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Rachel Reeves considers cut to tax-free pension withdrawals

Lump-sum limit may be reduced by two thirds to £100,000 after recommendations from think tanks

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Rachel Reeves risks accusations of another attack on pensioners after the winter fuel raid Anthony Devlin/Bloomberg

Charlotte Gifford Senior Money Reporter. **Daniel Martin** Deputy Political Editor

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Savers face a cut to the tax-free lump sum they can take from their pensions, under plans being considered by the Chancellor.

The Telegraph understands that government officials have asked one of Britain's top pension providers to assess the impact of cutting the tax-free lump sum to £100,000, a third of the current limit.

At the moment, most savers can take 25 per cent of their pension pot tax-free once they reach the age of 55, up to a maximum of £268,275.

A source told The Telegraph that the Government was looking at recommendations by two major think tanks to reduce the limit in an effort to raise around £2 billion in revenue at the Budget.

However, such a move would be seen as another attack on pensioners after Rachel Reeves's winter fuel raid.

Experts also warned it could open the door to legal challenges.

Both the Institute for Fiscal Studies (IFS) and the Fabian Society have argued that the lump sum should be cut from £268,275 to £100,000 because the current cap favours the wealthy.

How much will my pot provide as a yearly income?

Size of pot	Income	Income with full state pension added	Tax-free lump sum
£100,000	£4,911	£16,411	£25,000
£200,000	£9,849	£21,349	£50,000
£300,000	£14,658	£26,158	£75,000
£400,000	£19,189	£30,689	£100,000
£500,000	£23,720	£35,220	£125,000
£600,000	£28,251	£39,751	£150,000

Source: Aviva | Assumptions: you take 25pc of your fund as a tax-free lump sum before buying your annuity, your income is fixed, paid monthly just to you and stops if you die, it will pay out for at least a year and you're in good health

The move could affect one in five retirees, the IFS estimated.

Steven Cameron, of the pension company Aegon, said: "Many individuals will have planned their retirement finances on the assumption they could take 25 per cent of their full fund as a tax-free lump sum. Being stopped from doing so would cause a major outcry."

Mike Ambery, of the pension firm Standard Life, said: “Operationally, it would be complicated. That’s because pension funds are normally written under trust and also you can’t really retrospectively make changes to benefits that people have already built up. It could be subject to a legal challenge.”

Because of these risks, the Treasury could be tempted to taper away the tax-free lump sum gradually over time. But this would have a knock-on effect on revenue.

The Chancellor has reportedly backed down on plans to reduce the 40 per cent pension tax relief for higher earners amid concerns it would unfairly hit those working for the public sector.

She is also considering abandoning her pledge to abolish non dom status over fears it may fail to raise any money and is now thought to be looking for other ways to plug a claimed £22 billion hole in the public finances.

However, the Government has already faced a backlash, including from Labour MPs, over the decision to hit pensioners by scaling back the winter fuel allowance for most.

There have been fears about the erosion of the £268,275 cap ever since the abolition of the lifetime allowance.

The £268,275 figure equates to 25 per cent of the £1.073 million allowance, which used to be the maximum someone could build up in their pensions without paying extra tax until the Tories scrapped it in April 2024.

The IFS said in a report published last month: “While there is a case for encouraging people to save at least a certain amount for their retirement, it is hard to justify continuing to subsidise extra saving for individuals with pension wealth little short of £1,073,100.”

With the autumn budget looming, more savers have been drawing their tax-free lump sum as soon as they hit retirement age or upping their pension contributions in advance of any fiscal changes.

Retiring early, and living comfortably

Retirement age	Gross income required	Pension pot	Pot remaining at age 82	Age funds exhausted
55	£37,300	£700,000	£78,690	88
57	£37,300	£660,000	£88,655	88
58	£37,300	£640,000	£84,178	88

Source: Quilter

Bestinvest, an investment platform, said it had seen a tenfold increase in contributions to Sipp (Self-invested personal pensions) in September. Meanwhile, the number of pension withdrawal requests doubled year-on-year, driven mainly by savers accessing their tax-free lump sum.

The Chancellor was last week urged to reassure pensioners after it emerged savers were pulling money out of their retirement pots early owing to fears of an Oct 30 tax raid.

In a letter to the Treasury, Quilter, a wealth manager, warned that Budget fears had prompted clients to take “knee-jerk decisions” that could jeopardise their financial security.

Steven Levin, Quilter’s chief executive, said: “We are witnessing more clients considering whether to withdraw their pension tax-free cash prematurely.

“The knock-on uncertainty around changes to pension tax reliefs, tax-free cash and possible amendments to pension contributions is causing anxiety and confusion for those trying to plan their financial futures.”

The letter added: “A prompt statement from the Treasury, advising against changes to pension arrangements pre-Budget, would be highly beneficial.”

Wealth managers warned that changes to tax-free withdrawals would be destabilising for those in their late 50s and early 60s who have already earmarked funds in their retirement plans, such as paying off their mortgage.

Jason Hollands, of wealth manager Evelyn Partner, said: “More customers are getting in touch to ask about withdrawing money early. This has been fuelled by think tanks, such as the IFS, saying the lump sum should be slashed to £100,000.

“This has petrified some people who might have been banking on tax-free cash to clear mortgages or reduce debt in the next few years.

A Government spokesman said: “We do not comment on speculation around tax changes outside of fiscal events.”

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