Pension Lump Sum Recycling

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We regularly receive questions from clients about using their tax free lump sum to fund further pension contributions and boost pension benefits in the future.

However, using your tax free lump sum in this way is essentially generating tax relief on monies that have already benefitted from tax relief and is regarded as 'recycling' by HMRC. There are 6 key factors that the Revenue will use to determine whether the recycling rules apply and if so, will levy a tax charge of 40-55% of the lump sum taken.

1. The individual receives a pension lump sum.
2. Because of the lump sum, the level of contributions paid into a registered pension scheme is significantly greater than it otherwise would be.
3. The additional contributions are made by the individual or by someone else, such as an employer.
4. The recycling was pre-planned.
5. The amount of the lump sum, together with any other lump sums taken in the previous 12-month period, exceeds £7,500 for events on or after 6 April 2015, or 1% of the standard lifetime allowance for events before 6 April 2015.
6. The cumulative amount of the additional contributions exceeds 30% of the pension lump sum.

Example 1 - Paying the lump sum as a contribution

A 57-year-old member of a registered pension scheme has built up a pot of £100,000 in a money purchase arrangement. The member has earnings of £75,000. The member is making contributions amounting to 10% of those earnings to another registered pension scheme in respect of a pensionable employment. The only other asset of note that the member has is the member's family home, which is mortgaged. The member draws a pension commencement lump sum of £25,000 from his £100,000 pot, which is fully covered by lifetime allowance.

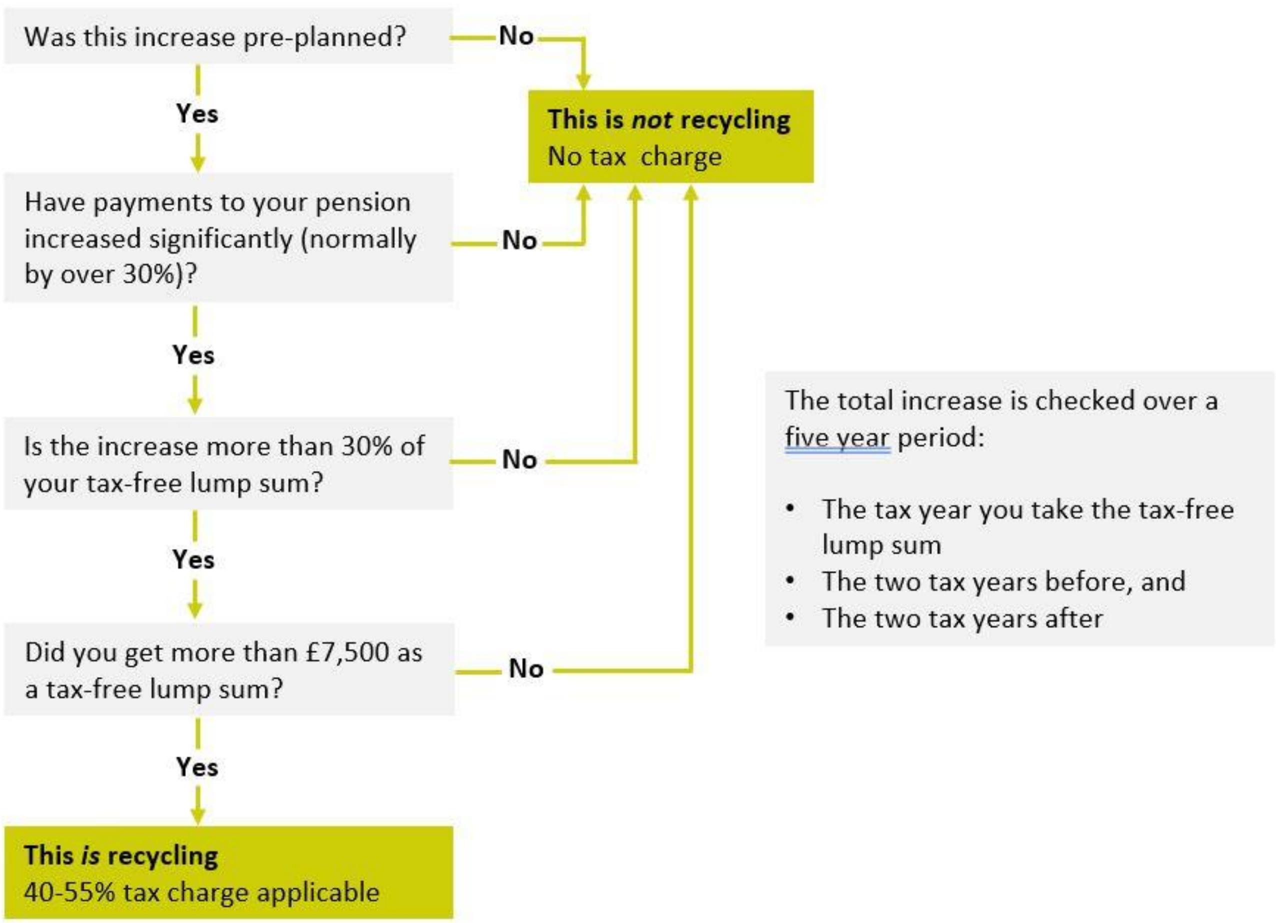
The member pays an immediate contribution of £25,000 into a registered pension scheme. The member is able to claim higher rate relief in respect of all of the contributions of £32,500 that the member makes in the tax year. Where the member had the intention at the time of taking the pension commencement lump sum of using that lump sum to make additional contributions, those contributions would be regarded as triggering the recycling rule. There would be an unauthorised payment of £25,000.

Example 2 - Significant increase in contributions

A member's annual contributions to registered pension schemes have been £20,000 a year for the last 10 years. In the year in which a pension commencement lump sum is received, the contributions are £30,000. The member took the lump sum with the prior intention of using it to make significantly greater contributions to a registered pension scheme.

Based on the previous 10 years, the amount of contributions that might have been expected is £20,000. So, there is a significant increase in contributions as the increase of £10,000 is more than 30% of the amount that would have been expected in that year (the limit is reached where the amount of the increase in contributions - £10,000 - exceeds £20,000 x 30% = £6,000).

Decision Tree – is it recycling?



Please note the above examples and simply for illustration purposes only and each case is considered on its own merit with other specific factors contributing to each case. We therefore strongly recommend taking professional advice.

Call us for a complimentary, no obligation, discussion on 01789 263257 or email: justask@jjfsltd.com

Information in this document is valid for tax year 2024-25