Understanding Tax-Free Cash

For most people, the ability to take a chunk of their pension completely free of tax is one of the most valuable features of UK pension saving. Yet it's also one of the most misunderstood — how much you can take, when, and what happens if your pension is larger than average. This first article in our series sets out the basics.

What is "tax-free cash"?

When you start drawing money from a defined contribution pension, HMRC allows you to take a portion of it without paying any income tax at all. Formally, this is called a **Pension Commencement Lump Sum (PCLS)** — most people simply know it as tax-free cash. For the majority of savers, this is set at 25% of the value of the pension being accessed.

This is separate from - and far more valuable than - an ISA allowance or dividend allowance. The Lump Sum Allowance applies cumulatively across your pension arrangements. Each qualifying tax-free lump sum you take uses part of your available allowance, and once withdrawn the money is yours to spend, reinvest or set aside as you choose.

> **The 25% rule, in short**
>
> Take 25% of your pension pot as cash, with no income tax to pay — up to a maximum lifetime cap that applies across all your pensions combined.

The cap that limits larger pensions

The 25% figure isn't unlimited. Since April 2024, when the old Lifetime Allowance was abolished, tax-free cash has instead been governed by the **Lump Sum Allowance (LSA)**, currently set at **£268,275** for the 2026/27 tax year. This is a lifetime, cumulative limit across every pension you hold — not a per-pot allowance.

- If your total pension savings are below roughly £1.07 million, the 25% rule is what limits you — the cap simply won't bite.
- If your pensions are larger than that, your tax-free cash is capped at £268,275, even though 25% of the pot would technically be more.
- Every time you take tax-free cash from any pension, it reduces the LSA you have left to use elsewhere.

> Example: Priya has a pension pot worth £200,000. She can take up to £50,000 (25%) completely tax-free. Assuming she has no protected lump sum allowance, if instead her pot were worth £1.2 million, her tax-free cash would be capped at £268,275 - not £300,000 - because the standard LSA limits the amount available.

Why this matters for your planning

Tax-free cash sits at the heart of most retirement plans — whether that's clearing a mortgage, gifting to family, or simply having a cash buffer alongside ongoing pension income. But because the allowance is cumulative and lifetime, the order in which you draw from multiple pensions, and when you choose to crystallise them, can materially affect how much of your total pension wealth ends up being tax-free versus taxed at your marginal rate later on.

In the next article in this series, we'll look at the practical ways you can take your tax-free cash — as a single lump sum, in stages, or through drawdown — and the trade-offs involved in each approach.

> Every situation is different, and pension tax rules can change. Please do take the opportunity to reach out — we are only too happy to talk through your own circumstances. Contact us at **info@synergi-investment.ch**

This article is for general information only and does not constitute financial or tax advice. It reflects our understanding of HMRC rules for the 2026/27 tax year, which are subject to change, and does not take into account your personal circumstances. You should seek personalised advice before making any decisions about your pension.