



Paying tax on pension benefits

Video transcript

So this section is about paying tax once your benefits come into payment. Once you retire and take your benefits you'll get an income for life and a one-off, tax-free (up to certain limits) cash lump sum of three times your pension.

You can choose to have a lower monthly income and a higher cash sum — or vice versa, it's up to you. There is a limit though on the amount of benefits that can be taken as tax-free cash and USS will tell you this limit when they send you your retirement quote.

Your benefit options on retirement, including pension and lump sum options, are covered in more detail in the Approaching retirement webinar.

You may be taxed on the monthly pension income that you receive, depending on the total level of your income. Your tax code is provided by HMRC and it'll be used to calculate the tax payable on your income in retirement. The amount of income tax you pay on your USS benefits will also be determined by any income you earn from other sources.

You'll generally pay income tax if your total annual income adds up to more than your Personal Allowance, and this income could include any State Pension that you receive, a private pension such as a personal pension or workplace pension like the one you've built up with USS. It could be employment or self-employment earnings and any taxable benefits that you receive or any other income that you might receive from sources such as savings, investments or property.

In 2026/2027, the Personal Allowance is set at £12,570 a year, or £1,084 a month. For anything you earn over and above your Personal Allowance, you'll be charged the relevant tax rate. Again, this depends on your total income.

For the basic rate, which is currently between £12,571 and £50,270, you'll be charged 20% tax. For the higher rate, which is anything between £50,271 and £125,140, you'll be charged 40% tax, and for the additional rate, which is anything above £125,140, you'll pay 45% tax.

Now the rates are slightly different in Scotland. And note that if your income is above £100,000 a year, your Personal Allowance actually reduces by £1 for every £2 that your income is over £100,000.



That means that your Personal Allowance is therefore £0 if your income is £125,140 or above, and so you would pay tax on that first £12,570 of earnings as well. For simplicity, all our examples assume that the member has that full Personal Allowance.

So let's first look at the example of someone who's receiving the full State Pension, which is £12,547 a year, and pension from the USS of £12,453 a year. So this brings their total income from all sources to £25,000 a year and so they pay income tax at a rate of 20%.

Their Personal Allowance is £12,570 and they would not pay tax on this level of income. Their remaining income is £12,430 and they would pay the 20% tax on this amount, which is £2,486. So that means their total tax payable is £2,486.

We've also got the example of someone who has a full State Pension, again of £12,547 a year, and this time a pension from USS of £42,453 a year. So they receive an income of £55,000 a year and therefore they're paying income tax at a rate of 40%, again assuming they're not in Scotland.

Their Personal Allowance is £12,570 and they would not pay tax on that level of income. Their income between £12,571 and £50,270 is £37,700 and they would pay 20% tax on this, which amounts to £7,540. Their remaining income is £4,730 and they would pay 40% tax on this which is £1,892 tax. So that means their total tax payable is £9,432.

HMRC uses tax codes to tell your employer or pension provider how much Personal Allowance that you have to use on that income. Depending on how much of your Personal Allowance you're using from other sources, you may not receive all of your Personal Allowance on your USS pension.

But until HMRC issues a notification of a new tax code for your pension, USS might need to use an emergency tax code. And the emergency tax code assumes that you have the full £12,570 Personal Allowance available.

But that could result in a member paying too much or too little tax as it does not make any allowance for when in the tax year the payment actually starts or what other income a member may have. Once your new tax code is confirmed by HMRC and in place, any adjustments will be made to your income tax.

And it's also useful to be aware that starting to receive any new pension or cash payments that impact your taxable income levels might push you into a higher tax band, or it might have an impact on your tax-free Personal Allowance, or it might mean that you need to complete a Self Assessment tax return.