

# Helping people to avoid pension pitfalls

## Personal tax

30 July 2021

**LITRG's online postbag contains numerous examples of people making costly mistakes when drawing on their pension savings.**

**We have recently responded to two consultations in the hope that in future more people will get guidance which might help them avoid the pitfalls.**

Pensions freedom has, since 6 April 2015, allowed savers much more flexibility over how and when they take funds from defined contribution pension pots. However, in so doing, people can unwittingly incur unexpected tax charges; for example, taking out a lump sum can tip them into the higher rate of tax. They may even create a high income child benefit charge (HICBC), where adjusted net income for the year (including the taxable part of the pension lump sum) exceeds £50,000 and child benefit is being paid. The consequences of falling within the HICBC's ambit can be even more devastating if the taxpayer does not realise this results in an obligation to notify HMRC of liability, with consequent penalties for failure to do so.

They might also not realise that the taxable element of their pension withdrawal is income for tax credits purposes. Depending on the amount of the withdrawal, this can give rise to a tax credits overpayment for the year and loss of some tax credits for the next year.

Claimants of other welfare benefits can also trigger adverse consequences. For example, a lump sum withdrawn from a pension might be taken into account when working out how much capital they have. By contrast, when it was in the pension pot, it would usually have been disregarded for benefits purposes.

One of the reasons that people fall into these traps is that those with smaller pots often cannot afford to access advice before making their decision. Furthermore, take up of the government's PensionWise guidance appointment offering is low, with

estimated usage being between 1% and 3% of the eligible population.

LITRG has therefore responded to two recent consultations, highlighting how awareness could be improved.

First, the Financial Conduct Authority has been consulting on how people can be given a stronger nudge towards getting guidance on their pension choices. Our response (see [www.litrg.org.uk/ref2476](http://www.litrg.org.uk/ref2476)) emphasises, amongst other things, that tax and benefits impacts of decisions should be given more prominence.

Second, we have supported the Department for Work and Pensions' plan to mandate the use of simpler pension statements for defined contribution savers. These will be limited to two sides of A4 and will aim to get key information across in a consistent format. While appreciating that there is limited space available, LITRG's response (see [www.litrg.org.uk/ref2501](http://www.litrg.org.uk/ref2501)) stresses that a single line warning should be included about the interaction of pensions with tax and benefits.