

Uncrystallised Funds Pension Lump Sum (UFPLS)



Introduction

An individual can access some or all of their money purchase savings through an Uncrystallised Funds Pension Lump Sum (UFPLS), which is an authorised lump sum, without having to designate the funds for drawdown or purchase a lifetime annuity.

Eligibility for UFPLS

UFPLS is available subject to the scheme allowing and the following conditions being met:

- the individual must be aged 55 or over, or eligible for early retirement due to ill health, or have a protected early retirement age
- it may only be paid from uncrystallised rights held under a money purchase arrangement.

An UFPLS wouldn't be available in the following circumstances:

- if they have either primary or enhanced protection with registered lump sum protection (i.e. the lump sum at 6 April 2006 was more than £375,000)
- from a 'disqualifying pension credit' (i.e. a pension sharing credit, following divorce, that originated from crystallised pension benefits of their former spouse/civil partner)
- if they have an enhancement factor (e.g. due to primary protection, periods of non-residence, or transfers from recognised overseas pension schemes) and the available tax-free cash is less than 25% of the proposed UFPLS.

An UFPLS is also unlikely to be attractive to individuals who qualify for scheme-specific protected tax-free cash as their tax-free amount will be restricted to 25%.

Tax

An UFPLS is a Relevant Benefit Crystallisation Event and so is tested against both the individual's Lump Sum Allowance (LSA) and Lump Sum and Death Benefit Allowance (LSDBA).

25% of the UFPLS is tax-free unless the first 25% exceeds the lower of the member's available LSA and LSDBA. The amount by which it exceeds the lower of available LSA and LSDBA will be taxed as pension income at the individual's marginal rate.

An individual does not need available allowances to be paid an UFPLS, as their available allowances determine only the tax treatment of the lump sum paid. Therefore, an UFPLS can be paid when an individual has no available allowances remaining and would be entirely taxable at the individual's marginal rate.

It is important to note that the tax-free amount is not a Pension Commencement Lump Sum (PCLS). A PCLS can only be payable where there is an arising entitlement to pension income under the same scheme (i.e. drawdown, annuity or scheme pension).

Therefore, if an individual wishes to take a tax-free lump sum but not take the whole of the fund or does not want to take any income then, plan permitting, they will have to designate funds as available for drawdown, taking 25% PCLS and nil income.



Emergency Tax

The taxable part of an UFPLS is taxed as 'earned income'.

This means that the payer of the income, the pension scheme provider, must operate Pay As You Earn (PAYE) and pay out the income based on a tax code supplied by HMRC.

However, if it's the first taxable payment under the plan, the pension scheme provider is unlikely to hold a tax code for the individual which means the payment is normally taxed using an Emergency Month 1 tax code.

An 'Emergency Month 1' tax code essentially means any income is tested using 1/12th of the personal allowance and 1/12th of the various tax bands, with the highest rate of tax (additional rate tax for UK taxpayers and Top Rate tax for Scottish taxpayers) applying to the rest.

If an emergency tax code means the individual has paid too much in tax then the individual can either wait until the end of the tax year to claim a refund from HMRC or, if they are unable to wait that long, reclaim any overpaid tax from HMRC during the same tax year using the appropriate claim forms.

Example of Emergency tax using UK (excluding Scotland) tax rates and allowances

Tom has a fund of £100,000 and wishes to access the full fund.

He will receive £25,000 tax-free and £75,000 will be taxed at his marginal rate for earned income:

£1,047.50 at 0%	= £0
£3,141.67 at 20%	= £628.33
£7,286.67 at 40%	= £2,914.67
£63,524.16 at 45%	= £28,585.87
Total tax	= £32,128.87

So, in total, Tom will receive £67,871.13 net.

If Tom decided that he wanted to take a £10,000 UFPLS from his £100,000 fund then he would receive £2,500 tax-free and £7,500 taxed at his marginal rate for earned income:

£1,047.50 at 0%	= £0
£3,141.67 at 20%	= £628.33
£3,310.83 at 40%	= £1,324.33
Total tax	= £1,952.66

So, in total, Tom will receive £8,047.34 net.

Note: For Scottish taxpayers, the Scottish Rate of Income Tax may produce a different result to the rest of the UK due to the different tax rates and bands.

Note: For Welsh taxpayers, the overall rates of income tax payable will be the same as UK taxpayers (excluding Scotland).

Further Pension Contributions

Where an individual accesses their fund via an UFPLS they will be subject to a reduced annual allowance – the Money Purchase Annual Allowance (MPAA).

The MPAA will apply only to money purchase contributions. The individual may in addition accrue benefits in a defined benefit scheme up to the value of £60,000, less any money purchase contributions within the MPAA, before an annual allowance charge applies.

Carry Forward is not available in conjunction with the MPAA.

Key point summary

Individuals need to understand the implications of taking all their money purchase pension arrangement as cash via an UFPLS otherwise they could end up with unwanted tax consequences.

Individuals using UFPLS will not be able to access their tax-free cash and leave the rest of their pension fund invested as each withdrawal is part tax-free and part taxed income.

If an individual wants to access funds through UFPLS, they will trigger the MPAA. Anyone who needs to contribute more than this annually will have limited options, thereby compromising their long-term savings plans and restricting future access to long-term income.

This represents Zurich's understanding of HMRC regulations governing Uncrystallised Funds Pension Lump Sum (UFPLS). This is subject to change and Zurich does not accept responsibility for any action taken or refrained from, by any person relying on this information.

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