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Ill-health and early retirement

Introduction

Sometimes people need to stop working due to ill-health and accessing their pension can be an option when certain conditions, which are set by the HMRC, are met.

Serious ill-health lump sum

Clients may have the option to take their uncrystallised pension funds as a lump sum, if they are diagnosed with a terminal illness and a registered medical practitioner confirms they have less than 12 months to live. There is no minimum age for the payment of a serious ill-health lump sum.

The following conditions must be met in order for a payment to be treated as a serious ill-health lump sum.

1. The pension plan administrator must receive written evidence from a registered medical practitioner confirming the client is expected to live for less than one year.
2. The client must not have used up all their lifetime allowance.
3. The payment must extinguish all uncrystallised rights that could reasonably have been known about at the time of the payment, under the arrangement. If some benefits have previously been crystallised, then the full remainder of uncrystallised rights under the arrangement must be taken as a lump sum.

If the client is 75 or over, then the lifetime allowance test on unused pension funds (either defined benefit or defined contribution) which was carried out when the client reached age 75 should be ignored, when considering if the pension funds are uncrystallised (to meet the conditions above) and when calculating if the client has used all of their lump sum death benefit allowance.

Lump sum death benefit allowance

The payment of the serious ill-health lump sum is a relevant benefit crystallisation event for lump sum death benefit allowance purposes if it is paid to a client under age 75. While the client must have available lump sum death benefit allowance for a serious ill-health lump sum to be paid, the level of lump sum paid is not limited by the level of lump sum death benefit allowance available. From 6 April 2023, where the amount crystallising exceeds the available lump sum death benefit allowance, the excess will be subject to normal PAYE rules meaning it will be treated as pension income, taxed at the client's marginal rate. The pension plan administrator deducts this tax charge before paying the serious ill-health lump sum to the client.

Taxation

Serious ill-health lump sums don't count towards the individual's lump sum allowance (LSA). The standard LSA is £268,275 for those without transitional protection.

If a serious ill-health lump sum is paid before age 75, the full amount will also count towards the individual's lump sum death benefit allowance (LSDBA). If the serious ill-health lump sum is more than the remaining LSDBA available, the excess will be subject to income tax at the individual's marginal rate. The standard LSDBA is £1,073,100 for those without transitional protection.

Early retirement

Clients can take their pension benefits at any age if they are physically or mentally unable to continue with their current employment. In practice, some pension plan rules may have stricter ill-health criteria, and, for example, may state clients must be incapable of carrying out any occupation. To consider an early retirement request, the pension plan administrator will require:

- Written evidence from a registered medical practitioner confirming the client is unable to return to their current employment because of physical or mental ill-health.
- Confirmation they have stopped their current employment from the medical practitioner or the former employer (e.g. a P45).

If an early retirement request is granted, the client can choose to access all or part of their pension. If the client initially opts for partial drawdown and makes a subsequent request to crystallise more monies, no evidence of continued ill-health is required.

Income withdrawals can be reduced, increased or stopped at any time.

Normal taxation and lump sum and lump sum death benefit allowance limits apply.

If you only read one thing

- Clients can take all their uncrystallised pension funds as a lump sum before age 55 if the pension plan administrator receives written evidence from a registered medical practitioner confirming the client is expected to live for less than one year, they have not used up all their lump sum death benefit allowance, and the payment extinguishes all uncrystallised pension benefits.
- This is a relevant benefit crystallisation event if the client is under age 75. Any excess over the individual's lump sum death benefit allowance is taxed at the client's marginal tax rate.
- If the client is under age 75 the lump sum is paid out tax free. If the client is 75 or over, then the lump sum is taxed at the client's marginal rate.
- Clients can take their pension benefits at any age if they are physically or mentally unable to continue with their current employment. The pension plan administrator will require written evidence from a medical practitioner and confirmation they have stopped their current employment.

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