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Research Briefing

4 November 2024

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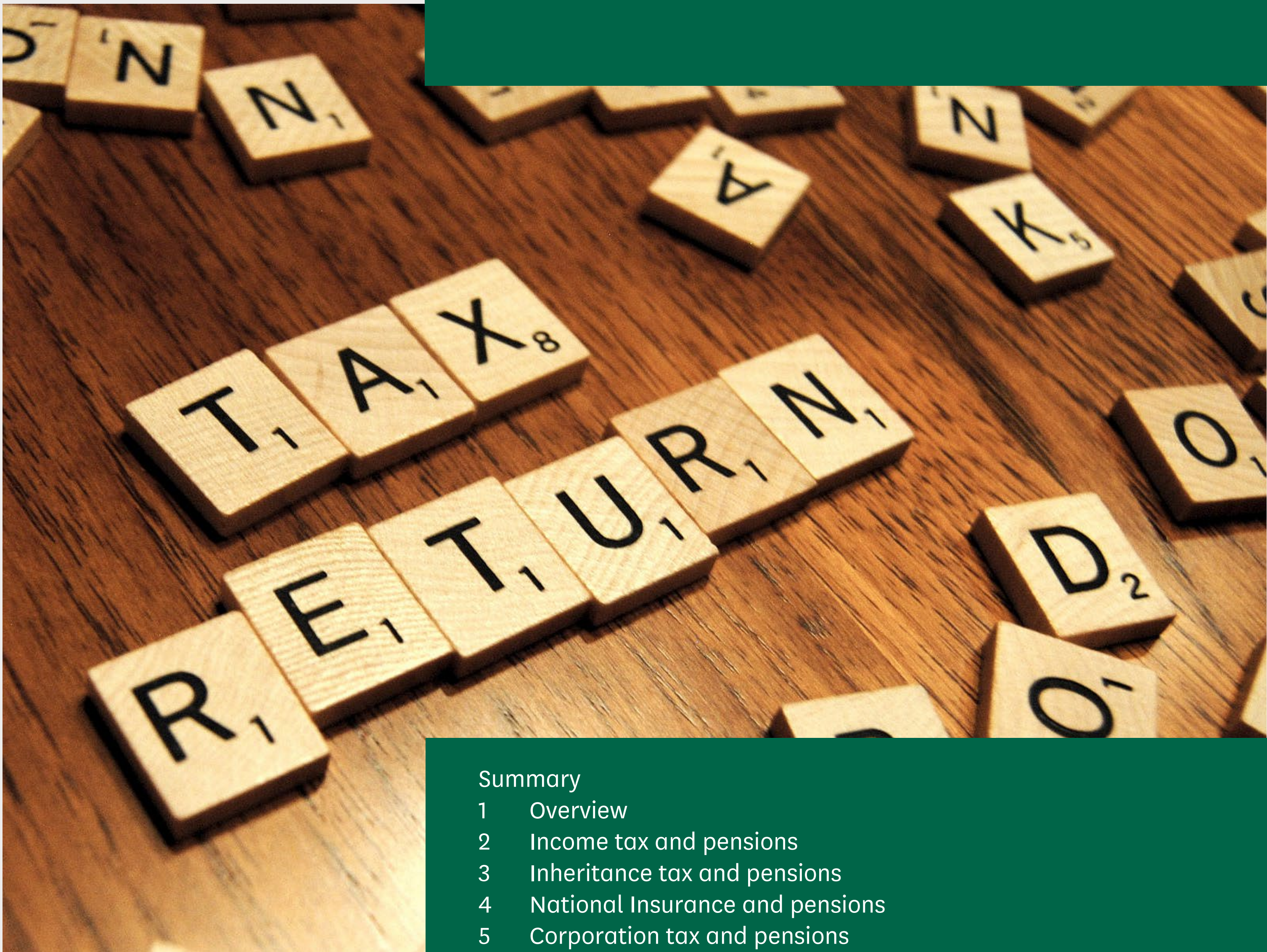
Pensions tax



Summary

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Summary

This briefing gives an overview of pensions taxation in the UK. HMRC's Pensions Tax Manual has much more detailed information.

The Library briefing Direct taxes: rates and allowances for 2024/25 outlines the direct tax rates and principal tax allowances in the UK. More detail on tax rates and allowances for the 2024/25 year are set out in Annex A to HM Revenue & Customs, Overview of Tax Legislation and Rates.

Income tax

Income from pensions, including the state pension, is liable for income tax, just as income from earnings, taxable social security benefits, trading profits, and income from property. However, pension savers do not pay income tax on contributions to pension schemes (they receive tax relief).

There are limits to the tax relief they receive. People may need to pay income tax on pension contributions if they exceed the tax relief limits.

Limits to pensions income tax relief

Usually, people cannot receive income tax relief on pension contributions above their annual earnings. However, they can still contribute up to £3,600 a year with tax relief even if their earnings are lower than this.

The annual allowance limits how much tax relief people can receive on pension contributions. In 2024/25, people can contribute up to £60,000 into pension schemes without paying income tax. The annual allowance tapers for higher earners, meaning that it reduces as earnings increase.

People who have already accessed a pension may also be limited by a lower allowance – the money purchase annual allowance.

Paying income tax on payments from pensions

People pay income tax on income from pensions, including the state pension.

People can access up to 25% of their pension without paying income tax. In 2024/25, the standard maximum tax-free lump sum is £268,275.

In cases of serious ill-health people might be able to receive a lump sum of up to £1,073,100 without paying income tax.

Inheriting a pension

How someone inherits a pension when a member of a pension scheme dies depends on the type of pension scheme, the age of the member when they died, and the rules of that scheme.

Someone inheriting a pension will pay either no tax, income tax, or inheritance tax.

At the Autumn Budget 2024, the government announced that from 6 April 2027 most pension funds and pension death benefits will fall within someone's estate and will be considered when calculating inheritance tax.

National Insurance Contributions

Employees, the self-employed, and employers pay National Insurance Contributions (or NICs).

Employers do not pay NICs on pension contributions, but employees and self-employed people do. Some employers offer salary sacrifice pension schemes to make tax-efficient use of this difference.

Corporation tax

Companies, public corporations, and unincorporated associations pay corporation tax on profits. Employers can usually deduct pension contributions from taxable income when calculating a company's taxable profit – reducing taxable profits and therefore corporation tax due.

Unauthorised payments from pensions

Unauthorised payments from pension schemes may incur additional tax charges. Any payment not envisaged under tax legislation is an unauthorised payment. Unauthorised payments include lump sums paid before someone's normal retirement age, unless made on ill-health grounds.

Pension investments

Generally, pension scheme investment growth is not taxed. However, certain types of investments are taxed.

1 Overview

1.1 How are pensions taxed in the UK?

What is an EET model?

The UK pensions tax system is often described as using an “exempt, exempt, taxed” or “EET” model:

- Exempt: contributions into pensions are exempt from tax.
- Exempt: investment growth is exempt from tax.
- Taxed: savings withdrawn as pension payments incur tax.[1]

In an EET model, people defer paying tax on their earnings by saving into a pension scheme and instead pay tax later when they receive pension payments.

An EET model enables people to spread their taxable income over their lifetime, shifting taxable income from periods of higher earnings (working life) to periods of lower earnings (retirement).

Does the UK have an EET model of pensions tax?

Some parts of the UK pensions tax system use an EET model and other parts do not. For example, pension savings mostly follow an EET model for income tax:

- Exempt: People do not pay income tax on pension contributions, although there are limits on these contributions.
- Exempt: People do not pay income tax if their pension investments increase in value.
- Taxed: Withdrawals from pensions incur income tax like other income. However, people can withdraw up to 25% of their pension as a tax-free lump sum.[2]

However, other taxes on pensions follow different models:

1 HMRC, Pensions Tax Manual, PTM024100 - General principles: overview of pensions taxation: the basics, 27 August 2024

2 As above

- Employers do not pay tax on pension contributions and employers do not pay tax when their employees withdraw their pension – an “exempt, exempt, exempt” (EEE) model. See section 4 and section 5 of this briefing for more details.
- Employees pay National Insurance Contributions on pension contributions, but people do not pay National Insurance Contributions on pension payments – a “taxed, exempt, exempt” (TEE) model. See section 4 of this briefing for more detail.

This briefing paper provides more details in the relevant sections. The Library briefing Reform of pension tax relief discusses the different approaches that may be taken to taxing pensions, and reforms that have been made to the UK system in more detail.

1.2 How did the current pensions tax system develop?

The current pensions tax system is based on reforms introduced on 6 April 2006, known as “A-day”. On A-day, the pensions tax system was significantly simplified by replacing the eight previous tax schemes with a single system.[3] The new system covered both defined benefit and defined contribution pension schemes (see box 1 below).

1 Defined benefit and defined contribution schemes

There are two main types of pension schemes in the UK:

- Defined benefit schemes pay a promised pension based on factors, such as salary and length of service. A sponsor, usually an employer, guarantees the payment of the promised benefits. The pension provides an income for life and may include a lump sum.
- Defined contribution schemes provide a pot of money for retirement instead of a guaranteed pension. The value of the pension pot can increase or decrease depending on factors, including investment returns and contributions made.

Although there have been subsequent reforms, such as the abolition of the lifetime allowance (see section 2.4 of this briefing), A-day remains the foundation of the current pensions tax relief system. Further background on A-day is available in the December 2008 Library briefing Pension tax simplification.[4]

[3] HC Deb 17 March 2004, c 329

[4] Commons Library research briefing SN 2984, Pension tax simplification, 11 December 2008

1.3 How much does pension tax relief cost?

In 2022/23, HMRC estimated that pensions received £70.6 billion of tax relief. In the same year, the government collected £23.8 billion in tax from pension schemes. HMRC estimated the overall cost of pension income tax and National Insurance Contributions (NICs) relief to be £48.7 billion.[5]

Table 1: Estimated cost of pension tax relief

£ m (rounded to the nearest £100m)	2021/22	2022/23p
Pension tax relief	68,100	70,600
Pension tax charges	20,500	22,000
Net pension tax relief	47,600	48,700

p: provisional

p: provisional

Source: HM Revenue & Customs, Private pension statistics, 27 September 2023, Table 6

Notes: Person tax relief includes relief on income tax and national insurance contributions (NICs). See section 2 (income tax) and section 4 (National Insurance) of this briefing for further details.

Pension tax charges include income tax liable on payments from pension schemes and charges for exceeding the annual allowance and lifetime allowance. See section 2 of this briefing for further details.

However, the figure for the overall cost of tax relief may not appropriately estimate the cost to the government. The Treasury explained in 2015, there can be a significant gap between when someone receives tax relief on contributions and pay tax on the pensions they receive. People's tax rates also change over their lifetime – meaning that the relief they receive may not correspond with the amount of tax they ultimately pay when they withdraw their pension.[6]

These figures do not yet include information after 6 April 2023 when the government made significant changes to tax relief. The changes are covered briefly in section 2 below and in more detail in the Library briefing Pension tax relief: The annual allowance and lifetime allowance.

[5] HM Revenue and Customs, Private pension statistics, 27 September 2023, table 6

[6] HM Treasury, Strengthening the incentive to save: a consultation on pensions tax relief, Cm 9102, July 2015, para 2.4

2 Income tax and pensions

2.1 Income tax

All “non-savings” income is subject to income tax at the same rates. This includes income from earnings, pensions, taxable social security benefits, trading profits, and income from property.[7] Income from savings and from dividends incur income tax at different rates.

There is no income tax on the first part of someone’s earnings – their personal allowance. The standard personal allowance is £12,570 in 2024/25.[8]

There are three main rates of income tax:

- The basic rate of 20%
- The higher rate of 40%
- The additional rate of 45%[9]

There are different rates of income tax in Scotland (see box 2 below).

2 Devolution and income tax

The Scotland Act 2012 introduced the Scottish rate of income tax from April 2016, and the Wales Act 2014 introduced the Welsh rate of income tax from 6 April 2019.[10]

In Scotland, income tax rates now differ from those in the rest of the UK.

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7 Further information is available in Commons Library research briefing CBP 9993, Direct taxes: rates and allowances for 2024/25

8 The personal allowance may be larger for people claiming marriage allowance or blind person’s allowance. It is tapered for people with an income over £100,000 and reduces as their income increases until £127,000 where people have no personal allowance remaining.

9 HMRC, Overview of Tax Legislation and Rates, March 2024 (Annex A)

10 Scotland Act 2012, sections 25-27, and Wales Act 2014, sections 8-11

People pay income tax in bands, which means they pay different rates of tax on different parts of their income. Table 2 below shows the income tax rates people pay in each band if they have the standard personal allowance of £12,570 in 2024/25:

Table 2 Income tax rates 2024/25

England, Wales and Northern Ireland			Scotland		
	Band	Rate		Band	Rate
Basic	£12,571 to £50,270	20%	Starter	£12,571 to £14,7876	19%
Higher	£50,271 to £125,140	40%	Basic	£14,877 to £26,561	20%
Additional	Over £125,140	45%	Intermediate	£25,562 to £43,662	21%
			Higher	£42,663 to £75,000	42%
			Advanced	£75,001 to £125,140	45%
			Top	Over £125,140	47%

Source: HM Government, Income Tax rates and Personal Allowances

2.2 Income tax relief

When people contribute to their pension they receive income tax relief.[11] People do not pay income tax on their pension contributions, although there are limits to the amount of tax relief people receive. The amount of tax relief someone receives depends on their marginal rate of income tax (see box 3 below).

3 Marginal rate of income tax

Because people do not pay income tax on their pension contributions, they receive income tax relief at the same rate as the income tax they would have paid if they had not contributed to a pension.

The marginal rate of income tax is the tax rate someone would have paid on their last pound of earnings.

[11] HMRC, Pensions Tax Manual, PTM044100 - Contributions: tax relief for members: conditions, 27 August 2024

2.3 Limits to income tax relief

Annual allowance

The annual allowance restricts the amount of tax relief someone can receive on pension contributions.[12] In 2024/25, people can contribute up to £60,000 into pension schemes without paying income tax.[13]

Usually, people cannot receive tax relief on pension contributions above their annual earnings.[14] However, people can still contribute up to £3,600 a year with tax relief even if their earnings are lower than this (see box 4 below).[15]

4 What relief do people who do not pay income tax receive?

People earning below the personal allowance – £12,570 in 2024/25 – do not pay income tax. However, they can still receive income tax relief at the basic rate of income tax – 20%.

For example, someone with no income could contribute £2,880 to a pension scheme and receive £720 tax relief (20% of the total) to take their contribution to £3,600.

How this works depends on how someone's pension scheme administers income tax relief. Section 2.5 of this briefing paper covers this in more detail.

Tapered annual allowance

The annual allowance tapers, which means that it reduces for higher earners. In 2024/25 someone's annual allowance tapers if:

- Their income before tax is above £200,000; and
- Their income including pension contributions is above £260,000.[16]

For every £2 someone earns over £260,000, including their pension contributions, the annual allowance reduces by £1.[17]

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[12] Finance Act 2004, sections 227-238A
[13] Finance Act 2004, section 228
[14] Finance Act 2004, section 190
[15] Finance Act 2004, Section 190
[16] Finance Act 2004, Section 228ZA
[17] Finance Act 2004, Section 228ZA

Money purchase annual allowance

There is a further limit on pension tax relief for some people who have already accessed a pension.

Once someone accesses a defined contribution pension scheme, the tax relief they receive on contributions to defined contribution pension schemes in future permanently reduces to the money purchase annual allowance.[18] In 2024/25 the money purchase annual allowance is £10,000.[19]

The government intended the money purchase annual allowance to prevent people using pension tax relief to avoid tax on their employment income. Without the money purchase allowance, people could place their income into a defined contribution scheme before immediately withdrawing 25% tax-free. People could also withdraw the remaining 75% and pay income tax on that the same way as other income.[20]

Calculating annual allowance contributions

he calculation of contributions towards the annual allowance differs between defined contribution schemes and defined benefit schemes.

The calculation for defined contribution schemes

Defined contribution schemes provide a saving pot. Any contribution to a defined contribution scheme which receives tax relief counts towards someone's annual allowance.[21]

The calculation for defined benefit schemes

The calculation for defined benefit schemes is more complicated.[22]

Defined benefit schemes pay a promised pension based on factors such as salary and length of service. Defined benefit schemes usually pay an income and may also pay a promised lump sum at retirement.

The amount that a defined benefit pension contributes towards someone's annual allowance is:

- The change in the value of any lump sum
- Plus 16 times the value of the annual pension

This then adjusts for inflation as measured by the consumer prices index.

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18 Defined contribution schemes are referred to as money purchase schemes in legislation.
19 Finance Act 2004, Section 228ZA
20 HM Treasury, Freedom and choice in pensions: Government response to consultation, July 2014, para 2.27
21 Finance Act 2004, sections 230 to 233
22 The calculation is set out in the Finance Act 2004, sections 234 to 236

Exceeding the annual allowance

People may need to pay income tax on pension contributions if they exceed the annual allowance. This is not always the case, and there are options to support people who need to pay income tax on pension contributions above the annual allowance.

Carry forward

Someone who has not used all their annual allowance in one year can use it future years. Carry forward allows someone to make use of any unused annual allowance from three previous tax years.[23]

The government introduced carry forward in October 2010 to stop people who typically contributed below the annual allowance from facing a tax charge by exceeding it in a single year.[24]

Scheme pays

People can use their pension savings to pay a tax charge of more than £2,000 for exceeding the annual allowance. Scheme pays involves the scheme effectively making a loan to pay the charge, which they repay with interest.

The government introduced scheme pays for people who may have difficulty paying the charge directly from their current income.[25]

Further information

The Library briefing Pension tax relief: The annual allowance and lifetime allowance has more information on the annual allowance.

2.4 The lifetime allowance

There is not a limit on the amount people can build up in pensions over their lifetime. Previously the lifetime allowance was the maximum pension savings someone could usually receive tax relief on. The government abolished it on 6 April 2024.[26]

There remain related limits on the amount people can receive from a pension without paying income tax which link to the value of lifetime allowance. This briefing covers these in section 2.6 and 2.7.

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[23] The relevant legislation is sections 228A, 228B and 228C of the Finance Act 2004. These sections were introduced by schedule 17 of the Finance Act 2011.

[24] HM Treasury, Restricting pensions tax relief through existing allowances: a summary of the discussion document responses (PDF), October 2010

[25] HM Treasury, Options to meet high annual allowance charges from pension benefits: a discussion document, November 2010, para 1.7

[26] Finance Act 2024, Schedule 9

Further information

The Library briefing Pension tax relief: The annual allowance and lifetime allowance has more information on the lifetime allowance.

2.5 Administration of income tax relief

How employers administered income tax relief on pension contributions affected the amount of tax relief people received. The government introduced measures to reduce these differences in the 2024/25 tax year.

Difference between net pay and relief at source

Employers use one of two arrangements to administer income tax relief on pension contributions:

Net pay

Net pay arrangements deduct pension contributions from earnings before income tax. People then pay income tax on their remaining earnings.[27]

Because the person has not paid income tax on their pension contribution, they have received tax relief at their marginal rate of income tax (see box 3 above).

Relief at source

Relief at source arrangements pay income tax before deducting pension contributions from earnings. The scheme then claims tax relief at the basic rate of income tax – 20%.[28]

Impact on different tax payers

People paying the basic rate of income tax – 20% - will receive the same tax relief in a net pay scheme arrangement and a relief at source arrangement.

People who pay more or less than the basic rate of income tax would receive higher tax relief in one arrangement than the other without additional measures being in place.

People who pay more than the 20% basic rate of income tax

In relief at source arrangements, people who pay more than the basic rate of income tax still receive 20% tax relief on their pension contributions. People

27 HMRC, Pensions Tax Manual, PTM044230 - Contributions: tax relief for members: methods: net pay, 27 August 2024

28 As above

can claim the additional relief they are entitled to through a self-assessment tax return.

In net pay arrangements, people who pay more than the basic rate of income tax receive tax relief at their marginal rate of income tax.

People who pay less than the 20% basic rate of income tax

In relief at source arrangements, people who pay less than the basic rate of income tax still receive 20% tax relief on their pension contributions. They are entitled to pension tax relief at 20% even if though they may have paid income tax at a lower rate than this or no income tax at all.

In net pay arrangements, people who pay less than the basic rate of income tax receive less than 20% tax relief on their pension contributions. People who do not pay income tax do not receive any tax relief at all. Instead, HMRC will make a top-up payment to low earners in net pay arrangements (box 5 below).[29]

5 Top-up payments for low earners in net pay arrangements

From the 2024/25 tax year the government introduced top-up payments for people paying below the basic rate of income tax in net pay arrangements. The government will make the first payments in the 2025/26 tax year once HMRC has identified eligible individuals.

The government estimates that 1.2 million people will be eligible for a top-up.[30]

A government assessment expects the policy to cost £10 million in 2025/26 and £15 million in 2026/27. IT changes for the policy and it estimates the operational cost of administering it to be £38 million.[31]

HMRC will notify eligible individuals, who would need to provide the necessary details to receive the top-up payment into their bank account. This means that from 2024/25 someone who does not pay income tax contributing £100 to a pension scheme through a net pay arrangement would pay the full £100 themselves, then they would receive a £20 payment to their bank account from HMRC the following tax year.[32]

29 HMRC, Pensions relief relating to net pay arrangements, 15 March 2023
30 As above
31 As above
32 As above

2.6 Paying income tax on payments from pensions

Payments from pensions are subject to income tax. This includes incomes from defined benefit schemes or annuities and withdrawals of cash from defined contribution schemes.

6 Withdrawing money from a pension

Defined benefit schemes usually pay a promised income in retirement. Many defined benefit schemes also pay a specified lump sum when someone retires. People may receive a lump sum in exchange for a lower income in retirement.

People can choose how they receive money from a defined contribution scheme. The broad options available to someone accessing their defined contribution pension pot are:

- Annuities provide a guaranteed regular income for life or a fixed period. Joint life annuities pay a chosen beneficiary when the member dies.
- Drawdown provides a regular income while keeping the pension pot invested. Drawdown income is not guaranteed and varies based on investment performance.
- Members can take cash lump sums directly from pension pots after the age of 55. People often leave the remainder untouched to potentially grow further through investment. Typically, people can take the first 25% tax-free, with the remaining 75% taxed as regular income.

Members can choose one or more of these options.[33]

Tax-free lump sum

People can access up to 25% of their pension without paying income tax. This is commonly referred to as a tax-free lump sum.

Lump sum allowance

Before 6 April 2024, the maximum tax-free lump sum someone could receive from all their pensions was equal to 25% of the lifetime allowance.[34] The standard lifetime allowance was £1,073,100, which meant that the standard maximum tax-free lump sum was £268,275.[35]

[33] HMRC, Pensions Tax Manual, PTM063300 - Member benefits: lump sums: uncrystallised funds pension lump sum (UFPLS), 27 August 2024

[34] Finance Act 2004, Schedule 29, Paragraph 2A

[35] Some people had a lifetime allowance above £1,073,100 and therefore could receive a higher tax-free lump sum. Further details are in the Commons Library research briefing CBP-5901 Pension tax relief: The annual allowance and lifetime allowance.

Since the abolition of the lifetime allowance, the lump sum allowance limits maximum tax-free lump sum someone can receive from all their pensions. On introduction in the 2024/25 tax year, the lump sum allowance was set at 25% of the lifetime allowance in 2023/24. This meant that the standard maximum tax-free lump sum remained at £268,275.[36]

Once someone has used their lump sum allowance, they pay tax on future lump sums at their marginal rate of income tax.[37]

Serious ill-health lump sum

People might be able to receive a higher tax-free lump sum in cases of serious ill-health. The person needs to be under 75 years old and the pension scheme making the payment needs to receive written evidence from a medical practitioner that the person expects to live for less than one year.[38]

Someone's "lump sum and net benefit allowance" limits their serious ill-health lump sum. In 2024/25, the standard lump sum and death benefit allowance is set at £1,073,100 – the same level as the standard lifetime allowance was in 2023/24.[39] Section 2.7 of this briefing has further information on the lump sum and death benefit allowance.

Interaction with the state pension

The state pension is subject to income tax. In 2024/25, the amount many people receive from the state pension is below the personal allowance.[40] In these cases, if someone's total income, including the state pension, is above the personal allowance they will pay income tax through their pension scheme or employer.

If their state pension is above the personal allowance, then they may need to complete a tax return under Self-Assessment or HMRC may send that person a Simple Assessment.[41]

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36 People who had a lifetime allowance higher than the standard allowance in 2023/24 also had a higher lump sum allowance. Further details are available from HMRC, Pensions Tax Manual, PTM171000 - Lump sum allowance and lump sum and death benefit allowance: lump sum allowance, 27 August 2024.

37 HMRC, Pensions Tax Manual, PTM171000 - Lump sum allowance and lump sum and death benefit allowance: lump sum allowance, 27 August 2024

38 HMRC, Pensions Tax Manual, PTM174200 - Lump sum allowance and lump sum death benefit allowance: Transitional rules for the tax year 2024-25: Lump sum and death benefit availability, 27 August 2024

39 People who had a lifetime allowance higher than the standard allowance in 2023/24 also had a higher lump sum and death benefit allowance. HMRC, Pensions Tax Manual, PTM171000 - Lump sum allowance and lump sum and death benefit allowance: lump sum allowance, 27 August 2024

40 The full new state pension is £11,502, below the personal allowance of £12,570.

41 Where HMRC sends a calculation of the tax owed for that year.

2.7 Inheriting a pension and income tax

Someone inheriting a pension will pay either:

- no tax;
- income tax; or
- inheritance tax (see section 3 of this briefing).[42]

Whether or not beneficiaries pay income tax depends on the age that the member died and the type of pension they had.

Lump sums

If someone dies before their 75th birthday most lump sums paid from their pension are tax-free up to a limit, usually set at £1,073,100. If someone dies after their 75th birthday, the person receiving a lump sum pays income tax like they would on other income.[43]

If a lump-sum payment is not made within two years of the scheme knowing, or could have been reasonably expected to know, of the member's death, then income tax will be due regardless of the member's age when they died.

Income tax will also be due if the lump sum payment is a "trivial commutation lump sum". A trivial commutation lump sum death benefit is payment of under £30,000 made to a beneficiary of a deceased pension scheme member. It replaces the entire value of a small pension income or other regular payment with a lump sum.[44]

Lump sum and death benefit allowance

Although the government abolished the lifetime allowance on 6 April 2024, certain limits however remain in place.[45] The lump sum and death benefit allowance is the maximum amount someone and their beneficiaries can receive from all their pension schemes as a tax-free lump sum. In 2024/25 it is set at £1,073,100, but some people have a higher protected allowance.

Further information is available from the HMRC guidance Find out the rules about individual lump sum allowances.[46]

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[42] HMRC, Employment Income Manual, EIM75620 - The taxation of pension income: lump sums paid by registered pension schemes following a member's death, 21 August 2024

[43] As above

[44] HMRC, Pensions Tax Manual, PTM073200 - Death benefits: lump sums: uncrystallised funds lump sum death benefit , 27 August 2024

[45] Finance Act 2024, Schedule 9; further information is available in HMRC, Pensions Tax Manual, PTM090000 - Protection from the lifetime allowance charge: contents, 12 January 2024

[46] HMRC, Find out the rules about Individual Lump Sum Allowances, 29 May 2024

Income

Pensions provided by pension schemes to beneficiaries as an income are subject to income tax regardless of the age the member died.[47]

Incomes from annuities and newer drawdown arrangements paid to beneficiaries are usually tax-free. However, they are subject to income tax if the deceased member was 75 or older.[48] Newer drawdown arrangements are those set up after 6 April 2015 when the pension freedoms were introduced (see box 7 below).

Annuities purchased by a beneficiary from a pension where the member died before 3 December 2014 will incur income tax, regardless of the member's age at death.[49]

7 Pension freedoms

The pension freedoms, introduced in April 2015, gave people aged 55 and over more flexibility about when and how they accessed their defined contribution pension savings.[50] Whereas previously most people had to buy an annuity which provided a guaranteed income, they now have more freedom to enter drawdown arrangements or to draw cash lump sums (see box 4 above).

More information on pension freedoms is available in the Library briefing Pension flexibilities: the freedom and choice reforms.

Further information

The Library briefing Inheriting pension rights has further details on inheriting private and state pensions.[51]

A summary of when income tax is and is not usually paid by beneficiaries on the pensions they inherited is available from gov.uk's Tax on a private pension you inherit.[52] A more detailed description is available in the death benefits section of HMRC's pensions tax manual.[53]

47 HMRC, Employment Income Manual, EIM75600 - The taxation of pension income: death benefits, 21 August 2024
48 As above
49 As above
50 Taxation of Pensions Act 2014
51 Commons Library research briefing CBP 8635, Inheriting pension rights
52 Gov.uk, Tax on a private pension you inherit [accessed 3 October 2024]
53 HMRC, Pensions Tax Manual, PTM070000 - Death benefits: contents, 27 August 2024

3 Inheritance tax and pensions

3.1 Inheritance tax

Inheritance tax is a tax on someone's estate when they die. A person's estate includes their property, money, and other possessions when they died.

Inheritance tax is not charged on someone's estate if its value is below the threshold, set at £325,000, or if everything above that threshold is left to their spouse, civil partner, a charity, or a community amateur sports club.[54]

The standard inheritance tax rate of 40% is charged on parts of the estate above that threshold.[55]

Further information on inheritance tax is available in the Library briefing Inheritance tax: Current policy and debates.[56]

3.2 When is inheritance tax paid for a pension?

Before April 2027 (section 3.3 below), inherited pensions usually fall outside someone's estate and are not considered when calculating inheritance tax.[57] However, there are circumstances where inheritance tax will be due.

Pension scheme rules usually specify what discretion trustees can use to decide who to make a payment to if a member dies. If the trustees make a payment using this discretion, that payment usually falls outside the estate and will not be considered when assessing liability for inheritance tax.[58]

If the pension scheme trustees are unable to use their discretion under the scheme's rules, then the scheme might make a payment to the member's estate – which would be considered when assessing liability for inheritance tax. This might occur if the member had no surviving family and had not nominated a beneficiary.[59]

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[54] Inheritance Tax Act 1984, Schedule 1

[55] Gov.uk, How Inheritance Tax works: thresholds, rules, and allowances [accessed 3 October 2024]

[56] Commons Library research briefing CBP 93, Inheritance tax: Current policy and debates

[57] HMRC, Inheritance Tax Manual, IHTM17051 - Pensions: IHT Charges: death benefits introduction, 2 October 2024

[58] As above

[59] As above

3.3 Changes to pensions and inheritance tax from 6 April 2027

At the Autumn Budget 2024, the government announced that from 6 April 2027 most pension funds and pension death benefits will fall within someone's estate and will be considered when calculating inheritance tax.[60]

The government launched a technical consultation on the proposals alongside the Budget on 30 October 2024. Most payments from both defined contribution and defined benefit schemes would fall within scope of the change. The main exception to this would be dependants' pensions which would be taxed at the beneficiaries' marginal rate of income tax (see box 8 below). The exception does not include other payments to dependants, such as annuities or drawdown.[61]

8 Who can be a dependant?

Pension schemes may define a dependant in their own terms to pay lump sum death benefits to beneficiaries. However, for a beneficiary to receive an income – without incurring significant tax penalties – then they must satisfy tax legislation's definition of a dependant:[62]

- A spouse or civil partner of the member
- The member's child who is under 23 years old
- Someone who depended on the member due to physical or mental impairment
- Someone who was financially dependent on the member
- Someone who had a mutually dependent financial relationship with the member.[63]

60 HMRC, Inheritance Tax on pensions: liability, reporting and payment, 30 October 2024
61 As above
62 Finance Act 2004, sch 28
63 HMRC, PTM071200 - Death benefits: essential principles: definition of dependant, 13 May 2024

4 National Insurance and pensions

4.1 National Insurance

National Insurance Contributions (or NICs) are a tax charged on employees, the self-employed, and employers.

People pay NICs if they are employed or self-employed, and aged 16 or over but below the state pension age.

Further information is available in the Library briefing National Insurance contributions: an introduction.[64]

4.2 Employee National Insurance contributions

For employees, NICs are deducted directly from wages. There are different rates based on how much someone earns. Employees earning above £242 per week pay class 1 NICs in 2024/25.[65] The main rate is 8% on earnings between £242 and £967 per week, and 2% on anything above this.[66]

National Insurance and pension contributions

NICs are based on someone's full salary before making pension contributions. This means that people pay NICs on their pension contributions.[67]

NICs might reduce if an employer uses salary sacrifice (see section 4.4 below).

National Insurance and pension payments

People only pay NICs on earnings.[68] This means they are not paid on pension payments, whether the payment is a lump sum or regular income.

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64 Commons Library research briefing CBP 4517 National Insurance contributions: an introduction
65 HMRC, Rates and allowances: National Insurance contributions, 22 July 2024
66 As above
67 HMRC, 2024 to 2025: Employer further guide to PAYE and National Insurance contributions, 23 May 2024
68 Social Security Contributions and Benefits Act 1992

4.3 Self-employed national insurance contributions

Self-employed people pay different a NICs rate to employees. In 2024/25 Class 4 NICs are 6% on profits between £12,570 and £50,270, and 2% on profits above this.[69]

Pension contributions and payments by self-employed people interact with NICs in a similar way as they do for employees. However, as there is no employer, self-employed people do not have the option of using salary sacrifice to reduce their NICs (see section 4.4 below).

4.4 Employer National Insurance contributions

For employers, NICs are an extra cost on top of wages. In 2024/25, employers pay NICs at 13.8% on any earnings above £175 per week per employee.[70]

Employer pension contributions are not subject to employer NICs.

Employers will however pay NICs on pension contributions made by their employees from their salary.

Salary sacrifice schemes

Employers do not pay NICs on pension contributions, but employees do. Some employers offer salary sacrifice pension schemes to make tax-efficient use of this difference.

In a salary sacrifice scheme an employee agrees to reduce their salary and the employer contributes the reduction to the employee’s pension. Because the employee’s salary is now lower, both the employee and employer pay lower NICs.[71] Employers pay no NICs on the employer’s pension contribution. Some employers choose to pass employer NIC savings into their employee’s pension.[72]

69 HMRC, Rates and allowances: National Insurance contributions, 22 July 2024

70 As above

71 HMRC, Salary sacrifice for employers, 29 July 2021

72 HMRC, Employment Income Manual, EIM42775 - Salary sacrifice: contributions to a registered pension scheme: practical considerations, 21 August 2024

5 Corporation tax and pensions

5.1 Corporation tax

Corporation tax is charged on the profits made by companies, public corporations, and unincorporated associations such as industrial and provident societies, clubs, and trade associations.

Corporation tax is a single flat rate. In 2024/25, it is:

- 25% for companies with profits over £250,000
- Between 19% and 25% for companies with profits between £50,000 and £250,000
- 19% for companies with profits under £50,000.[73]

Further information is available in the Library briefing Corporate tax reform.[74]

5.2 Pensions and corporation tax

Employers' pension contributions are generally considered a tax-deductible expense.[75] This means that companies can deduct the cost of these contributions from their profits before they calculate the amount of corporate tax they owe. In effect this means employers pay no tax on pension contributions.

73 HMRC, Corporation Tax rates and allowances, 4 April 2024

74 Commons Library research briefing CBP 9178 Corporate tax reform

75 HMRC, Pensions Tax Manual, PTM043100 - Contributions: tax relief for employers: introduction, 27 August 2024

6 Authorised and unauthorised payments

6.1 Authorised payments

Authorised payments are payments envisaged under tax legislation and therefore do not incur an unauthorised payment tax charge.[76]

Authorised member payments

Authorised payments to members from pensions include:

- Pensions
- Lump sums
- Pension and lump sum death benefits
- Transfers to recognised pension schemes
- Payments due to a pension sharing order (often part of divorce proceedings)
- Scheme administration member payments. [77]

Authorised employer payments

Authorised payments to members from pensions include:

- public service scheme payments
- authorised surplus payments
- compensation payments
- authorised employer loans
- scheme administration employer payments.[78]

[76] HMRC, PTM131000 - Unauthorised payments: essential principles, 27 August 2024

[77] HMRC, PTM131000 - Unauthorised payments: essential principles, 27 August 2024; Details on what constitutes a scheme administration member payment and how these are taxed are set out in HMRC's Pensions Tax Manual, PTM143100 - Other authorised payments: Scheme administration member payments: overview, 27 August 2024

[78] HMRC, PTM131000 - Unauthorised payments: essential principles, 27 August 2024

6.2 Unauthorised payments

Any payment which does not fall into an authorised category is an unauthorised payment. These include:

- Lump sums paid before normal retirement age, except those on ill-health grounds (see below)
- Transfers to a pension scheme which is neither registered nor a qualifying overseas pension scheme
- Loans to members (see box 9 below).[79]

9 Scams

Pension savings can be an attractive target for fraud.

Fraudulent “pension liberation” happens when someone receives encouragement to access their pension early, often on the false promises of legal loopholes to avoid tax charges – for example through a pension scheme making a loan to its members. HMRC however warns that this “can carry tax charges of more than half the unauthorised payment.”[80]

The Library briefing on pension scams provides more information and sources of support.[81]

Normal minimum pension age

The normal minimum pension age (NMPA) is the earliest age most people can access their workplace or personal pensions without incurring a significant tax charge. However, people can access their pension benefits earlier due to ill-health or if they have a “protected pension age.” People with a protected pension age can access their pension earlier than their NMPA, usually because they had a right to do so before the introduction of the NMPA.

Since April 2010, the NMPA has been 55 years old.[82] The NMPA will increase to 57 on 6 April 2028. [83]

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79 HMRC, PTM131000 - Unauthorised payments: essential principles, 27 August 2024
80 HMRC, Transfer a pension scheme member's savings, 6 April 2024
81 Commons Library research briefing CBP 8643, Pension scams
82 Finance Act 2004, part 4; further information is available in the Commons Library research briefing SN-02984, Pension tax simplification (11 December 2008)
83 Finance Act 2022

HMRC considers payments from a pension before the NMPA "unauthorised" unless someone is retiring due to ill-health or has a protected pension age.

The NMPA is different from the state pension age. Information about this is available in the Library briefing on the state pension age review.

Further information is available in the Library briefing Minimum pension age.

Taxation of unauthorised payments

If someone receives an unauthorised payment from their pension before their NMPA, they will incur tax charges:

- An unauthorised payment charge of 40% of the amount they received.[84]
- An unauthorised payment surcharge of 15% of the amount that they received if it is above a certain threshold.[85]

The scheme that allowed the unauthorised payment also pays a scheme sanction charge of 40%. The charge paid by the scheme reduces if the member pays their unauthorised payment charge. The minimum scheme sanction charge is 15%.[86]

The charges do not relate to the amount of tax relief someone received on their pension contributions.

HMRC may recover money owed by adjusting income tax codes. More detail on unauthorised payments is available from HMRC's Pension Tax Manual.[87]

[84] Finance Act 2004, s208

[85] Finance Act 2004, s209; further information on how the surcharge is calculated is available from HMRC, Pensions Tax Manual, PTM134400 - Unauthorised payments: the unauthorised payments charge and the unauthorised payments surcharge: surchargeable unauthorised member payments, 27 August 2024

[86] Finance Act 2004, s239-241

[87] HMRC, Pensions Tax Manual, PTM130000 - Unauthorised payments: contents, 13 May 2024

7 Investments

Investments by registered pension schemes qualify for certain tax exemptions. These include:

- Income from investments in pension schemes is exempt from income tax.
- Gains from the increase in the value of investments are exempt from capital gains tax (see box 10 below).

10 Capital gains tax

Capital gains tax is a tax on the profit made from selling or disposing of an asset which has increased in value. The tax is only paid on the gain made, not the total sale amount.

As well as investments within pension schemes there are various other exemptions including an individual annual tax-free allowance, investments in ISAs, and the sale of personal belongs for less than £6,000.[88]

Further information is available in the Library briefing Direct taxes: rates and allowances for 2024/25.[89]

Generally, investment growth in pension schemes is exempt from taxation.[90] However, there are tax charges on certain types of investments. These include:

- Certain trades and transactions
- Some tangible moveable property, such as art, antiques, and vintage cars
- Residential property
- Commercial property

These are outlined in more detail in HMRC's pensions tax manual, PTM121000 - Investments: essential principles.

88 Gov.uk, Capital Gains Tax: what you pay it on, rates and allowances: Overview
89 Commons Library research briefing CBP 9993, Direct taxes: rates and allowances for 2024/25
90 HMRC, Pensions Tax Manual, PTM121000 - Investments: essential principles, 27 August 2024

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