Pre 6 April 2016 state pension lump sums

Personal tax

30 July 2019

Kelly Sizer looks at LITRG website visitors' tax problems when claiming 'old' state pension lump sums

People who reached state pension age before 6 April 2016 were able to defer claiming their state pension and then, when claiming it, they can choose between an increased regular pension or taking a lump sum. Those reaching state pension age on or after that date can only claim an increased pension if they defer.

Those choosing a lump sum find that it is taxed in its own way, with a flat rate being applied according to the top rate of tax the individual's other income determines. So a non-taxpayer on other income will pay 0% on their lump sum, a basic rate taxpayer will pay a flat 20% and so on. The lump sum itself cannot push the claimant into a higher tax bracket. See 'Lump Sums', *Tax Adviser* December 2017.

The Low Incomes Tax Reform Group website provides some guidance on the tax treatment of state pension lump sums, given that official guidance is minimal. The main GOV.UK guidance on deferred state pensions does not mention the tax treatment and even if you delve deeper into that site and find the further guidance from the Department for Work and Pensions, there is no detail about how it works.

The paragraph relating to choosing when to get the lump sum payment concludes by saying people should contact HMRC if they are not sure what the tax position will be, but LITRG have found that our website enquirers' experiences in contacting HMRC for help are poor.

We have also received complaints of misinformation from both HMRC and DWP helplines, and of people getting pushed back and forth between the two.

For example:

> *‘I contacted DWP and was told the lump sum will be taxed and told to contact tax office if I want to know more. I contacted tax office twice. First I was told the lump sum will be taxed, but there is £30,000 exemption. I phoned a second time to confirm what I was told previously. This time I was told there is no exemption and the only exemption I would get would be £11,850 for 2018/ 19 tax year and the lump sum would be included as my income. When I mentioned that the explanation I saw on the website was not as I was told, I was told to contact DWP, for they deal with state pension taxation. I contacted DWP again and was told the lump sum would be taxed.’*

We are quite concerned at this and other similar examples, particularly given that it is extremely difficult for people to understand the rate at which they would pay tax on their other income and hence the rate applicable to their lump sum. Tax advisers will know that of course you can appear to be a non-taxpayer when in fact you are (albeit one with no net liability), due to the way other tax reliefs and so-called ‘allowances’ operate.

Such misunderstandings can make an enormous difference to the tax people pay on their lump sum. We have heard from people who have received four and five-figure tax bills because for example the tax credit received from the transferable tax allowance for married couples, or the dividend and personal savings allowances (in fact nil rates of tax for someone who would otherwise be a taxpayer) have made it look like they were a non-taxpayer.

We are hoping to secure a meeting with the HMRC and the DWP to raise some of the queries that we have seen from members of the public. If you have come across these or any other issues with deferred state pension lump sums, we would be interested to hear about them. Please email Kelly Sizer.