House of Commons Library

Research Briefing
16 May 2025
Number CBP 10250

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Taxation of state pension

Summary

The state pension is liable to income tax. Historically governments have taken the view that state pensions, as well as other 'earnings-replacement benefits', should be taxed this way.

The state pension is paid by the Department for Work and Pensions (DWP) without any tax being deducted first. To ensure the right amount of tax is paid on someone's total income – that is, their private or occupational pension plus their state pension – their pension provider takes the state pension into account when calculating how much tax to deduct under PAYE.

Generally pensioners whose only income is the state pension will not have to pay any income tax in practice. This is because their annual income will fall below the personal tax allowance – the amount of income taxpayers may receive tax-free.

Recently there have been some concerns that an increasing number of pensioners in this position may find that they are liable to pay some tax on their state pension. This is because the government has continued to apply the 'triple lock' when uprating the basic and new state pension, while freezing the personal tax allowance at £12,570, which is the level it reached in 2021/22.

1 What is the tax treatment of the state pension?

1.1 Overview

While some state benefits are not liable to income tax, the state pension is taxable.

HM Revenue & Customs (HMRC) has guidance on which state benefits are taxable and which are not.[1] The Low Incomes Tax Reform Group (LITRG), a well-respected charity that publishes a lot of guidance for taxpayers, particularly those who may not be able to afford professional legal advice, also have guidance on this issue.[2]

When the state retirement pension was first introduced in 1946, it was taxable, and this approach to the tax treatment of state pensions has remained unchanged.[3] The then Treasury Minister Dawn Primarolo (Labour) set out the case for the state pension being liable to tax in answer to a PQ in June 2006:

> This ensures equality of tax treatment in the same year between someone whose income is all from earnings and someone with the same level of income but which is derived partly from earnings and partly from benefit.[4]

In answer to another PQ the year before, the then Exchequer Minister, Ivan Lewis (Labour) noted the following:

> State pensions are not subject to national insurance contributions. Successive governments have believed that a pension, whether state or occupational, is a form of income like earnings and as such should be taxable [...] around half of all pensioners do not pay income tax. Exempting the state pension from income tax would therefore only benefit the better off pensioners.[5]

The then Financial Secretary Jesse Norman (Conservative) reiterated the principle underpinning the taxation of social security benefits in answer to a PQ in March 2021.[6]

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1 HMRC, Income Tax: introduction: Tax-free and taxable state benefits, retrieved 8 May 2025

2 LITRG, State benefits, updated 6 April 2025

3 Office of Tax Simplification, Review of pensioners' taxation: interim report, (PDF), March 2012 para A14. Provision to this effect was made by section 27(2) of the Finance Act 1946.

4 HC Deb 8 June 2006 c864W

5 HC Deb 5 July 2005 c279W

6 PQ162554, 12 March 2021. See also, PQ HL7259, 4 May 2023; and, PQ 43258, 9 April 2025.

1.2 The case for making the state pension tax-exempt: the Office for Tax Simplification's 2012-13 review

The question of making the state pension tax-exempt has not been debated recently in Parliament, but it was considered by the Office for Tax Simplification (OTS) as part of a major review of the taxation of pensioners it undertook in 2012-13.[7]

In their interim report published in March 2012, the OTS noted that there were a number of misconceptions amongst pensioners as to how the taxation of the state pension worked:

> The key point is probably that many people do not understand that it is taxable at all. Furthermore, many of those who do understand that it is taxable feel that this is unjust, given that they have contributed through the national insurance system throughout their working life […]
>
> There is some feeling that because there is no tax relief on national insurance contributions (NICs) which count towards eventual entitlement to the state pension, the state pension should not be taxed when it is paid out. Contrasting this to private pension savings, where tax relief is generally available on pension contributions and part of the eventual fund can be withdrawn tax-free, the confusion is perhaps understandable. We acknowledge that pension contributions are not deductible for national insurance contributions purposes but the symmetry is maintained with no national insurance contributions on pensions.[8]

Annex D to this report presented a variety of data on the pensioner population. The OTS noted the findings of a survey 'Attitudes to Pensions', published by the DWP in 2009. This found that 37% of respondents were not aware of any rules about pensions and tax. Less than half (41%) were aware that pension income is subject to tax like regular income. In addition there was a drop in confidence (28% very confident to 21% very confident) about tax knowledge between the run up to the state pension age and immediately after.[9]

In its final report published in January 2013 the OTS argued that exempting the state pension from tax was not a realistic option:

> For many, the most radical simplification we could recommend would be to exempt the State Pension from tax. However, this is in our view not a realistic option, even with some pragmatic adjustment to the personal allowance in exchange. Whilst noting that such an exemption would simply confirm what

7 The OTS was established in 2010 to provide independent advice to the Government on simplifying the tax system, but was closed at the end of 2022.

8 OTS, Review of pensioners' taxation: interim report, (PDF), March 2012 para 3.79, para 3.81

9 As above p83

many mistakenly believe to be the case, one cannot ignore the large hole in the public finances it would create. There are significant issues of fairness towards other taxpayers, especially as the wealthiest pensioners would benefit most, and over the last decade, pensioners have seen their incomes increase faster than other groups.[10]

2 How is tax collected on the state pension?

Generally pensioners in receipt of private pension income pay income tax under PAYE. Their pension provider deducts the right amount of tax 'at source', before paying out their pension, in the same way as an employer does before paying an employee's earnings. HMRC provides the pension provider with a tax code, so the provider can calculate someone's tax-free amount: the part of their pension they can receive tax-free. This calculation will include someone's personal allowance, but also certain other items which may increase or decrease the tax-free amount.[11]

One of these items is the state pension. This is because the state pension, while it is taxable, is paid to pensioners by the DWP without any tax being deducted. To ensure the right amount of tax is paid on someone's total income – their private or occupational pension plus their state pension – the pension provider has to take the state pension into account when calculating how much tax to deduct.

HMRC provide an online tool to enable people to check if they need to pay tax on their pension.[12]

If HMRC cannot collect tax on someone's state pension through the PAYE system, that person may have to complete a Self Assessment tax return each year.

Alternatively, HMRC may send that person a Simple Assessment. In the latter case, HMRC send someone a calculation of the tax owed for the tax year, rather than that person submitting a tax return. HMRC will base this on information that the DWP and other organisations provide them. Simple Assessment was introduced in 2016/17, covering new pensioners whose state pension exceeded the personal allowance, though HMRC is using it for other

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10 OTS, Review of Pensioners' Taxation: final report, (PDF) January 2013 p5. In relation to this last point the OTS cited some work on pensioner incomes published by the DWP in 2012 (The Pensioners' Income Series 2010-11 (PDF), 2012). The DWP collates more recent analysis of pensioner incomes on its site here: Pensioners' Incomes Series statistics.

11 For a basic explanation see, LITRG, Pay As You Earn (PAYE), updated 6 April 2025

12 HMRC, Check if you have to pay tax on your pension, 17 March 2025

taxpayers with very simple tax affairs.[13] HMRC publish a short guide on the way Simple Assessment works for pensioners.[14]

HMRC publishes a monthly Agent Update to provide tax agents and advisers guidance and news. In its most recent edition, published on 15 May, HMRC noted that from June 2025 it will start issuing Simple Assessment letters providing a detailed calculation for any tax owed by customers for income received between April 2024 and April 2025. It notes that most taxpayers receiving these letters will have "no previous knowledge of what a Simple Assessment is, how it is calculated or why they have underpaid tax."[15]

The LITRG publish detailed guidance on the way tax is collected on the state pension, and on pensions generally.[16]

The Library briefing Pensions in the UK provides an overview of pensions in the UK, including key data on the new and old state pension and private (occupational and personal) pensions.

3 Why are some pensioners whose only income is the state pension now paying tax?

3.1 Overview

The personal allowance is the amount of income someone can receive in a year before they start paying income tax. Usually the allowance is increased each year in line with inflation, but the allowance has been frozen at £12,570 since April 2021.[17] Freezing tax thresholds increases people's taxable income without nominal tax rates actually increasing. This results in additional revenue to the government. This phenomenon is called 'fiscal drag', as more taxpayers are 'dragged' into paying tax, or into paying tax at a higher rate.[18]

Over the period 2021 to 2023 the Conservative government introduced legislation in two stages to freeze the personal tax allowance at £12,570 for

13 HMRC, Simple Assessment - ending the tax return, 22 September 2017; LITRG, Simple Assessment, updated 6 April 2025.

14 HMRC, Pensioners and tax: communications materials, updated 22 August 2024. See also, HMRC, Pay your Simple Assessment tax bill, retrieved 16 May 2025.

15 HMRC, Issue 131 of Agent Update, 15 May 2025

16 LITRG, How tax is collected on the state pension, and, PAYE on pensions, updated 6 April 2025

17 For more details see, Commons Library research briefing CBP-10237 Direct taxes: Rates and allowances for 2025/26, 8 April 2025.

18 For more details see, Institute for Fiscal Studies, Income tax explained, updated 22 November 2023; and, Commons Library research briefing CBP-9687 Fiscal drag: An explainer, 31 January 2025.

the period 2022/23 to 2027/28.[19] In the Autumn 2024 Budget the current government confirmed the freeze would be maintained until the end of the 2027/28 tax year, and that the personal allowance would be uprated in line with inflation after this point.[20]

Over this period the basic and new state pension have been uprated annually in line with the 'triple lock'. This is the commitment to uprate the basic and new state pension every year by the highest of earnings growth, inflation, or 2.5%. The triple lock was implemented from the 2011/12 financial year and has been applied every year since, except for a temporary suspension in 2022/23.[21] Most recently in the 2024 Autumn Budget the government announced that for 2025/26 the basic and the new state pension would be increased by 4.1% in line with this commitment.[22]

These two trends have meant that in recent years there has been an increase in the number of pensioners paying income tax. For some pensioners, the rise in their state pension combined with income from other sources (such as savings income, or another pension) has put their total income above the personal allowance.

HMRC publish figures on the numbers of people paying income tax, as part of their statistics on income tax.[23] Over the five-year period 2020/21 to 2024/25, the total number of individuals paying income tax rose from 31.7 million to 37.4 million. Over the same five-year period, the numbers of individuals of state pension age paying income tax rose from 6.47 million to 8.51 million.[24]

There has been some commentary that if the state pension continued to be increased in line with the triple lock, and the personal allowance continued to be frozen, the state pension could well exceed the personal allowance in future years.[25] Some pensioners who are entitled to a state pension as well as an additional state pension under the former state earnings related pension scheme, may have a total income from these sources that is now above this level.[26]

19 under section 5 of the Finance Act 2021, and section 5 of Finance Act 2023. For more background see, Commons Library research briefing CBP-9186 Spring Budget 2021: personal allowance and higher rate threshold, 4 March 2024.

20 Autumn Budget 2024, HC 295 (PDF) November 2024 para 2.36. See also, PQ 44606, 28 April 2025.

21 For more details see, Commons Library research briefing CBP-7812 State Pension triple lock, 6 November 2023.

22 For more details see, Commons Library research briefing CBP-10105 Benefits Uprating 2025/26, 21 November 2024.

23 HMRC, Income tax statistics and distributions, updated 27 June 2024

24 HMRC, Income tax statistics - Table 2.1: number of individual income tax payers, updated 27 June 2024. See also, PQ 46984, 30 April 2025

25 For example, LITRG, Tax on state pensions: looking back and ahead, 1 February 2024; "The state pension tax hit coming for your retirement", Times, 29 March 2025.

26 "UK pensions warning: don't get caught by an out-of-the-blue tax bill", Guardian, 21 October 2023

3.2 What has the government said about this trend?

When ministers in the Conservative government were asked about this trend, they noted the personal allowance has been set at a level high enough to ensure that those pensioners whose sole income was the new state pension or basic state pension, and who did not have deferred payments or receive protected payments, would not pay any income tax.[27] In answer to a PQ in April 2025 the current Exchequer Secretary James Murray made a similar point:

> The Personal Allowance - the amount an individual can earn before paying tax - will continue to exceed the basic and full new State Pension this tax year. This means pensioners whose sole income is the full new State Pension or basic State Pension without any increments will not pay any income tax.[28]

During the 2024 General Election the issue was not mentioned in the Labour Party's General Election manifesto (PDF), although in their manifesto (PDF) the Conservative Party had proposed introducing an age-related addition to the personal allowance, aligned to the triple lock, to ensure the new state pension did not exceed the personal allowance in future years.[29]

On 12 May 2025 MPs debated an e-petition which relates to the personal allowance and the taxation of the state pension.[30] The petition proposes that the allowance should be set at £20,000, suggesting that it is "abhorrent to tax pensioners on their state pension when it is over the personal allowance." It goes on to suggest that increasing the allowance by this amount would "would lift many low earners out of benefits and inject more cash into the economy creating growth."[31]

Prior to the debate the government published a response to the petition, reproduced below:

> The Government is committed to keeping taxes for working people as low as possible while ensuring fiscal responsibility and so, at our first Budget, we decided not to extend the freeze on personal tax thresholds.
>
> The Government has no plans to increase the Personal Allowance to £20,000. Increasing the Personal Allowance to £20,000 would come at a significant

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27 see, for example, PQ4352, 4 December 2023; HC Deb 19 March 2024 c797; PQ22482, 24 April 2024; and, PQ25174, 13 May 2024.

28 PQ 46234, 24 April 2025. See also, PQ 51097, 13 May 2025; PQ 43160, 9 April 2025; PQ 40654, 1 April 2025; and, PQ 31161, 26 February 2025.

29 For details see, Chartered Institute of Taxation, Tax and the state pension – an explainer, 31 May 2024

30 HC Deb 12 May 2025 cc1-14WH

31 UK Government and Parliament, e-petition 702844 relating to the Income Tax Personal Allowance, retrieved 7 May 2025. To date the petition has received 253,435 signatures.

> fiscal cost of many billions of pounds per annum. This would reduce tax receipts substantially, decreasing funds available for the UK's hospitals, schools, and other essential public services that we all rely on. It would also undermine the work the Chancellor has done to restore fiscal responsibility and economic stability, which are critical to getting our economy growing and keeping taxes, inflation, and mortgages as low as possible.
>
> The Government keeps all taxes under review as part of the policy making process. The Chancellor will announce any changes to the tax system at fiscal events in the usual way.[32]

The Commons Library estimates it would directly cost the government around £50 billion per year to raise the personal allowance for all individuals from £12,570 to £20,000 in 2025/26.[33] Currently, the point at which individuals start paying employee or self-employed National Insurance contributions (NICs) – the NICs primary threshold and lower profits limit – is aligned with the income tax personal allowance.[34] If the NICs primary threshold was also increased so that it continued to be aligned with the income tax personal allowance it would cost a further £10 billion-£15 billion, taking the total cost to closer to £65 billion per year.[35,36]

These estimates only capture the direct impact on income tax and NICs, after some allowance for individuals changing their behaviour (as explained in the methodology section in the footnotes). Making such a large increase to the personal allowance would also likely have effects on the wider economy, and government tax receipts and spending, which the Library cannot capture in our estimates.

In his contribution to the debate the Exchequer Secretary James Murray noted "the substantial support for this petition", but went on to argue that

32 As above. The response was published on 20 February 2025.

33 Calculations by Matthew Keep, Economic Policy & Statistics Section.

34 For more details see, Commons Library research briefing CBP-10237 Direct taxes: Rates and allowances for 2025/26, 8 April 2025.

35 The estimates assume that: (i) the higher rate income tax threshold (the point at which individuals begin to pay 40% income tax) increases by the same amount as the personal allowance (£7,430). The higher rate threshold (currently £50,270) is the sum of the personal allowance (currently £12,570) and the range of income that individuals pay 20% income tax (known as the basic rate limit, currently £37,700). Therefore, increasing the personal allowance without altering the basic rate limit increases the higher rat threshold. (ii) the point at which individuals start paying the lower 2% rate of employee/self-employed NICs remains aligned with the income tax higher rate threshold.

36 Estimates produced using UKMOD policy simulation model version B2025.05 developed and maintained by the Centre for Microsimulation and Policy Analysis (CeMPA) at the University of Essex Institute for Social and Economic Research (ISER), supported by the Nuffield Foundation, with underlying data on household incomes and circumstances drawn from the 2022/23 Family Resources Survey, adjusted using data from the DWP's Households Below Average Income, and uprated for later years using the OBR's March 2025 forecasts. The UKMOD model is explained in more detail in CeMPA's latest country report. We can't say exactly how individuals would change their behaviour if the UK government introduced any of the scenarios set out above, but we have estimated them using UKMOD.

increasing the allowance to £20,000 “would undermine the work that the Chancellor has done to restore fiscal responsibility and economic stability, and it would slash the funding available for vital public services.”[37]

[37] HC Deb 12 May 2025 c12WH

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