



Do You Understand Your Lump Sum Choices?

As you approach your return to civilian life there will be important choices about lump sums that you need to understand. In this article Mary Petley of the Forces Pension Society describes them and their implications.

The options are:

- **AFPS 75** provides an automatic tax-free lump sum of three times the pension. Those leaving with an Immediate Pension (IP), but not an invaliding pension, can choose to buy another lump sum and pay for it from their pre-tax pension between their retirement from the Armed Forces and age 55. This is called Resettlement Commutation which can be tax-efficient as it reduces 'earned income'. At age 55, the pension is restored to its original value.
- **AFPS 05** provides an automatic tax-free lump sum of three times the pension. Members may choose to give up some or all of this lump sum to improve their taxable pension. This is called Inverse Commutation and may increase your tax bill as it increases 'earned income'.
- The **AFPS 05 Early Departure Payment (EDP)** scheme provides an automatic tax-free lump sum normally worth three times the pension to those who have given at least 18 years service and are at least age 40 on discharge. There are no options in respect of this lump sum.
- **AFPS 15** has no automatic pension lump sum. One can be generated by surrendering pension, which may reduce tax liability as it reduces 'earned income'.
- The **AFPS 15 EDP** scheme provides an automatic tax-free lump sum of 2.25 times pension to those who have given at least 20 years service and are at least age 40 on discharge. The EDP lump sum can be surrendered in its entirety to improve EDP income - this may increase tax liability by increasing 'earned income'.

Here's an example using current pay and pension rates:

Sergeant Bloggs leaves the Army on 31 March 2024 at age 40 with exactly 22 years reckonable service – 20 years in their legacy scheme (so, AFPS 75 or AFPS 05) and 2 years in AFPS 15. The assumptions used are:

- Their pensionable pay for the last 3 years was £38,451 for 2021/22, £39,470 for 2022/23 and £40,536 for 2023/24.
- For the AFPS 05 calculation, Consumer Price Index (CPI) rates for 2021/22 and 2022/23 of 3.1% and 10.1% respectively have been used in the calculation of Final Pensionable Salary (FPS). FPS is the best figure for pensionable salary in the last three years, with the earliest two years increased by CPI.
- For the AFPS 15 calculation, an Average Weekly Earnings increase of 7% has been used to revalue the pension earnings for 2022/23.
- The 2022/23 Pension Codes have been used to calculate AFPS 75 benefits.

Benefits would be due from AFPS 15 and AFPS 75 or AFPS 05 as follows:

From **AFPS 15**:

£1,760.95 pension payable at state pension age (68 in this case) when they can commute – rule of thumb: £1 surrendered generates £12 tax-free. In this case, the maximum lump sum would be £7,546.93 (Pension x 20/56 multiplied by 12) reducing the pension to £1,132.04.

An AFPS 15 EDP tax-free lump sum of £3,962.14 and EDP annual income of £598.72 payable on discharge. If the lump sum was surrendered the taxable EDP income would increase by £215.14.

PLUS

From **AFPS 75**:

An AFPS 75 IP of £11,201.82 and a tax-free lump sum of £33,605.46. Were they to take the maximum commutation lump sum (£19,266), their pre-tax pension would be reduced by £1,809.46 until age 55.

OR

From **AFPS 05**:

£12,470.55 pension and tax-free lump sum of £37,411.65, preserved until age 65. As each £100 of lump sum surrendered improves the pension by £6.07pa, the pension could be improved by a maximum of £2,270.89.

An AFPS 05 EDP tax-free lump sum of £37,411.65 and EDP income of £6,235.28, with no choices to make.

As you can see, the lump sums involved can be significant, so it is important to consider your options carefully.

If you are a member of the Forces Pension Society and have a pension enquiry, please contact us via 'Submit a Question' in the members area on the website. If you are not a member but would like to know more about us, visit www.forcespensionsociety.org.