

LCP on point 

The tax treatment of state pensioners

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Executive Summary

Since April 2021, the tax-free personal allowance has been frozen at £12,570, a policy which is set to continue until at least April 2030.

At the same time, the standard rate of the new state pension has risen rapidly, driven by a combination of high inflation and high wage growth. As a result, in the current year, the new state pension rate of £12,548 per year is now just £22 below the tax threshold. The government expects the April 2027 rate to exceed the tax threshold for the first time.

The rate of state pensions relative to the tax threshold is, however, politically sensitive. For example, the Conservative manifesto of 2024 included a measure which would have increased tax thresholds for pensioners each year to ensure that the new state pension never exceeded the tax threshold. Given this sensitivity, the Chancellor announced in her 2025 Budget that pensioners solely dependent on the new state pension (or the old basic pension) in 2027/28 would not be charged income tax, even if the pension was in excess of the tax threshold. A similar policy would apply for the rest of this Parliament.

In this paper, we look at who would be affected by this policy, what issues it raises, and whether there are any better ways to tackle this issue.

In terms of numbers affected, we find that:

- **Out of around 5.5m pensioners on the new state pension, fewer than 1 in 5 would benefit from the concession.** These are those on the full rate of new pension with no other sources of income, or those just below the full flat rate, but who will be taken over the tax threshold in the coming years via indexation.
- **None of the 7.7m pensioners on the old state pension will benefit.** The large majority of old state pensioners (6.6m) receive 'additional' state pension, such as SERPS or State Second Pension, and are therefore not 'solely' dependent on the old basic pension. And someone who has nothing but the old basic pension would be on an income nearly £3,000 below the tax threshold and so would be at no risk of being taxed in the next few years in any case.

Taken together, these calculations suggest that just under one in sixteen pensioners will benefit from this plan.

We also find a number of anomalies and other issues of concern about the plan:

- **Differential treatment of old and new state pensioners:** under this proposal, someone solely receiving the new state pension will be exempt from tax, but someone whose state pension is identical but comes from the old basic plus additional state pension will have to pay tax.
- **Cliff edge for those with £1 of other income:** someone who qualifies for the easement in 2027/28 does not have to pay £88 of income tax but someone who just misses out

because of £1 of other income (or a similarly trivial 'increment') will have to pay income tax not just on the £1, but also the £88 income tax on their state pension. Over time, this cliff edge will increase.

- **Interaction with Automatic Enrolment:** if someone has a small DC pot which they cash out in full, they will receive 25% tax free but pay tax on the other 75%. However, they will presumably then be treated as not being 'solely' dependent on the state pension, and therefore not eligible for the concession. It seems perverse that, on the one hand, the Government is encouraging people to take out private pensions to supplement their state pension in retirement, but on the other they then face a (rising) tax penalty if/when they decide to access that pension once they are retired.
- **What happens after 2030?** This is clearly a policy designed to provide a 'fix' until the next General Election, but with every passing year, the amount of tax being written off will increase. It is hard to see that this is a long-term solution, but as we have seen with the triple lock policy, once implemented, it may be hard to 'switch off'.

There is no easy fix to this problem, which has resulted from a policy (under successive governments) of freezing tax thresholds, resulting in more pensioners becoming taxpayers or being close to becoming taxpayers.

There are, however, two possible 'cleaner' solutions which could be considered:

- **An across-the-board increase in the tax allowance for all pensioners:** if the increase was set to make sure that the tax threshold exceeded the new state pension rate, this particular political problem could be dealt with, but this would come at a considerable cost because it would also benefit over 8 million pensioners already paying tax. This would not be a targeted solution to the problem.
- **A write-off of small tax bills for pensioners:** given that pensioners solely dependent on the new state pension will have relatively small tax bills – at least for now – it would be a reasonably cheap solution to simply write off all such small tax bills. This would be targeted at the group of most concern and would not benefit better off pensioners. A further advantage would be that it would not discriminate between those on the old and those on the new tax systems. It would also reduce the risk of a 'cliff edge' where just one pound of extra income would remove the concession altogether. However, it would still be only a temporary fix and would still leave any future Government with a headache as to how to tackle the growing cost of such a measure.

01 Introduction

The number of pensioners paying income tax has risen sharply in recent years. According to HMRC, in 2020/21, there were 6.47m people over state pension age paying income tax, compared with 8.72m in 2025/26.

There have been two main reasons for this trend:

- The value of the tax-free personal allowance has been frozen at £12,570 since 2021/22 (and is set to remain frozen for the rest of the decade).
- The state pension has increased substantially in cash terms, partly because of the generous ‘triple lock’ indexation policy, and partly because of relatively high levels of wage and price inflation. For example, the pension rose by 10.1% in 2023/24 (in line with inflation) and by 8.5% in 2024/25 (in line with earnings growth).

For those wholly dependent on the standard rate of the new state pension, the annual pension, which now stands at £12,548, is still just below the income tax threshold. The increase for 2027/28 is expected to take the new state pension rate over the tax threshold, with increases for 2028/29 and 2029/30 taking it steadily further over the frozen tax threshold.

If we assume increases in line with OBR’s assumptions published in March 2026, we can expect to see a 3.7% increase in April 2027, followed by increases of 2.5% in April 2028 and April 2029. Table 1 shows what this would mean for the standard rate of the new state pension compared with the tax threshold. It also shows how much income tax would be due, assuming no other income.

Table 1. Rates of new state pension, tax allowance and tax due 2026/27 to 2029/30

| | New State Pension | Tax Allowance | Tax Due |
|---------|-------------------|---------------|---------|
| 2026/27 | £12,548 | £12,570 | NIL |
| 2027/28 | £13,012 | £12,570 | £88 |
| 2028/29 | £13,337 | £12,570 | £153 |
| 2029/30 | £13,671 | £12,570 | £220 |

There has been growing political outcry around the increased number of pensioners paying income tax, and a particular focus on the possibility that people wholly dependent on the new state pension could find themselves paying income tax – a situation which seems certain to arise in 2027/28.

In response to this, the Chancellor announced in her November 2025 Budget that steps would be taken to ensure that certain groups of pensioners would not pay income tax even if their state pension went above the tax threshold.

This promise would run for the rest of this Parliament. The Budget ‘Red Book’ says¹:

“The Government will ease the administrative burden for pensioners whose sole income is the basic or new State Pension without any increments so that they do not have to pay small amounts of tax via Simple Assessment from 2027-28 if the new or basic State Pension exceeds the Personal Allowance from that point. The Government is exploring the best way to achieve this and will set out more detail next year.”

(para 4.167, Red Book, 2025)

Although the wording of this paragraph is slightly ambiguous, it has since been clarified that the proposal is more than an administrative change, and that this particular group of pensioners will simply not pay income tax each year for the rest of this Parliament.

In this paper, we consider two issues:

- How might this policy be implemented in practice?
- Are there better ways to tackle this issue?

In Section 2, we look at the position of different groups of pensioners, including considering separately those on the old and new state pensions, to see how many people are potentially affected by this issue.

In Section 3, we consider the Government’s stated policy and how this might be implemented in practice. We also consider potential criticisms of the policy, including the differential treatment of different groups of pensioners, and potentially unwelcome behavioural effects.

In Section 4, we consider some alternative ways of tackling these issues before offering some conclusions in Section 5.

¹ [Budget 2025](#)

02 Which pensioners are affected?

The Government has indicated that the proposed policy will apply to two groups of pensioners:

- Those solely dependent on the New State Pension (for those who reached pension age since 6th April 2016).
- Those solely dependent on the old 'basic' state pension.

In each case, this would apply only to those who receive either pension 'without increments'.

We assume (though this has not been spelt out yet) that 'increments' would include things like:

- 'Protected Payments' are paid in addition to the New State Pension in some cases.
- 'Additional State Pension' (SERPS) and 'Graduated Retirement Benefit'.
- Enhanced payments because of the deferral of the state pension.

At this stage, it is unclear exactly what 'solely' dependent means. For example, 1.7m pensioners currently receive Attendance Allowance and so are not 'solely' dependent on the state pension. It seems unlikely that this would be enough to disqualify someone from the proposed concession. But less clear is a case where someone, for example, has interest income from an ISA. This is received tax free (so does not affect their income tax position) but does mean they are not 'solely' dependent on the state pension.

For the purposes of this paper, we will assume that the Government would not disqualify those whose only other income is in the form of other social security benefits, but would exclude those with (say) interest income, regardless of whether that was taxed or not. Our broad findings would not change if the Government decided to ignore 'untaxed' interest income (eg in ISAs or under the Personal Savings Allowance), though the number of beneficiaries would increase slightly.

To assess the numbers and types of pensioners potentially affected, we look separately at the new and old systems.

a) The new state pension

Many recipients of the new state pension already have a combined income from the state pension and their private pension to take them into the income tax bracket. Such people will not qualify for the Government's exemption as they are not 'solely' dependent on the state pension.

As far as we can know, the exemption will apply to those who:

- Live in / are taxed in the UK.
- Have no 'increments' on their new state pension.
- Are 'solely' dependent on the new state pension (ie have no other income).
- Will have enough new state pension at some point in the next three years to take them over the tax allowance.

We will estimate the numbers on the basis of DWP data for 2025/26 (the latest available online) before 'rolling forward' our estimate to 2027/28 and beyond.

Our main data source is the DWP 'stat xplere' online system², which is the most reliable source of information about the state pension population. But we will supplement it where necessary with information about the wider income of pensioners from the Family Resources Survey, which we can access for 2023/24.

To take each step in turn:

- DWP indicates that in August 2025, there were 5.043m recipients of the new state pension.
- If we assume that the policy applies to those resident in the United Kingdom, the total drops to 4.751m.
- Some of these recipients are getting a 'protected payment' – a top up to the standard rate included as a form of transitional protection when the new system was introduced. We assume that the DWP would define this as an 'increment' to the new state pension and hence would disqualify these people from the Government's proposed concession; taking these people out reduces the target group to 3.699m.
- Of this remaining group, some will be short of the full new state pension rate; if they are well short, then even with three years of increases, they may not get above the tax threshold and so not need the Government's concession. To be more precise, if we assume increases of 3.7% in April 2027, followed by 2.5% in April 2028 and April 2029, anyone with a new state pension of less than around 92% of the full rate currently, will not reach 100% with these increases. If we exclude those on less than 92% of the full rate we knock out a further 1.179m, leaving 2.52m.
- Finally, we need to work out how many of this remaining group are 'solely' dependent on the new state pension and how many have other income, such as private pensions, which would make them ineligible.

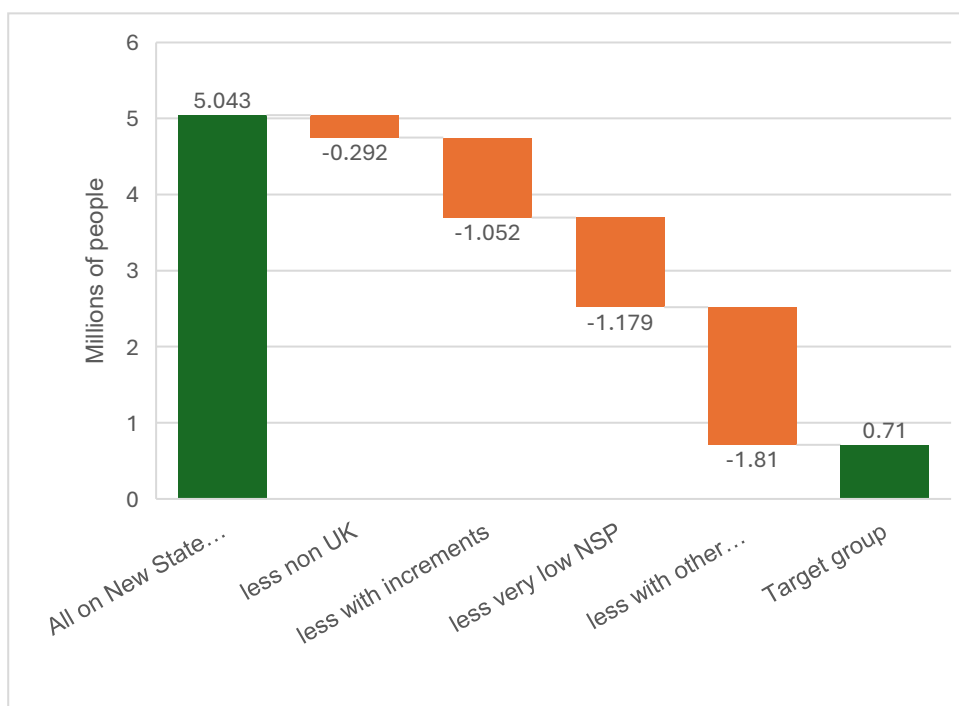
Based on the Family Resources Survey, we estimate that:

- Around 60% of this group has some occupational or private pension income;
- A further 12% of those with no private pension have some investment income;
- If we assume a strict definition of 'solely' dependent on the state pension, this removes 72% of our remaining group, taking us down to a target population of 0.71m.

² [Stat-Xplere - Home](#)

These various steps are summarised in the chart below:

Chart 1. Refining the New State Pension population to those in scope of the proposed concession



Note that we have excluded everyone who has investment income, including those with interest income from ISAs (which is not taxable) or those with interest income below the £1,000 pa 'personal savings allowance', which is also not taxable. The Family Resources Survey data suggest that this is the vast majority of those who only have investment income and no pension income. A more relaxed approach, which only included 'taxable' investment income, would bring roughly 300,000 more people into scope.

Finally, we need to roll forward our data from 2025/26 to 2027/28 to see how many people will be covered when the policy goes live.

We know from published DWP estimates that the total number of new state pensioners will rise from 5.045m in 2025/26 (financial year average), to 5.841m in 2027/28, an increase of just under 15.8%. If we apply this increase to our final figure of 0.71m people potentially in scope, **we end up with around 0.82m new state pensioners likely to benefit from this concession when it goes live in 2027/28.**

a) Old State Pension

The Government has said that its proposed concession will apply to those who retired before April 2016 and are on the old 'basic' state pension without any 'increments'. We assume that this means those who also receive additional state pension (SERPS) or graduated retirement benefit will therefore not be eligible.

This is, however, a rather confusing statement.

The full rate of the basic state pension is roughly £3,000 pa below the tax threshold. If the Government literally meant that the concession would only apply to those wholly

dependent on the old basic state pension, then this would seem to mean that no one on the old system would qualify (because the full old basic pension is well below the tax threshold and will remain so for the next three years).

Attempts to obtain greater clarity on this point have been unsuccessful, as the Government simply says that the policy is currently under development. But until there is further explanation, it is hard to see how anyone on the old basic state pension alone would need the proposed concession, so we assume for now that we are purely talking about the around 0.82m people on the new state pension as discussed in the previous section.

There must be some risk of legal challenge if the Government were to go ahead on this basis. Based on the policy as described, two pensioners with identical incomes, one solely from the new state pension and the other from a combination of old basic pension plus additional state pension, would be treated differently, with the younger pensioner having a tax write-off and the older one paying tax as normal. It may be that this will lead the Government to consider an alternative approach, something we consider later in this document.

03 Implementing the Government's proposed policy

There must be some risk of legal challenge if the Government were to go ahead on this basis.

a) How might it work

Where an individual's sole taxable income is from the state pension, they typically come under the 'simple assessment' process. As HMRC are notified by DWP of amounts of state pension being paid, HMRC can work out at the end of the tax year whether any income tax was due. This would be in cases where the state pension exceeded the tax allowance. Where this happens, it is not necessary for the pensioner to file a tax return. Instead, HMRC undertake a 'simple assessment' and issues a tax bill after the end of the financial year.

If we concentrate on those wholly reliant on the standard rate of the new state pension, we can see from Table 1 above that, without action by the Government, these individuals would face a simple assessment bill of £88 in respect of 2027/28, £153 in respect of 2028/29 and £220 in respect of 2029/30.

A relatively simple way for HMRC to implement the Government's policy would be not to issue 'simple assessment' demands in such cases.

Using our 'ballpark' estimate of around 0.82m new state pensioners potentially in scope of the concession, this would presumably cost the Government around £72m in respect of 2027/28 (though the impact would be seen in 2028/29 tax revenues because assessments are issued after the tax year has ended), £125m in respect of 2028/29 and £180m in respect of 2029/30.

There are, however, a number of issues around this policy which might prompt a rethink.

The key ones are:

- **Differential treatment of old and new state pensioners:** as we have seen, someone on the standard rate of the new state pension will not face income tax under the proposed concession; but someone on the old state pension with increments (such as additional state pension) will be taxed. The most extreme example of this anomaly would be a case where an old basic plus additional state pension exactly equalled the standard rate of the new state pension, but where tax would still be levied because the old state pensioner would not qualify for the concession.
- **Differential treatment of different types of income:** basic rate taxpayers are able to earn up to £1,000 per year in interest income without paying tax on that interest because of the Personal Savings Allowance. It may be that someone with just a new state pension plus (say) £500 of interest income would qualify for the concession because their only residual taxable income came from the state pension; but as far as we can see, someone with £500 of occupational pension income (or earnings) would not qualify for the concession; in this case, eligibility for the concession would depend not just on total income but on the 'type' of income being received.
- **Cliff edge for those with £1 of other income:** someone who qualifies for the easement in 2027/28 does not have to pay £88 of income tax but someone who just misses out

because of £1 of other income (or a similarly trivial 'increment') will have to pay income tax not just on the £1, but also the £88 income tax on their state pension.

Over time, this cliff edge will increase.

- Interaction with Automatic Enrolment: on a phased basis since 2012, employers have been required to enrol workers earning £10,000 per year and aged 22 to state pension age into a workplace pension. The result of this is that increasing numbers of people reaching state pension age now do so with a (typically modest) DC pension pot. The question is how this will interact with the proposed concession on taxation.
- For example:
 - If someone has a small DC pot which they cash out in full, they will have 25% tax free but pay tax on the other 75%; if they do this alongside drawing a standard new flat rate pension, then presumably they will be treated as not being 'solely' dependent on the state pension, and therefore not eligible for the concession.
 - Similarly, if someone has a (slightly larger) DC pot and takes a quarter tax free and puts the rest into drawdown, any chunks of pension taken from drawdown will be taxable; so anyone who accesses any part of their DC pot will presumably invalidate their access to the concession.

The implication of this is that retirees with modest DC pension pots will have an incentive not to touch them for as long as this concession applies. In Year 1 of the new policy, the retiree will save £88 in tax by not touching their pension, rising to £153 in Year 2 and £220 in Year 3.

It does seem perverse that, on the one hand, the Government is encouraging people to take out private pensions to supplement their state pension in retirement, but on the other, they then face a (rising) tax penalty if/when they decide to access that pension once they are retired.

- **What happens next?** – this policy is clearly something of a 'sticking plaster' to run up to the next Election; but whoever wins the next Election will then need to work out what to do in future years; whilst we do not know what will happen to tax allowances, even if the state pension rises in line with average earnings and the allowance rises with prices, we can expect the scale of this problem to get bigger; it may be reasonably easy to defend not collecting (say) £88 in tax from relatively low income pensioners in year 1, but as the years go by the Government would be writing off hundreds of pounds per eligible pensioner per year, at a growing cost to the taxpayer; at some point a more durable solution will need to be found.

In light of these concerns, we consider in the next section whether there might be other ways of tackling this issue which would be less vulnerable to these criticisms.

04 *Alternative approaches*

Given the long list of potential criticisms of the practicalities of this policy, we consider in this section two alternative ways of addressing the issue of the standard rate of the new state pension going above the tax threshold.

a) Option 1. An across-the-board increase in the tax-free allowance for pensioners

If the issue is that the standard rate of the new state pension has gone above the tax threshold, then an obvious solution would be to increase the tax allowance for pensioners to prevent this from happening. Indeed, such a policy was included in the 2024 Conservative manifesto, which pledged that tax allowances for pensioners would rise in line with increases in the ‘triple lock’ on the state pension, ensuring that the headline rate of the new pension was always below the tax threshold.

There is, of course, precedent for pensioners having a higher tax allowance, under the system of ‘age allowances’ which was largely abolished as a result of the 2012 Budget³.

Whilst this approach is clearly much simpler than the Government’s approach, it is also much more expensive.

The reason for this is that an increase in the tax-free allowance would benefit all taxpaying pensioners, and not just those wholly dependent on the new state pension.

Given that there are currently around 8.7m taxpaying pensioners, an allowance increase for 2027/28 would cost roughly £750m, rising to around £1.5bn in 2028/29 and £2.3bn in 2029/30. These costs are more than ten times the cost of the Government’s approach, primarily because the policy is so poorly targeted⁴.

b) Option 2. Across-the-board write-offs

Another relatively straightforward approach would be for the Government to simply ‘write off’ all small amounts which would otherwise arise under Simple Assessment. This would be similar to the published policy except that it would not distinguish between:

- Those on the old vs those on the new state pension.
- Those with taxable income from different sources (eg additional state pension, occupational pension, interest income etc).

There would be a strong equity argument for applying this policy to all taxpayers, whether pensioners or not, but it is more likely that the write-off would apply to pensioners only.

In the first year, the write-off could be in respect of simple assessment bills of £88 or less, in

³ There are, however, some residual age allowances still in the system for those already entitled to them when the change was made.

⁴ We have assumed that the Government would want to avoid a situation where the allowance rise gave extra benefit to higher and additional rate taxpayers, so we assume in these calculations that the extra help would be delivered in the form of a ‘tax credit’ of equal cash value to all pensioner taxpayers.

Year 2, bills of £153 or less and in Year 3, bills of £220 or less.

The cost of this policy would be slightly more than that proposed by the Government because it would cover all those (pensioners) with small tax bills, and not just those whose 'sole' income was from the basic/new state pension with no increments.

Groups who would benefit from this policy but not from the Government's policy include:

- Pensioners on the old basic state pension with 'additional' state pension, taking them just above the tax threshold from 2027/28
- Pensioners on the new state pension below the full standard rate, and with other taxable income taxing them just above the tax threshold from 2027/28

It is difficult to cost this version very precisely, but we expect it will still be substantially cheaper than an across-the-board increase in pensioner tax allowances for all pensioners. It would also be politically far more attractive than the stated policy, which treats different groups of pensioners differently depending on whether they are on the old or new system, and on what types of income make up their total taxable income.

One tricky issue would be what happens when people have tax bills which are marginally over the written off figure. One option would be to charge the full tax due for anyone over the de minimis. This would not be ideal as it would create a different but similar 'cliff edge' to the existing proposal, where £1 of extra income could trigger a tax bill of £88 (in Year 1) or more. A preferable option might be to charge tax only on excess.

This policy would not solve all of the problems with the Government's approach. In particular, it would still leave an issue about what happens beyond the next three years. It could also still discourage people from accessing their DC pension pots to avoid triggering unwelcome tax bills. But it would at least be seen to be less arbitrary than what has so far been proposed.

Conclusions

There is no doubt that the rising number of pensioners paying income tax is a politically sensitive issue. This issue will come into sharper relief in 2027/28 when it is expected that the standard rate of the new state pension will exceed the frozen tax-free allowance. A combination of continued state pension indexation and further freezes in the personal allowance would mean that the bills faced by those who simply receive a standard new state pension will rise steadily for the rest of this Parliament.

It is therefore understandable why the Government has felt it necessary to come up with a plan to tackle this issue.

It would be fair to say that there is still very little clarity on exactly how the new concession will work. Although, based on what we do know, there are several issues around the proposed solution. These include treating people on the old and new state pension system differently, treating different types of taxable income differently, and potentially discouraging people from accessing the pensions into which they have been automatically enrolled under a separate Government policy. It also creates a problematic issue for the next Government to face, as the cost of this concession is likely to rise year-on-year.

There are, however, other ways of tackling this issue.

One would be to simply increase the tax free allowance at least for pensioners, so that those on just the standard new state pension will not have any tax bill. However, any across-the-board increase of this sort will benefit millions of taxpaying pensioners. As a result, the cost of the policy will quickly be measured in billions of pounds and may be regarded as unaffordable. A more affordable compromise, designed to deal with some of the worst features of the Government's stated policy, would be to simply write-off small 'simple assessment' tax bills for anyone over pension age. This would avoid the need to 'pick and choose' on the basis of which state pension system people came under and would not discriminate between different types of taxable income.

However, even this cleaner solution would not be without its problems, including the outstanding issue of how long such write-offs would continue to grow.

For as long as successive governments simultaneously freeze tax thresholds whilst increasing state pensions, this problem will only get worse. Whilst a three-year 'fix' until the next Election is understandable, a more fundamental review of the tax system is needed in order to come up with a system that will endure for the long term and be seen as fair.

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