Twice as many pensioners paying tax under the Tories

More than 9 million retired savers will break the income tax threshold next year, up from 4.5 million in 2010

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An extra 650,000 pensioners could be dragged into paying income tax from April.

The number being taxed on their pension income is expected to reach 9.15 million in the 2024-25 tax year as the state pension rises but income tax thresholds remain frozen, according to the consultancy Lane Clark & Peacock (LCP). Experts say that the “stealth tax” raid will mean millions miss out on the full benefit of the state pension rise and make it even harder to cope with the effects of inflation.

The number of pensioners paying income tax is on track to have doubled under Conservative rule. When the party was voted into power in 2010 about 4.5 million over-65s paid income tax. This year about 8.5 million people aged 65 and over are expected to pay the tax, according to HM Revenue & Customs (HMRC). That’s an increase of 770,000 from 2022-23 after a record 10.1% rise to the state pension in April.

More pensioners will pay tax from April if the new state pension rises £902 from £10,600 to £11,502 in line with wage growth. The state pension is at the moment protected by the triple lock, which guarantees that it will rise by inflation, 2.5% or average wage growth — whichever is higher. The data from September is usually used to determine the next April’s increase, and this month’s wage growth figure for the three months to July was 8.5%.

This year the prime minister, Rishi Sunak, promised to maintain the triple lock — seen as key to securing core Conservative votes in the forthcoming general election. But the policy has come under scrutiny because of the high inflation rate and the growing cost of meeting such big increases. Ministers are understood to be reviewing the planned 8.5% rise. Some argue that underlying pay, with bonus payments stripped out, would be a fairer increase of about 7.8%.

But more pensioners could still face a surprise tax bill because the income threshold at which you start paying 20% tax will not increase for at least four years. The threshold at which the 40% higher rate of income tax kicks in will remain frozen too. The personal allowance — the amount you can earn or receive each year before paying income tax — has been stuck at £12,570 since 2021. The chancellor, Jeremy Hunt, has pledged to keep the allowance at this level until at least 2028, despite rising earnings and stubborn inflation.

If the personal allowance had increased with inflation each year it would be about £14,300 by April, according to the investment platform AJ Bell. Laura Suter from the company said: “A pensioner only needs a small additional income to their state pension to breach their tax-free limit under the current personal allowance.

“It feels absurd that current government policy means that pensioners are getting a big pay rise on one hand but frozen tax thresholds are effectively taking part of that increase away. This is on top of a cost of living crisis, under which pensioners on fixed incomes have been among the hardest hit.”

Anyone getting an income from a private pension will automatically pay any tax due through their pension company. HMRC factors in their state pension and automatically collects money owed through the tax code that is applied to withdrawals from their private pot. The system becomes more complicated for some pensioners who rely solely on the state pension, which is paid before tax is deducted. More than 400,000 who get payments from the old state pension system will receive enough to trigger an income tax bill next year but will have no other source of income that HMRC can automatically collect tax through, according to LCP.

Most of these pensioners will have reached state pension age before April 2016 and get the old basic state pension plus an additional state pension under the former state earnings related pension scheme, which allowed workers to top up their state pension.

The absurdity of receiving a government state pension then having to pay some of it back to the government in tax will not be lost on many people. Steve Webb from LCP was the pensions minister during the Conservative-Lib Dem coalition government. He said: “At a time in your life when you want to relax and be done with bureaucracy, many pensioners will still have to engage with HMRC, with little understanding of how much tax they owe.

“You might be sent a tax code in the post, but the explanations are complex and gibberish to most people. If you also have a private pension you might find that it is taxed more because your state pension has increased — the unpredictability makes budgeting much harder.”

Pensioners who owe income tax on their state pension with no means for HMRC to deduct it will be billed through the “simple assessment” system. The Department for Work & Pensions tells HMRC at the end of the tax year how much state pension someone has received and a bill is sent the next year if it exceeds the tax-free allowance.

Webb said: “This means that pensioners could have received — and spent — all their pension during one financial year only to receive a tax bill the following year.

“Any pensioner with a pension next year over £242 a week will have tax to pay, and if they do not have a private pension through which the tax can be collected they may need to set some money aside for an unwelcome tax demand.”

The Treasury said: “Pensioners whose sole income is the new state pension do not pay any income tax, and this year we provided the biggest ever increase to pension payments, a 10.1% rise.

“Our tax burden remains lower than any major European economy – and by raising personal thresholds over the past decade we have taken three million people out of paying tax altogether. The best tax cut we can provide right now is to halve inflation, which we’re on track to do this year.”