RECYCLING PENSIONS TAX-FREE CASH

APRIL 2025

Pension rules have been greatly relaxed in recent years, and you are now **able to take your tax free cash** (Pension Commencement Lump Sum/PCLS) if you are over age 55 (57 from April 2028), **regardless of whether you have actually stopped working**. So if you are still earning, what is to stop you further enhancing the tax efficiency of your pension by taking the PCLS, and reinvesting in a pension to gain the tax relief? And rinse and repeat.

HMRC introduced specific **anti-avoidance rules** for just this scenario, but as ever, they may inadvertently catch out some of those who were not intentionally 'recycling' their PCLS. Increasingly, individuals have a **phased retirement period** where they may be both taking pension benefits, but also working and contributing to pensions. It is important that those individuals are **fully aware of these rules** to prevent being inadvertently caught out.

SUMMARY

Anti-avoidance provisions exist to prevent the recycling of tax-free cash (the **pension commencement lump sum** or **PCLS**) into further pensions contributions. The provisions were effective from 6 April 2006, and further tightened from April 2015 in anticipation of potential misuse of the new pension freedoms to artificially enhance pensions tax relief received.

As the **conditions are relatively prescriptive**, individuals taking pensions in the normal course of events should not be affected. However, a **declaration** is required that no recycling is taking place, and so advice should be sought if you are unsure. In addition, anybody considering making **large pension contributions** in the **two years before or after taking a tax free cash lump sum** should ensure that they do not **inadvertently** fall foul of the rules.

CONDITIONS

An unauthorised payment charge will be levied on a PCLS if **all** the following four conditions are met.

1. **The use of the PCLS to pay additional pension contributions must be pre-planned.**

   This is the least specific aspect of the legislation. The onus is on the Revenue to prove that the use of the PCLS to pay the pension contribution was pre-planned, which may be difficult, although any evidence pointing towards this can be taken into account.

   The additional pension contribution can be paid before or after the PCLS is taken (see point 3), and the intention of using the PCLS for such a purpose must be present at the earlier of these two events.

2. **The PCLS taken, together with any other PCLSs taken in the previous 12 months must exceed £7,500.**

   These rules are therefore only designed to catch individuals who are taking benefits, over 12 months, from pension funds worth over £30,000.

CONDITIONS

3 As a result of taking the PCLS, contributions have increased significantly – by over 30% of the regular contributions.

- Contributions include those received from all sources, i.e. family members, employers, as well as personal contributions.
- The level of contributions is tested on a cumulative basis over five years – the tax year the PCLS is taken, and the two years before and after this.
- The expected level of contributions may have increased using a pure monetary basis, but if the basis upon which these are made has remained the same (e.g. a percentage of salary, a contractual obligation) then the expected level will reflect this. Where there is no pattern of contributions, i.e. only a single contribution in the 5 years, then the contribution can be indexed by RPI to provide a current value for comparison.

It is not necessary for the pension contribution to be made from the PCLS directly – the contribution can be made from available savings (or via salary sacrifice etc.), so long as the intention was that the PCLS would fund the contribution, e.g. that the PCLS would top up the savings again.

This is not to say that all larger contributions made will be caught, even where these are funded from savings and part of the reason for making the contribution is a larger total PCLS; the rule is simply that the PCLS must be the reason driving the additional contribution.

Exactly how the Revenue may prove this intention is hard to see, however, as noted above, the onus is on the Revenue to prove that the contribution was planned as a result of the PCLS, rather than the individual to prove the absence of intention.

4 The cumulative amount of additional contributions must exceed 30% of the PCLS within two years of the receipt of the PCLS.

- Where several PCLSs are taken, so that the cumulative total exceeds £7,500, it is the last PCLS taken which is tested under this rule (and to which the unauthorised payment charge would apply if all the conditions are fulfilled).

UNAUTHORISED PAYMENT CHARGE

Where all the four conditions above have been satisfied, an unauthorised payment charge of up to 55% of the PCLS will be levied on the member, comprising:

- 40% unauthorised payment charge of the PCLS.
- 15% surcharge where the unauthorised payment is 25% or more of the scheme from whence it came.

In addition, a scheme charge of 15% - 40% of the PCLS may also be levied, depending upon the amount of unauthorised payment charge paid by the member. This may mean an additional 15% charge, which the scheme would pass on to the member – giving a potential total charge of 70%.

In practice, this means that schemes will therefore usually ask members to self-declare that they are not planning to recycle the PCLS at the time of applying to take the PCLS. The Revenue may discharge the scheme's liability if such a declaration is obtained and reasonably relied upon.

The obligation is upon the member to declare the intention to recycle within 30 days of taking the PCLS (if contributions are increased first), or of increasing contribution (if the PCLS is taken first).

HMRC state in the Registered Pensions Scheme Manual that "It should be noted that very few lump sum payments will be affected by this recycling rule. Pension commencement lumpsum payments will not be caught if they are paid as part of an individual's normal retirement planning."

We suggest that any individuals who are not sure whether this applies to them, seek advice before acting.

Important Information: Our views are based upon our understanding of current legislation in England, unless stated otherwise. Levels and bases of, and reliefs from, taxation are subject to change and their value to you will depend upon your personal circumstances.

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