdrawal this can mean too much tax is taken off. You can, in effect, be pushed into a higher tax band, so 40% or even 45% Income Tax might apply to part of the money you take out, before it is sent to you.

The emergency tax code doesn't apply, however, when you're taking money out of a pension pot valued at up to £10,000, when your withdrawal is under the 'small pots' rule. In this instance you will get 25% tax-free with the rest taxed at 20%.



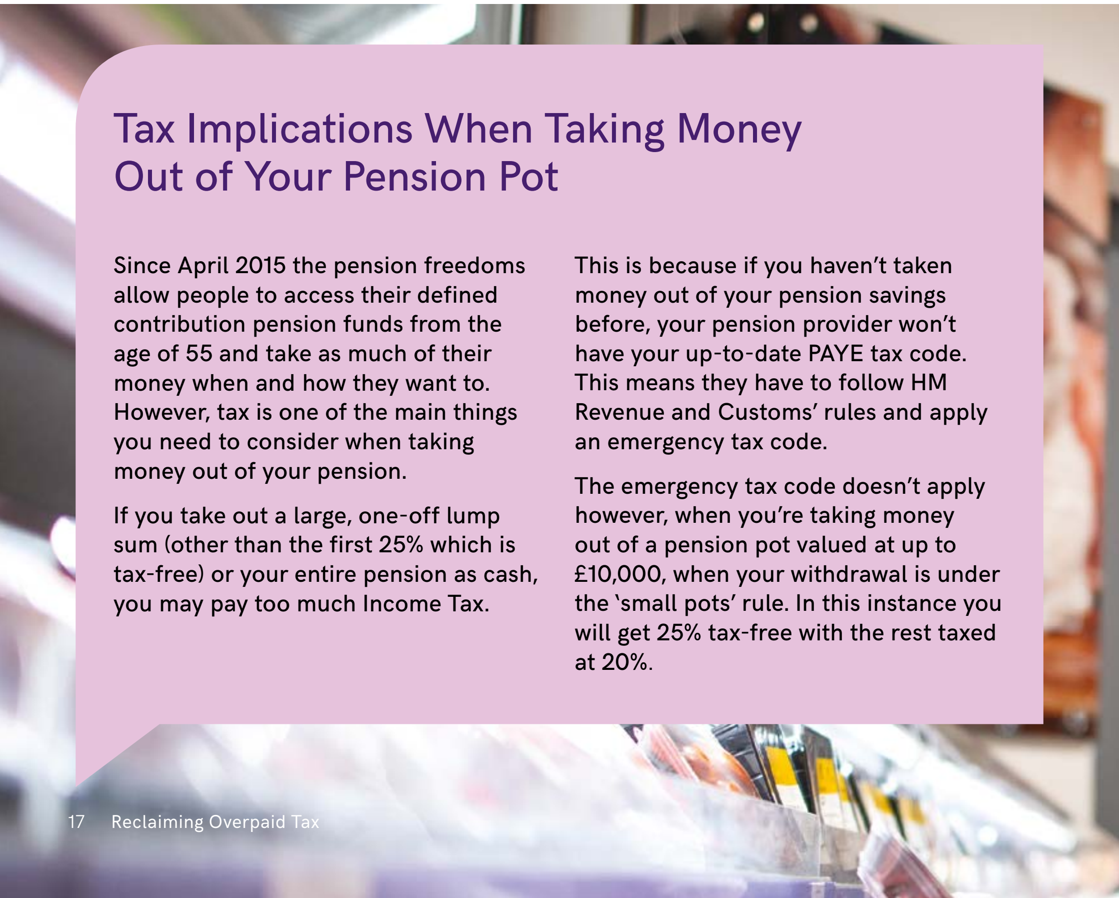
How to Claim Tax Back

You can complete a form on the HMRC website or claim the refund via your tax return if this applies to you.

You may need to complete one of the HMRC forms if you have paid too much tax on a pension lump sum (over and above your 25% tax-free lump sum allowance).

If you have taken your whole pension pot and don't have any other Pay-As-You-Earn (PAYE) or private pension income, then you can complete a form P50Z.

However, if you have other employment or pension income then you will complete a P53Z form.



Tax Implications When Taking Money Out of Your Pension Pot

Since April 2015 the pension freedoms allow people to access their defined contribution pension funds from the age of 55 and take as much of their money when and how they want to. However, tax is one of the main things you need to consider when taking money out of your pension.

If you take out a large, one-off lump sum (other than the first 25% which is tax-free) or your entire pension as cash, you may pay too much Income Tax.

This is because if you haven't taken money out of your pension savings before, your pension provider won't have your up-to-date PAYE tax code. This means they have to follow HM Revenue and Customs' rules and apply an emergency tax code.

The emergency tax code doesn't apply however, when you're taking money out of a pension pot valued at up to £10,000, when your withdrawal is under the 'small pots' rule. In this instance you will get 25% tax-free with the rest taxed at 20%.

If you want to take a large withdrawal or a series of ad-hoc withdrawals from your pension pot but without emptying it in this tax year then you would use form P55.

The Government website at: **www.gov.uk/claim-tax-refund** explains the different reasons and methods for reclaiming overpaid tax.

By planning ahead you could save a great deal in potentially unnecessary tax. For example, if you can afford to wait to take pension monies until the tax year after you retire from work, you might be liable to tax at a lower rate.

Alternatively you might be able to consider taking your money out in stages over several years thereby reducing your tax liability.

Other Considerations

Impact on State Benefits

You should check carefully the impact of your pension decisions on means-tested state benefits, such as Universal Credit and Pension Credit. Other benefits like Council Tax Support could also be affected.

It is not only the decision to take money out of a pension that could impact your current or future entitlement to means-tested state benefits. There could also be knock-on effects depending on how you use the money once you take it out. For example, if you were to decide to give pensions money away, for the purpose of receiving certain state benefits (such as help with care costs) it might be considered that you 'deprived yourself' of your pension savings.

We therefore recommend that you check your situation carefully before taking money out of your pension.

You should check carefully the impact of your pension decisions on means-tested state benefits, such as Universal Credit and Pension Credit. Other benefits like Council Tax Support could also be affected.

It is not only the decision to take money out of a pension that could impact your current or future entitlement to means-tested state benefits. There could also be knock-on effects depending on how you use the money once you take it out.

There is some guidance on the Government's Pension Wise website on state benefits impacts: **www.moneyhelper.org.uk/en/pensions-and-retirement/pension-wise**

The Department for Work and Pensions has also published a factsheet, available on GOV.UK, which considers how the pension flexibilities could affect entitlement to state benefits: **www.gov.uk/government/publications/pension-flexibilities-and-dwp-benefits**

But be aware that it is not only those currently in receipt of state benefits who might be affected. A decision you make now could affect your future entitlement.

Further Help and Advice

You can use the Government's 'Pension Wise' guidance service: **www.pensionwise.gov.uk/en,** or by making a telephone or face-to-face appointment: **www.moneyhelper.org.uk/en/pensions-and-retirement/pension-wise/book-a-free-pension-wise-appointment**

You might need to get specialist advice on your tax, tax credits and benefits position.

Some help is available for free for those on low incomes, from the Low Incomes Tax Reform Group: **www.litrg.org.uk**

The Low Incomes Tax Reform Group provides help and information to those least able in the community to afford to pay for tax advice and aims to help people understand the systems of taxation and related benefits whilst working to make them more equitable and accessible for their needs.

Scottish Income Tax

You pay Scottish Income Tax if you live in Scotland. It's paid to the Scottish Government.

Scottish Income Tax applies to your wages, pension and most other taxable income.

If you're employed or get a pension, your tax code will start with an 'S'. This tells your employer or pension provider to deduct tax at the Scottish rate.

Your tax code will be S1257L if you pay Scottish Income Tax and get the Standard Personal Allowance of £12,570 (2024/25), unless you were born before 1948 or earn over £100,000.

There is more information at: **www.gov.uk/scottish-income-tax** and **www.gov.uk/guidance/income-tax-and-national-insurance-contributions**

Notes

More Information

Do You Have A Question About Your Pension?

Submit your question online at:
www.usdaw.org.uk/PensionsQ

Scan the QR code to ask a question.

Usdaw Nationwide

Wherever you work, an Usdaw rep or official (Area Organiser) is not far away. For further information or assistance, contact your Usdaw rep or local Usdaw office. Alternatively you can phone our Freephone Helpline **0800 030 80 30** to connect you to your regional office or visit our website: **www.usdaw.org.uk**
You can also write to the Union's Head Office. Just write **FREEPOST USDAW** on the envelope and put it in the post.

Join Usdaw

You can join online at:
www.usdaw.org.uk/join

Scan the QR code to join today.

What Happens Next

Once we process your application, you will receive a membership card with our Helpline telephone number and a New Member's Pack giving details of all the benefits and professional services available to you.

Lft 451 April 2024
Stock photography, posed by models

USDAW