









When you receive a pension forecast, you may find the additional State Pension is reduced by an amount assumed to be provided by what your contracted-out scheme will pay. This involves complex calculations which may be difficult to understand. You have not 'lost' this amount.

It is paid either through a personal pension plan with a life insurance company or as part of a company pension (although the assumed amount and what you receive may be different). Many public-sector occupations such as the police, teachers, local authority staff, and civil servants often do not receive much above basic State Pension but do receive additional pension with their occupational pension.

Contracting out for defined contribution pension schemes was abolished in April 2012 (see section 2) and for defined benefit pension schemes in April 2016. Arrangements are in place to make sure you do not lose out if affected by these changes.

## 1.2 Boosting your National Insurance contributions

If there are gaps in your NI contribution record, you can usually make up a maximum of six years by paying voluntary contributions. Before paying, seek advice from the Pension Service or an independent advice agency on how much extra pension you might get. In particular, because of the changes to State Pension in April 2016, you might not receive any increase at all if you have already paid 35 years of contributions.

Contact the Pensions Service to ask how much more pension you receive for each extra year purchased. Ask about any deadlines to meet or exceptions to the six-year rule.

## 1.3 Claiming State Pension

You can claim State Pension up to four months before you reach State Pension age, whether you work or not. You can claim online, phone to claim or ask for a claim form. Alternatively, you can delay claiming ('defer') which can increase your State Pension when you do claim.

For details of how to claim, see [www.gov.uk/state-pension/how-to-claim](http://www.gov.uk/state-pension/how-to-claim)

## 1.4 Deferring the State Pension

If you reached State Pension age **after** 5 April 2016, the enhancement for deferring is approximately 5.8 per cent a year (so long as you defer for at least nine weeks) and you do not have the option of taking a lump sum. You can only receive the State Pension at the enhanced rate.

Note, if you defer claiming your State Pension whilst claiming means-tested benefits like Universal Credit or income-related Employment and Support Allowance, you do not receive any increase to your State Pension entitlement. If you defer whilst claiming Pension Credit, the deferred State Pension is included as notional income.



## 2 Occupational and private pensions

### 2.1 Occupational pensions

Occupational pensions, also called works pensions, are schemes run by private and public sector employers. They vary widely in the benefits provided and your contributions. See [this page](#) for more details.

**Defined benefit (DB) scheme** - The amount you receive depends on a combination of your length of service and final or average salary. It is fairly easy to calculate what your pension will be.

**Defined contribution (DC) scheme** - Your pension depends on the amount you and your employer contribute to the scheme.





### 2.3.3 Treating the pot like a bank account

Using your pension pot like

## Defined benefit schemes and pension freedoms

The position with DB schemes is different. If you wish to take advantage of the options offered by pension freedoms, you must first transfer your DB scheme into a DC scheme. If your notional pot value exceeds £30,000, you must take independent financial advice before transferring.

If your pension from a DB scheme is likely to be more than £1,500 a

## 2.4 Early retirement

Retiring earlier than your pension scheme allows usually means a reduced pension income. In the case of early retirement because of ill-health, you can shop around to buy an '*impaired life*' annuity which can pay up to 30 per cent higher than a standard annuity.

Defined benefit schemes usually enhance your pension with extra years of notional service if you retire because of ill health. There is no difference in the taxation of your pension in these cases. If you have less than twelve months to live, you normally receive the entire pot tax-free.

Other inducements to cash in pensions before age 55



### 3.3 Taxable income

Not all income counts towards Income Tax. The rules are different to those for benefits or local authority services. You must pay tax on:

earned income from employment or self-employment

pensions, including State Pension, and annuities (except war pensions)

interest from savings accounts (above certain limits)

dividends from investments (above certain limits)

income from lettings

some state benefits.

You do not have to pay tax on:

Pension Credit

Lottery, Premium Bonds,

## Examples

With earned income (including pensions) of £9,000, you have £3,570 of unused personal allowance (£12,570), followed by £5,000 of zero percent savings interest plus PSA £1,000 tax-free.

With earned income (including pensions) of £14,500, you use all your personal allowance (£12,570). Your £5,000 zero percent savings is reduced by £1,930 (the difference between £12,570 and £14,500). You have £3,070 of zero-rated savings interest plus PSA £1,000.

With earned income (including pensions) of £18,000, you have no zero-rated savings interest because your income exceeds the personal allowance of £12,570 + £5,000 zero band. PSA of £1,000 is available.

If your savings interest exceeds the PSA, you must notify HMRC and pay tax on the excess. If possible, HMRC collect via PAYE, i.e. reducing allowances on your code against a suitable source of income.

If that is not possible, you may have to complete a self-assessment return. Be wary of HMRC making inaccurate estimates of your savings interest. It is sometimes based on out-of-date information.

## Dividends

Shareholders receive an annual £500 allowance of tax-free dividend income. Thereafter, if you are a basic rate taxpayer, you normally pay 8.75 per cent, higher rate 33.75 per cent and additional rate 39.35 per cent tax.

### Note

Income from savings and dividends in ISAs continue to be ignored for tax purposes, so do not include them in calculations or tax forms.

Income from savings and dividends even from tax-free allowances (but not ISAs) are included in your gross taxable income and can push you into the next tax band.

## 3.4 Renting a room

You can let furnished accommodation in your home to a lodger and earn up to £7,500 a year without either paying tax or having to declare it.

The accommodation must not be self-contained or have a separate entrance, and you must share the household facilities.

If you exceed this threshold, you must register for self-assessment and claim the allowance if you wish, but not any expenses. Get tax advice in these circumstances and be aware this may count as income for benefit purposes.

### 3.5 Individual Savings Accounts (ISAs)

ISAs provide a tax-free option for savings and shares. There are six different types of ISAs into which you can save according to the different rules and your needs.

The overall maximum for the year is £20,000. If you make contributions, for example, to your grandchildren's Junior ISAs

### 3.7 Married Couple's Allowance

You can claim a Married Couple's Allowance (MCA) if you are a married couple or civil partners and one of you was born before 6 April 1935. It does not increase your tax-free allowance but is deducted from your tax bill. It is worth 10 per cent of its face value, so your bill reduces by 10 per cent of the total amount. In 2024/25, this is £11,080 which means up to £1,108



## 4 Income Tax and working in retirement

HMRC usually allocates your personal allowances against your State Pension and other pensions, so any income from work is taxed at the basic rate or occasionally the higher rate. If you change job mid-year,

### **Useful tip if you think HMRC have got things wrong**

Compare your State Pension with the figure which HMRC use on your coding notice. If you are confident your arithmetic is correct – multiply 4-weekly payments by 13, not 12 – phone HMRC to challenge. The evidence of what DWP are actually paying you is on the bank statement in front of you.

Work on annual figures. If you are paid weekly for part-time work or draw your State Pension weekly, multiply by 52. If State Pension is paid '*monthly*', remember that is every four weeks, so multiply by 13.

### **Example 1**

## 6 PAYE codes

PAYE is the system that collects tax weekly or monthly through the year as you get paid, rather than paying a lump sum at the end of the year as with self-assessment. PAYE codes are instructions given to employers and pension providers as to how much tax to deduct.

Employers and pension providers only do what HMRC instruct because they do not know the rest of your financial circumstances. If you disagree with or do not understand your coding, contact HMRC.

### 6.1 How to understand your codes

State Pension is taxed by reducing your tax-free allowance and any allowance left over can be used against other sources of income. The coding notice, known as a P2, is a copy of the notice issued to your employer or pension provider.

Your copy shows the personal allowances you are entitled to, from which are taken any amounts not taxed at source. What is left forms the basis of your code number.

#### Example

You are aged 68 with an overall income of £20,000. You have a personal allowance of £12,570. Your State Pension of £8,000 is deducted, leaving an available allowance of £4,570 to set against your occupational pension.

The last digit of the number is removed and replaced by the letter L,

The overall effect is to collect the tax due, after allowances, on the

## 7.1 Possible reasons for inclusion in self-assessment

You must probably complete a self-assessment return if you:

have complicated affairs

are self-employed, in partnership, or a company director

are a higher rate taxpayer with annual income of £100,000 or more

have investment income of £10,000 or more

have taxable income which has not had tax taken off it

have capital gains in excess of the exempt amount

have rental or foreign income

have a tax liability but no PAYE source of income.

## 7.2 Full return (SA100) and additional information (SA101)

You are normally sent a '*notice to file*'. HMRC want people to file online. If you cannot or do not want to file online, phone HMRC and ask for the paper SA return to be sent to you. You can no longer download it from the HMRC website, only any supplementary pages.

You usually complete a full return initially. The '*full*' return covers income from pensions, taxable benefits and investments, plus the opportunity to claim extra

There are automatic penalties for returns filed after 31 January and surcharges for final payments more than 28 days late. Interest is charged on late payments, in addition to penalties. You can appeal against penalties but need good reasons why you failed to file or pay on time e.g. being in hospital, death in the family etc. You should try to file or pay as soon as possible after the cause of the delay has gone away.

## 7.5 Record-keeping

You are not asked to send in supporting evidence with your tax return, but you should keep records for at least 12 months after the payment deadline. HMRC can enquire into your return. Keep the records for five years after the deadline if you are self-employed or have income from property.

## 7.6 Escape from self-assessment

Recently, HMRC have taken people out of the self-assessment system where their tax can be collected by other means (PAYE or deducting at source) and there is no other reason why they need an annual return. If they decide to do this with you, they will write.

If you think there is no longer a need to complete an SA return, ask HMRC to remove you from the system. Once out of self-assessment, you cannot forget about tax altogether. You have responsibility to tell HMRC of any new income or capital gains you need to pay tax on. You must do this by 5 October after the end of the tax year in which you get that income or gain.

You cannot assume HMRC will automatically get your tax right through PAYE, so keep an eye on tax codes and other deductions to make sure you pay the right amount overall. You might want to contact HMRC to tell them about tax reliefs you are entitled to, such as relief for Gift Aid donations or pension contributions if you are a higher rate taxpayer.



## 8 Paperwork and forms

When you retire, you will probably need to start dealing directly with HMRC. This is partly because of no longer being shielded by an employer and payroll office and partly due to changing financial circumstances. HMRC want to reduce the amount of paper contact by receiving more information electronically from employers, pension providers, banks etc. and not asking for information they already hold.

### 8.1 P800 – tax calculation

At the end of a tax year, HMRC do a reconciliation of the tax a PAYE taxpayer has actually paid with the tax that HMRC think you ought to have paid. If there is a discrepancy, under or over, they send you a P800 calculation explaining how they reached their conclusion as to whether you owe them tax or they owe you a repayment.

It is not a demand for tax, though it could turn into one if HMRC convert it





### 9.3 Value Added Tax

The relevant part of VAT that may arise at retirement is its application to disability. There are two main points.

Many goods or services bought solely because of need through disability (such as items specially designed for people with disabilities) are VAT-free (zero-rated)



## Useful organisations

### **Association of Taxation Technicians**

[www.att.org.uk](http://www.att.org.uk)

Telephone 020 7340 0551

Leading professional body for those providing tax compliance services and related activities in the UK.

### **Citizens Advice**

England [www.citizensadvice.org.uk](http://www.citizensadvice.org.uk)

Wales [www.citizensadvice.org.uk/wales](http://www.citizensadvice.org.uk/wales)

Northern Ireland [www.citizensadvice.co.uk](http://www.citizensadvice.co.uk)

Scotland [www.cas.org.uk](http://www.cas.org.uk)

In England telephone 0800 144 8848

In Wales telephone 0800 702 2020

In Scotland telephone 0800 028 1456

National network of advice centres offering free, confidential, independent advice, face to face or by telephone.

### **Chartered Institute of Taxation (CIOT)**

[www.tax.org.uk](http://www.tax.org.uk)

Telephone

**Pension Service (The)**

[www.gov.uk/browse/working/state-pension](http://www.gov.uk/browse/working/state-pension)

Telephone ~~0800~~ 731 0469

State Pension Forecasting Team 0800 731 0175

For details of state pensions, including forecasts and how to claim.

**Pensions Ombudsman (The)**

[www.pensions-ombudsman.org.uk](http://www.pensions-ombudsman.org.uk)

Telephone

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## Age UK

Age UK provides advice and information for people in later life through our Age UK Advice line, publications and online. Call Age UK Advice to find out whether there is a local Age UK near you, and to order free copies of our information guides and factsheets.

### Age UK Advice

[www.ageuk.org.uk](http://www.ageuk.org.uk)

0800 169 65 65

Lines are open seven days a week from 8.00am to 7.00pm

### In Wales contact

#### Age Cymru Advice

[www.agecymru.org.uk](http://www.agecymru.org.uk)

0300 303 4498

### In Northern Ireland contact

#### Age NI

[www.ageni.org](http://www.ageni.org)

0808 808 7575

### In Scotland contact

#### Age Scotland

[www.agescotland.org.uk](http://www.agescotland.org.uk)

0800 124 4222

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