

Lump Sum Allowances for Pensions Employee Guide 2025/26

Summary

From 6 April 2024, there is a limit on the total amount of lump sums and lump sum death benefits that you can receive free from income tax. These limits are the:

- Lump sum allowance (LSA) of £268,275
- Lump sum and death benefit allowance (LSDBA) of £1,073,100

Each time an individual (or beneficiary) receives a tax-free lump sum, it is tested against the individuals available LSA and LSDBA. If an individual exceeds the LSA or LSDBA, tax is payable on the excess at the individuals (or beneficiary's) marginal rate of tax.

Prior to 6 April 2024, whenever an individual took a pension or tax-free lump sum, the value of the new benefit was tested against the individual's available Lifetime Allowance (LTA). If an individual exceeded their available LTA an additional tax charge applied (although this tax charge was removed from the 2023/24 tax year).

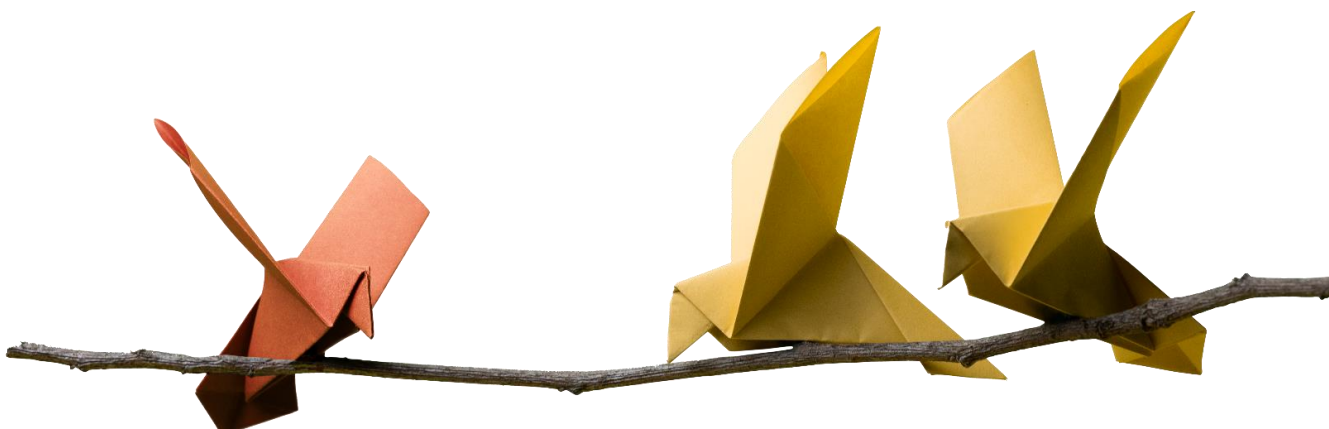
In certain circumstances, individuals could apply for LTA protection, giving them a right to a higher tax-free lump sum and pension before the tax charge applied. These protections still apply in the new regime, giving individuals a right to a higher LSA and / or LSDBA.

A further new allowance, called the overseas transfer allowance (OTA) also applies on all overseas transfers of pensions.

Please note that Mercer Marsh Benefits (MMB) are not lawyers or tax advisers and nothing in this document should be construed as legal or tax advice or relied on for this purpose. If you require financial advice, please speak to a regulated financial adviser.

This document gives an overview of the lump sum allowances which replaced the LTA, plus some information on the LTA and the various LTA protections. It also gives a brief update on the potential impact of inheritance tax on unused pension funds with effect from April 2027.

Please note that the content of this guide is based on information available as 1 February 2025 but may be subject to change by the Government before 6 April 2025.



The lump sum allowance (LSA)

From 6 April 2024, individuals are entitled to a new LSA. The LSA is the maximum amount of benefits you can take from all your pension schemes as tax-free cash.

An individual's LSA is £268,275 unless they have a protected right to a higher LSA as a result of previous LTA protection.

When an individual has a relevant benefit crystallisation event, such as a receiving a pension commencement lump sum or an uncrystallised funds pension lump sum, the tax-free element of the payment will be tested against this allowance.

If an individual exceeds their available LSA then any lump sum payment in excess of the LSA will be subject to income tax at their marginal rate.

Every time a relevant benefit crystallisation event occurs for an individual, a check against their available LSA must take place.

If an individual had an equivalent relevant benefit crystallisation event prior to 6 April 2024, then their LSA will reduce in line with His Majesty's Revenue & Customs (HMRC) transitional rules and may be less than £268,275.

The lump sum and death benefit allowance (LSDBA)

The LSDBA is the maximum amount of benefits you or your beneficiaries can take from all your pension schemes as tax-free lump sum and death benefits.

Individuals are entitled to a LSDBA of £1,073,100 unless they have a protected right to a higher LSDBA as a result of previous LTA protection.

If an individual exceeds £1,073,100 when a relevant benefit crystallisation event occurs, the excess of the lump sum will be subject to income tax at the recipient's marginal rate.

A relevant benefit crystallisation event occurs when an individual becomes entitled to a relevant lump sum or a person is paid a relevant lump sum death benefit in respect of the individual.

Examples of a relevant lump sum include a pension commencement lump sum, an uncrystallised funds pension lump sum and a serious ill-health lump sum. A relevant death benefit for the purposes of this allowance is broadly any lump sum death benefit paid

where the individual dies before age 75, with some specific exceptions listed by HMRC.

Every time a relevant benefit crystallisation event occurs for an individual, a check against their available LSDBA must take place.

If an individual had an equivalent relevant benefit crystallisation event prior to 6 April 2024, then their LSDBA will reduce in line with HMRC's transitional rules and may be less than £1,073,100.

This is a complex area. Further information on the LSA, LSDBA and relevant benefit crystallisation events can be found here:

<https://www.moneyhelper.org.uk/en/pensions-and-retirement/tax-and-pensions/lump-sum-allowances-for-pensions>

www.gov.uk/guidance/find-out-the-rules-around-individual-lump-sum-allowances

Overseas transfer allowance (OTA)

A new OTA came into effect from 6 April 2024 replacing the previous checks made against the LTA.

An individual's OTA is equal to the amount of their LSDBA of £1,073,100, unless they have a higher protected amount as a result of previous LTA protection.

An individual's available OTA is reduced by the amount of any previous overseas transfers on or after 6 April 2024 to a Qualifying Recognised Overseas Pension Scheme (QROPS) and by the amount of LTA previously taken.

If a member exceeds their OTA when transferring funds from a UK pension scheme to a QROPS, a 25% tax charge will be payable on the excess amount.

Please note that overseas transfers are very complex and we recommend that you speak to a specialist regulated financial adviser if you are affected by this. Further information can be found here:

<https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm102200#ota>

<https://www.moneyhelper.org.uk/en/pensions-and-retirement/building-your-retirement-pot/moving-your-uk-pension-overseas>

What was the Lifetime Allowance (LTA)?

The LTA was a limit, set by HMRC, on the total amount of pension benefits individuals could take in their lifetime before they needed to pay an additional tax charge known as the LTA tax charge. Testing against the LTA happened whenever benefits were taken from a pension, such as entering into drawdown, buying a lifetime annuity, taking a lump sum, on death and on reaching 75. These events were called benefit crystallisation events.

The Government announced in the Spring Budget 2023 that the LTA would be abolished with effect from 6 April 2024, and that in the meantime the LTA tax charge would be removed for the 2023/24 tax year.

LTA Protections

In certain circumstances it was possible to protect some or all of your pension benefits from the LTA charge by applying to HMRC for LTA protection.

If you have a right to LTA protection, these protections may allow individuals to have a higher lump sum allowance and also a protected right to a higher lump sum and death benefit allowance (see earlier).

You can find more information at <https://www.gov.uk/guidance/pension-schemes-protect-your-lifetime-allowance>

Inheritance tax

The Government announced in the Autumn Budget 2024 that from 6 April 2027 most unused pension funds and death benefits will form part of an individual's estate for inheritance tax purposes.

The full extent of this proposed change and wider implications is currently unclear as the Government is yet to decide how it will implement the policy. For some individuals this may mean that inheritance tax will be payable on benefits received from a pension scheme. Please speak to a regulated financial adviser if you require financial advice about the potential impact of this proposed change.



Important Notices

Please note that the income tax contribution rates shown in this document are for the 2025/26 tax year and are based on information available as at 1 February 2025.

This document is based on our current understanding of legislation, taxation and HMRC practice, which may change in the future, for example if Government policy changes.

Please also note that we are not lawyers or tax advisers and nothing in this document should be construed as legal or tax advice or relied on for this purpose. We strongly recommend that you seek appropriate advice in relation to matters of law and taxation.

This document is for information only and is not personal financial advice. It cannot cover all the scenarios which may apply to individual members depending upon their personal circumstances. If you require financial advice you should seek this from a regulated financial adviser.

This contains confidential and proprietary information of Mercer Marsh Benefits and is intended for the exclusive use of the parties to whom it was provided by Mercer Marsh Benefits. Its content may not be modified, sold or otherwise provided, in whole or in part, to any other person or entity, without prior written permission from Mercer Marsh Benefits.

Information contained herein has been obtained from a range of third party sources and may change in the future. While the information is believed to be reliable, Mercer Marsh Benefits has not sought to verify it independently. As such, Mercer Marsh Benefits makes no representations or warranties as to the accuracy of the information presented and takes no responsibility or liability (including for indirect, consequential or incidental damages), for any error, omission or inaccuracy in the data supplied by any third party.

References to Mercer Marsh Benefits shall be construed to include Mercer LLC and/or its associated companies.