

Explaining how pension withdrawals are taxed



As the saying goes “tax doesn’t have to be taxing”, but when it comes to pensions, it can feel like quite hard work. Because you get tax relief when you put money in, you usually have to pay income tax when you take it back out. After all, it’s an income – just like anything else you’ve earned during your life.

If you are thinking about accessing your pension pot for the first time, have recently requested a lump sum, set up a flexible retirement income with us or even changed an income instruction, it’s important to understand how tax could affect those payments.

In this guide we cover:

- Which pension withdrawals are taxed
- How we calculate and deduct tax
- How to reclaim if you believe you have been taxed too much



Principles of Income Taxation

People who live in the UK (or, to use the technical term, are 'resident in the UK') in any given tax year have to pay Income Tax on a variety of income, such as their salary or wages from employment, certain savings and investments, rent from any property they let out and, crucially, from pensions.

With pensions, you usually have to pay tax on income you receive that is above any tax-free cash you're entitled to – just like you do on other earnings. How much you pay depends on your total income and the Income Tax rate that applies to you.

How do we tax your pension payments?

Tax is calculated and deducted from pensions in the same way that salary or wages are paid by an employer. That means it's taxed under the Pay As You Earn (PAYE) system before it is paid to you.

As a result, any income from a pension that you hold with a pension company (both workplace pensions and personal pensions) or an employer (for example a defined benefit or final salary pension) will be taxed in this way. This applies whether it is flexible retirement income (also called 'income drawdown'), a lump sum (the 'uncrystallised funds pension lump sum', known as UFPLS) or a guaranteed income for life (an 'annuity').

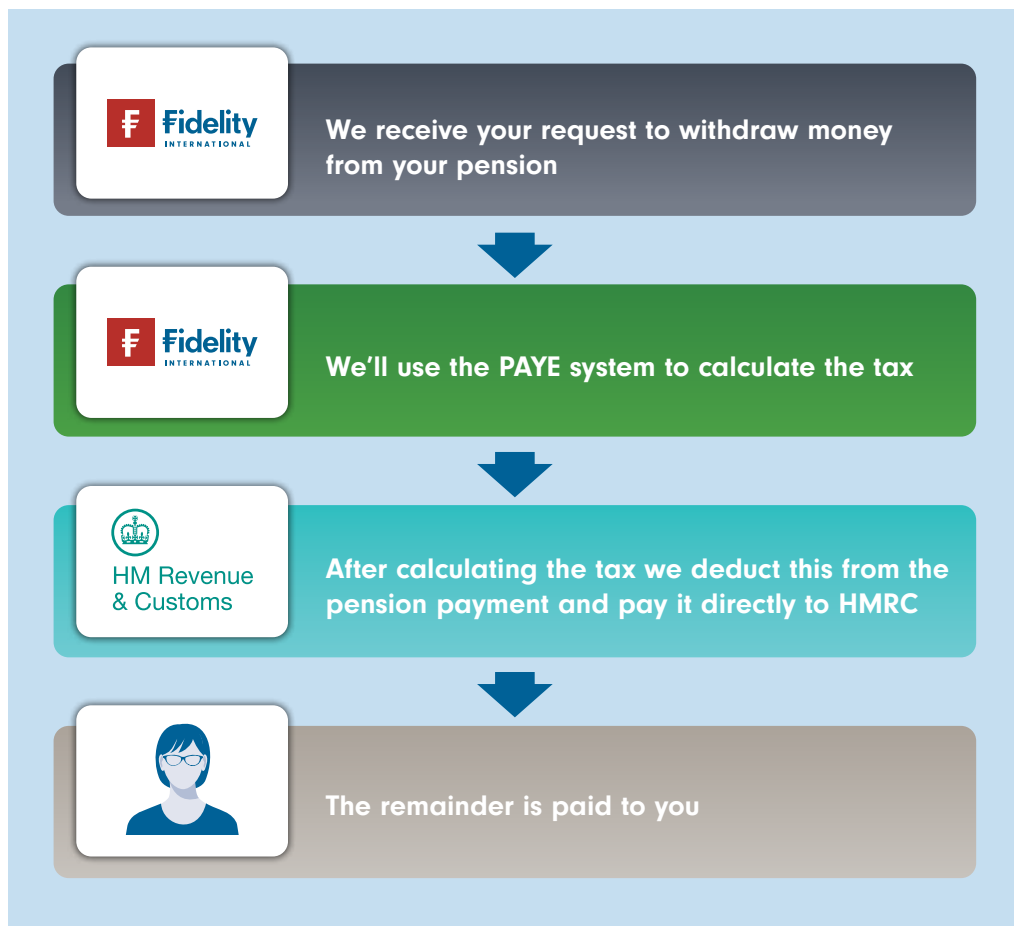
The State Pension is subject to income tax, but no tax is deducted by the government before it is paid to you.

Other pension-related benefits from the state may or may not be taxable and may or may not be taxed at source. You can find out more by visiting www.citizensadvice.org.uk Just head to the debt and money section.

Eligibility to invest in a pension and tax treatment depends on personal circumstances and all pension and tax rules may change in the future.

How does it work?

If you ask us for taxable income or a lump sum from your pension, we will use the following process:



Tax codes

How is the tax calculated?

We calculate tax in line with instructions from HM Revenue & Customs (HMRC). Usually, this means applying a tax code that HMRC has given us.

What is a tax code?

A tax code helps employers or pension providers determine how much tax to collect from individuals when they pay out salary and pensions. It contains information about your tax situation and explains how much tax-free personal allowance is available for the purposes of making the pension payments.

What is the annual tax-free personal allowance?

This is the amount of annual income you can have each tax year before you pay tax. You have to pay tax on any amount above your tax-free personal allowance.

HMRC calculates your tax-free personal allowance based on your age and any entitlement to allowances or tax reliefs, less any deductions. They use this information to produce a tax code which they supply to your employer or pension provider.

How do we get your tax code?

First taxable income withdrawal

The first time you request taxable income from us, we will not normally have a tax code for you. If you can send us a P45 for employment or a pension that ended in the current tax year, we will be able to use the tax code from this, though we will apply tax on a 'month 1 basis' (explained below). Alternatively, if we already hold a tax code for the current tax year, we can use that to tax the payment we are making.

If we do not have a tax code for you or a P45 from the current tax year, we have to use an emergency code on a 'month 1 basis'. This is a temporary code and means we'll deduct what is commonly known as 'emergency tax'. As a result, this could mean we deduct too much tax from your initial payment or not enough.

On-going income

After we have paid the first taxable pension withdrawal to you, further withdrawals will usually be taxed under PAYE using the relevant tax code as received through from HMRC. Generally, if we have not been contacted by HMRC by 5 April, we will carry forward the existing tax code to the new tax year but use it on a cumulative basis (taking into account any tax you've already paid this year and how much of your accumulated tax-free personal allowance has been used).

In some circumstances, we may be paying pension income to you under more than one payment stream. For example, you may have more than one workplace pension with us or a workplace pension and a self-invested personal pension (SIPP). Where this is the case, we are unable to use the same tax code for both payments. HMRC require us to apply emergency tax on the payments until they issue (and we receive) a tax code for these payments.

Understanding your tax code

Although there are a lot of tax codes, they are generally quite straightforward. You will normally see a number followed by a letter, a letter on its own or a letter followed by a number.

- A number tells your employer or pension provider how much personal tax-free allowance you have available for the purposes of taxing the income.
- Letters describe your situation and how it affects your personal allowance.

For example, if you are entitled to the full personal allowance of £12,570 for the tax year 2025/26, HMRC will divide this by 10 and issue a tax code of 1257L. The L confirms you are entitled to the standard tax-free personal allowance.

As everyone's personal financial circumstances are different, not everyone has the same tax code or standard personal allowance. Many people receive taxable income from a variety of sources, which could include bank deposits, investments, other pensions, benefits from the government and so on. HMRC takes all your sources of income and allowances into account to arrive at your tax code.

How much tax will I have to pay when I take money from my pension?

This depends on how you take your income. Here is a quick summary of the options along with the tax positions. Please be aware some of these options may not be available from your pension provider.

You can take part of your pension tax-free

Most pensions allow you take a quarter (25%) of their value free of tax. This is known as a tax-free lump sum or more simply as 'tax-free cash'. For example, if you had £20,000 in your pension, you could take £5,000 free of tax. The lump sum allowance (LSA) is the maximum amount of tax-free cash you can take from your pension savings in your lifetime. The standard LSA is £268,275.

Some pensions (typically older ones) may offer a higher amount of tax-free cash, while others may pay out less than 25% – defined benefit pensions such as final salary and career average schemes, for example, calculate tax-free cash differently.

You can take your whole pension pot in one go

You can take the whole amount as a single lump sum. A quarter (25%) of your pension pot can usually be taken tax-free – the rest will be taxed at your highest potential tax rate. Depending upon the amount this could move you into a higher tax bracket than you are currently in.

You can take your pension pot as a number of lump sums when you want

You can leave your money in your pension pot and take lump sums from it as and when you need to – until your money runs out or you choose another option. Each time you take a lump sum, normally a quarter (25%) of it is tax-free and the rest will be taxed. You may need to move into a new pension plan to do this.

You can get a flexible retirement income

You can leave your money in your pension pot and take an income from it. This means you will receive a payment on a periodic basis until your pension pot runs out. In the meantime, your pension pot remains invested, which may give it a chance to grow, but it could go down in value too. A quarter (25%) of your pension pot can usually be taken tax-free and any other withdrawals will be taxed whether you take them as income or as lump sums. You may need to move into a new pension plan to do this. It's worth keeping in mind that you do not need to take an income.

You can get a guaranteed income for life

A lifelong, regular income (also known as an annuity) provides you with a guarantee that the income will last as long as you live. A quarter (25%) of your pension pot can usually be taken tax-free before you buy the annuity and any other payments will be taxed. You will need to move your pension to a new pension provider to do this. We do not offer annuities.

You can choose more than one option and you can mix them

You can also choose to take your pension using a combination of some or all of the options over time or over your total pot. If you have more than one pot, you can use the different options for each pot. Some pension providers or advisers can offer you an option that combines a guaranteed income for life with a flexible income.

The Government offers a free and impartial guidance service to help you understand your options at retirement. This is available via the web, telephone or face-to-face through the Pension Wise service which is now part of MoneyHelper; the easy way to get free help for all your pension and money choices. You can find out more by going to **moneyhelper.org.uk/pensionwise** or call them on **0800 011 3797**.





These are the tax positions of the different income options:

Income option	Tax position	Tax collection position
Tax-free lump sum (a quarter, 25%, of the pension pot)	No tax is payable	N/A
Taking the whole pension pot in one go	25% (a quarter) of the payment is tax-free 75% (i.e. the remainder) of the payment is taxed	Taxed under PAYE using the relevant tax code or an emergency code if not initially available
One of a number of lump sums (UFPLS)	25% (a quarter) of the payment is tax-free 75% (three quarters) of the payment is taxed	Taxed under PAYE using the relevant tax code or an emergency code if not initially available
Flexible retirement income (drawdown payments)	25% (a quarter) of the pot can be taken tax-free Other withdrawals will be taxed whether taken as income or lump sums	Taxed under PAYE using the relevant tax code or an emergency code if not initially available
Guaranteed income for life (annuity payments)	25% (a quarter) of the pot can be taken tax-free at the start All income payments are assessed for tax	Taxed under PAYE using the relevant tax code or an emergency code if not initially available
Small pot lump sum (pensions worth less than £10,000)	25% (a quarter) of the payment is tax-free 75% (three quarter) of the payment is taxed	Taxed under PAYE with basic rate tax (20%) initially applied. This may result in an under/overpayment of tax.

Whichever option or options you choose, the company/pension provider that is paying the money to you will be required to calculate and deduct any relevant income tax from the payments before you receive them.

Taxable amounts will be added to your other income, which will probably give you an additional tax bill. The extra income could tip you into a higher rate of tax and it may mean you are no longer entitled to extra tax allowances.

Taxation of other payments that could be made from your pension pot

Taking money from your pension if you are in serious ill health

If you have a medical diagnosis that says you have less than twelve months to live and we agree to make payments to you from your pension pot, they will be tax free if you are under the age of 75 and you have sufficient lump sum and death benefit allowance available, but taxable if you are 75 or older. It is important to note though that any money that is withdrawn and not spent before you die would form part of your estate and could therefore be subject to inheritance tax.

Payments from your pension pot after your death

If you die and there is money left in your pension pot, the beneficiaries who inherit it may have to pay tax on any income or lump sum they take.

If they inherit the pension and you were under the age of 75 when you died, the withdrawals your beneficiaries take will not be taxed.

If they inherit the pension and you were over the age of 75 when you died, the withdrawals your beneficiaries take will be taxable under PAYE, based on their tax position.

Please note that the UK Government has announced that from April 2027 it is currently their intention for unspent pension pots to be included in the calculation of the value of estates and could therefore be subject to Inheritance Tax. Please visit [fidelity.co.uk/inheritance-tax-changes](https://www.fidelity.co.uk/inheritance-tax-changes) for more information.

What should I think about when taking money from pensions?

It is important not to rush a decision on your pensions, if you can avoid it.

Consider your circumstances (personal and financial), investment choices, charges you might incur if you take pensions early, future plans and, importantly, the consequences for tax, tax credits and other state benefits.

Taxable income from pensions is also income for the purposes of tax credits. You will need to take great care if you claim tax credits and take money from a pension. The decision could cost you dearly, as it may mean you end up with a tax credits overpayment for the year when you take the money out – this means that you may have been paid too much and have to pay it back.

Plan ahead. For example, you might pay less tax on money from pensions if you take it in stages, spread it out over a number of tax years or wait until after you have stopped work.

Consider how it could affect your future pension savings. If you take more than the 25% tax-free amount, or if you take one or more lump sums, your annual allowance for any future contributions (the amount you can pay into your pension pots each year and receive tax relief on) could drop from £60,000 to £10,000. This is known as the money purchase annual allowance. So, not only will you have less money invested to provide future income, but your ability to build it back up again may be greatly restricted. Find out more about this in our Money Purchase Annual Allowance factsheet.

Tax is not the only factor. There might be other reasons you need your money sooner. You will need to take into account possible future changes in your circumstances and you will have other investment-based issues to think about. We cannot cover those, but do strongly suggest you think about the tax situation very carefully before acting.

What statements do we send you?

You might receive a P45 or a P60 from us.

When might we send you a P45?

We send a P45 when we are making the final payment we expect to pay you from a particular pension pot. This could be because you have decided to move your pension to another provider or we may have paid out the total value to you. We will not issue you with a P45 until all of your pension pot has been withdrawn.

The P45 will show you how much tax has been deducted from your pension income within a tax year. It is split into four parts. We will only send you parts 1A, 2 and 3.

- Part 1A is your copy to retain for future reference. Please keep it safe as we are not allowed to provide you with another copy if you misplace it.
- Parts 2 and 3 should be handed to your next employer, pension provider or the Jobcentre Plus.

HMRC will know that we have made pension income payments to you from the data we have to send them. They will review your tax liability and send us a revised tax code to use if necessary.

When might we send you a P60?

We will send you a P60 when we have paid you a taxable income or lump sum from your pension pot within the tax year. We will usually issue this to you by 31st May following the end of the tax year (5th April). If you have only taken all or part of your tax-free lump sum from your pension pot during a given tax year, you will not receive a P60 from us.

What happens if I haven't received my P60?

Don't worry! If you haven't received your P60 from us by 31st May, and you are due to receive one, please visit the contact us page on the website.

Are the amounts displayed under 'Pay and Income Tax details' before or after tax?

To help avoid any confusion:

Pay	This is the amount of income or lump sum that we paid to you before tax was deducted
Tax Deducted	The amount of tax we deducted from your income or lump sum
Total for the year	The total amounts of pay and tax deducted

Why does my P60 mention pay and tax deducted in previous employment(s)?

If we received your P45 form from your previous employer or pension provider and it related to the tax year in question, we have to quote this information on your current P60 form. HMRC may also give us this information.

Overpayments and underpayments of tax

Overpayment or underpayment of tax can happen for all sorts of reasons. Some of the more common ones include use of an incorrect tax code, emergency tax being applied or a large one-off withdrawal.

How overpayments or underpayments may be dealt with

Ongoing income

If you have set up a regular income (so you expect to receive more than one payment from your pension in a tax year) or if you have taken, or intend to take, more than one withdrawal from your pension in a tax year, any overpayment or underpayment of tax can be dealt with in one of three ways.

1) Through the PAYE process

Payments made through the PAYE process tend to resolve themselves over the course of the tax year. This is because the calculation and deduction of tax on each payment takes into account any previous payments made in the tax year, along with any adjustments to your tax code that we receive from HMRC.

2) HMRC review your tax affairs

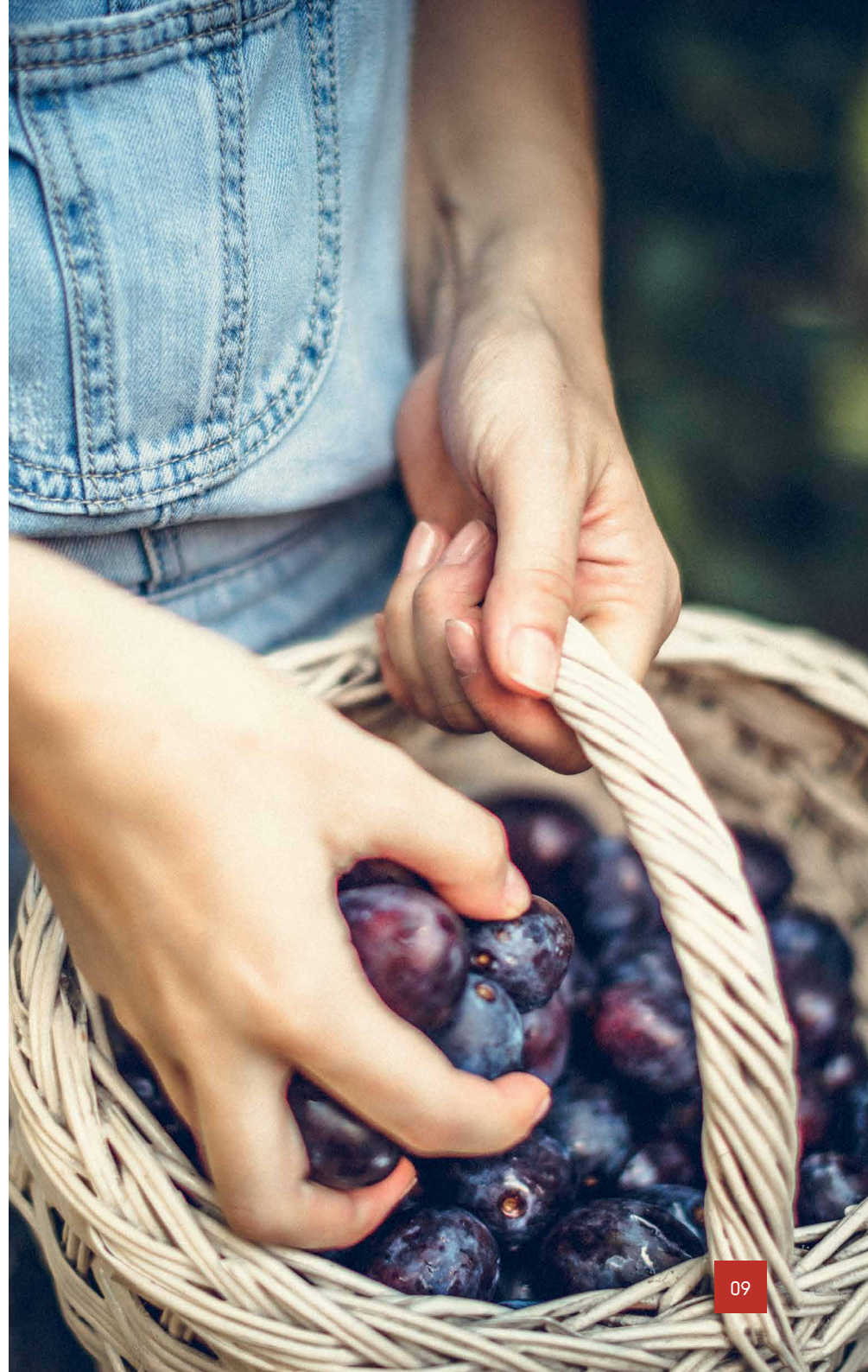
After the end of the tax year (5th April), HMRC will normally review your tax affairs automatically and notify you if you have paid too little or too much tax. For full details, visit:

www.gov.uk/tax-overpayments-and-underpayments

3) Complete self-assessment/Contact your local tax office

If you have other taxable income that you need to declare to HMRC, you may need to (or prefer to) complete a self-assessment following the end of the tax year. In this case, your tax liability will be calculated as part of the submission process. If you have paid too much tax, you will then be entitled to a rebate. If you have not paid enough, you may be required to pay more, or your tax code could be amended so that tax is reclaimed over the course of the next tax year.

If you do not have other taxable income that you need to declare to HMRC, or all the income you receive is taxed at source (so you do not need to or are unable to complete self-assessment), you can contact your local tax office who will review your tax affairs based on the information you submit to them.





Reclaiming tax on one-off pension withdrawals

If you do not intend to make any more taxable pension withdrawals in the same tax year, you can wait for HMRC to review your account at the end of the tax year, contact your local tax office, complete a self-assessment at the end of the tax year or, possibly, claim an in-year tax refund by completing the relevant HMRC form, which is available online.

Forms

The following forms can be used to reclaim tax during the tax year if you have not set up a regular income and/or do not intend to receive any further income from your pension in the tax year. They should be used when:

P50Z	your whole pension pot was paid out and you have no ongoing income from other sources (except the state pension)
P53Z	your whole pension pot was paid out but you do have ongoing income from other sources (such as a second job)
P55	you have taken some money out of your pension pot using the pension freedoms, but you are not taking regular income from the pension
P53	when you have taken your whole pension pot under the small pot rules or trivially commuted a defined benefit (salary related) pension

You can claim a refund if you've overpaid tax in the current tax year or any of the previous four tax years.

To obtain the relevant form, and for further details, visit HMRC at:
www.gov.uk/claim-tax-refund

If you live outside the United Kingdom, please contact HMRC directly to claim any in-year tax rebate, as there are different rules for claiming tax refunds on a UK pension if you live abroad.

Useful links

You can find more information about HMRC tax rules at:

www.gov.uk/tax-on-pension

www.gov.uk/tax-codes

www.gov.uk/income-tax-rates

www.gov.uk/tax-overpayments-and-underpayments

www.gov.uk/claim-tax-refund

HMRC contact details

Telephone: 0300 200 3300

Address: Pay As You Earn, HM Revenue and Customs, BX9 1AS,
United Kingdom

You may need to quote your National Insurance number when you contact them. You may also need to quote our reference numbers:

- Employer PAYE reference: 120/FA93220
- Accounts Office reference: 120PF00682014

Important information

The information within this guide is correct as at April 2025.

The minimum age you can normally access your pension savings is currently 55, but this is due to rise to 57 on 6th April 2028.

This information is not a personal recommendation for any particular product, service or course of action. Pension and retirement planning can be complex, so if you are unsure about the suitability of a pension investment, retirement service or any action you need to take, you should speak to an authorised financial adviser of your choice.

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