Your Tax Free Cash Pension Lump Sum under threat – don't panic?

The former Pensions Minister, Steve Webb, in the coalition government, was quoted in the Press at the weekend speculating that the Chancellor may remove the facility to draw 25% of your pension fund as a tax-free lump sum.

The Chancellor will use next month's budget to announce his plans for the future of pension tax relief following last year's consultation with the Treasury keen to reduce the cost of providing this benefit, particularly to higher and additional rate tax payers. He has a number of options for doing this, the most likely being a reduction in upfront tax relief.

The 25% tax-free lump sum is one of the most attractive features of the current pension regime and forms the basis of many peoples' retirement planning. Withdrawing this facility retrospectively could be political suicide for a Chancellor with serious leadership ambitions.

Consideration could be given to an attack on upfront tax relief for pension contributions.

Any change is likely to apply to future accruals, but even this probably won't achieve the desired policy outcome. It would also create an awkward dual system for pre & post budget pension accruals. The UK's big pension companies, who have just spent millions implementing pension freedom changes, will be lobbying hard against any kind of two-tier pension system. Don't forget Steve Webb now works for Royal London, a pension company with a drawdown product to promote. The type of product that anyone withdrawing his or her tax-free cash in a hurry would need to use.

Of course each year as we approach the Budget, rumours speculate that the tax-free lump sum will be consigned to history.

This year, that rumour may become reality, but with a big **but**. Any change to the tax-free lump sum is unlikely in the extreme to be retrospective.

Changes to the pensions tax regime (think of reductions in the Lifetime and Annual Allowances) are accompanied by protections of existing rights. This isn't because it's a nice thing to do; it's bound up with concerns over claims of infringement of human rights. Beyond that rather important point, the Government would think long and hard about removing existing rights with a referendum around the corner, people retiring imminently may be less disposed to give the Government's case a fair hearing if they have just been presented with a large unexpected tax bill!

In theory, the Chancellor could simply abolish the tax-free lump sum going forward, retaining the rest of the pensions tax regime. However, a more likely outcome is radical change to the regime.

Writing for the *Sunday Times* website over the weekend, Mr Webb, made the familiar point that moving the tax-regime for pensions to an ISA-style system would be tantamount to abolishing the tax-free lump sum. While all of the emerging benefit would be tax free, all of the contributions would have been taxed on the way in, there would be no 25% that avoided tax at both ends, as exists under the current regime.

However, if an ISA-style regime were to be introduced (with a Government top up), it would either apply only to contributions (or benefits accrued) from the date of the new regime or existing pension savings (which are due to be taxed in payment) would need to convert to the new regime. Conversion would be complex and would involve a levy – an expectation of the tax that would otherwise have been payable on the existing pension savings. It would take into account the tax-free lump sum on those savings.

We believe the most likely outcome is an attack on upfront tax relief for pension contributions. **Therefore it may well be very sensible to make any contributions before the 16th March to be on the safe side!**

This is a big cost to the treasury that benefits high earners disproportionately and would give big ongoing savings. The magnitude of the saving is only going to increase when you take into account the increase to Auto-Enrolment contribution rates. Putting a lid on his tax relief 'costs' would be preferential.

Overall we wouldn't be surprised to perhaps see a 20% flat rate and the Lifetime Allowance raised (or ideally abolished!).

Do not act on this information alone! Individuals should seek independent financial advice before taking any action.

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