US pension lump sums: navigating the Saving Clause

Personal tax International Tax

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HMRC’s revised interpretation of the UK/US Double Taxation Agreement changes the taxation of US pension lump sums and affects compliance, planning and reporting.

Key Points

What is the issue?
HMRC’s revised interpretation of the UK/US DTA means certain lump sum withdrawals from US pension schemes may now be subject to UK tax. We explore the role of the ‘Saving Clause’ and the practical consequences for UK-resident taxpayers.

What does it mean to me?
Advisers with clients holding US pension arrangements should review withdrawal strategies, ensure the correct UK tax treatment is applied and consider foreign tax

credit relief where both the UK and US assert taxing rights.

What can I take away?
We highlight the importance of understanding HMRC’s revised guidance, distinguishing between lump sums and periodic payments, and recognising planning opportunities, while ensuring compliance through timely reporting or correction of any historic errors.

For many years, the UK tax treatment of lump sum withdrawals from US pension schemes was widely regarded as settled. HMRC’s revised interpretation of the UK/US Double Taxation Agreement (DTA) has changed that position, fundamentally altering the retirement planning landscape for UK-resident holders of non-government US pension arrangements such as 401(k) plans and Individual Retirement Accounts (IRAs).

This article considers the issue from a UK tax perspective only, together with its practical implications for advisers. US tax and Internal Revenue Service (IRS) interpretation of the DTA are outside its scope, and separate advice should be sought from a US tax adviser where appropriate.

Previously, HMRC’s published guidance reflected the view that qualifying lump sum withdrawals were only taxable in the US, meaning UK-resident recipients were not generally subject to UK income tax on those payments.

However, in March 2025, HMRC significantly altered its interpretation of these rules by asserting that the UK also has the right to tax US pension lump sums. As a result, UK-resident recipients may now face a UK income tax liability alongside any US tax due, subject to relief available under the UK/US DTA.

Article 17(2): the previous position

HMRC’s revised interpretation is best understood in the context of the position that had governed these assets for the past 20 years. Article 17(2) of the UK/US DTA provides that:

‘a lump-sum payment derived from a pension scheme established in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in the first-mentioned State.’

Where a payment met the definition of a lump sum, the DTA was remarkably clear:

- the source state (the US) had the right to tax the pension; and
- the residence state (the UK) was prohibited from taxing that same distribution.

For UK residents with US pension arrangements, this created a highly efficient tax route, as a one-time lump sum withdrawal from a US pension scheme was exempt from UK income tax. In practice, the overall tax liability was therefore limited to any US federal and, where applicable, state taxes. As a result, many expatriates and returning UK nationals were able to repatriate significant portions of their US retirement savings without incurring an additional UK income tax charge.

HMRC’s revised interpretation

In March 2025, HMRC updated its guidance in International Manual at INTM163160, stating that, despite the wording of Article 17(2), the UK is also permitted to tax its own residents in these circumstances.

The rationale for this change is rooted in anti-avoidance. From HMRC’s perspective, the ability of a UK resident to receive a significant pension distribution entirely free of UK tax was an unintended consequence of the treaty that facilitated tax avoidance. As such, it has moved to close this ‘loophole’ by asserting that the UK now has a concurrent right to tax these distributions.

The legal mechanism: the ‘Saving Clause’

How can HMRC simply ignore a specific provision in an international treaty? The answer lies in Article 1(4) of the
UK/US DTA, commonly referred to as the ‘Saving Clause’. This provides that, notwithstanding any other provision of the treaty, each contracting state may tax its own residents (and, in the case of the US, its citizens) as though the DTA had not entered into force, subject to specified exceptions.

Historically, the Saving Clause was seen primarily as a mechanism allowing the IRS to tax its citizens wherever they reside. However, HMRC is now suggesting that this same provision also enables the UK to bypass the exemptions found in Article 17(2) and so to tax UK-resident recipients of qualifying US pension lump sums.

By invoking Article 1(4), HMRC’s stance will be as follows:

- This individual is a UK resident under domestic law.
- Article 1(4) allows the UK to tax its residents as if the DTA was not in place.

Therefore, the exemption in Article 17(2) can be disregarded by the UK authorities and does not prevent the UK from taxing the lump sum.

It is important to note, however, that Article 1(4) is not definitive. It provides that a country ‘may’ tax its residents, which does not create a strict obligation on HMRC to do so in every case. The extent to which HMRC’s interpretation will be tested or developed through future litigation remains to be seen.

What is a ‘lump sum’?

Neither the UK/US DTA nor UK tax legislation defines the term ‘lump sum’ for these purposes.

HMRC’s guidance in INTM163160 explains that, for these purposes, a lump sum means ‘any non-periodic, irregular or abnormal payment of a pension’. It also sets out the factors HMRC considers relevant in determining whether a particular payment should be treated as a lump sum.

According to HMRC’s guidance, a withdrawal is likely to be regarded as a lump sum where it represents at least 20% of the pension pot’s market value; and is an irregular, non-periodic payment. In other words, there should be no clear pattern to the timing of withdrawals (for example, monthly or annually) or to the amounts withdrawn. (A payment of £50,000 every two years, for example, would indicate a regular pattern rather than a lump sum.)

If a payment does not qualify as a lump sum, it falls within Article 17(1) of the UK/US DTA rather than Article 17(2). In that case, the UK has long taken the view that, as the recipient’s state of residence, it has the primary right to tax the payment.

Mitigating double taxation: foreign tax credits

Where both the US and the UK assert taxing rights over the same pension lump sum, the principal concern is the potential for double taxation. If both the US and the UK are now claiming taxing rights on the same US pension lump sum, how do taxpayers avoid a combined tax rate that could exceed 60% or 70%?

To mitigate double taxation, relief is generally available through the UK's foreign tax credit rules. Broadly, this process operates as follows:

- The full amount of the US pension distribution is reported on the individual's UK tax return.
- The UK tax liability is calculated at the taxpayer's marginal rate in the normal way.
- Credit is then claimed for any qualifying US federal tax already paid on the same income, reducing the UK liability accordingly.

Note that while this prevents double taxation, the taxpayer will effectively pay whichever rate is higher. As UK income tax rates are frequently higher than US federal rates, most UK residents will remain liable for the difference and face an additional 'top up' tax bill in the UK.

Moving forward

HMRC's revised interpretation may have a significant impact on retirement planning for UK residents with US pension arrangements. Individuals who had expected qualifying lump sum withdrawals to be free from UK income tax may now receive substantially lower net proceeds than anticipated once any UK tax liability has been taken into account.

It should also be noted that, unlike the UK, the US does not provide an equivalent to the UK's pension commencement lump sum (PCLS), amounting to a 25% tax-free lump sum withdrawal. Consequently, larger withdrawals from traditional US pension arrangements may result in higher marginal tax rates in the US, as well as giving rise to UK tax considerations.

In light of this, it may be more tax-efficient to take smaller, periodic distributions over several years, rather than taking a single large distribution that falls into the 45% additional rate band for UK income tax.

Article 17(1)(b) of the UK/US DTA also provides favourable treatment for Roth Individual Retirement Accounts (Roth IRAs). Unlike traditional IRAs, Roth IRAs are funded from post-tax income, meaning qualifying withdrawals are generally exempt from US tax. The DTA broadly requires the UK to mirror that treatment, so qualifying Roth IRA withdrawals are also generally exempt from UK tax.

For individuals with both traditional and Roth IRA holdings, there may therefore be opportunities to manage withdrawals more tax-efficiently. For example, an individual could withdraw up to £50,270 from a traditional IRA, making use of the 0% and 20% UK income tax bands, before meeting any additional cash requirements through tax-free withdrawals from a qualifying Roth IRA. The most appropriate strategy will depend on the individual’s wider tax position in both the UK and the US.

How to ensure compliance

From a compliance perspective, taxpayers should ensure that US pension lump sum withdrawals are reported in accordance with HMRC’s current guidance. Where an incorrect treatment has already been applied, there are generally two routes to correcting the position.

The first is to amend the relevant Self Assessment tax return. This is possible for up to one year after the original filing deadline. For example, a 2025/26 tax return may be amended online until 31 January 2028.

Where the amendment window has closed, taxpayers may instead be able to make a disclosure through HMRC’s Worldwide Disclosure Facility (WDF). For offshore matters, HMRC can in some circumstances look back up to 12 years. For example, in the 2026/27 tax year, a disclosure could potentially be made in respect of liabilities arising as far back as 2014/15.

Whichever route is appropriate, identifying and correcting any errors at an early stage is likely to reduce the risk of additional interest and penalties and help ensure compliance with HMRC’s current interpretation of the UK/US DTA.