

Update: 'Replacement' of the lifetime allowance

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In the 2023 Spring Budget, the announcement was made that the lifetime allowance (LTA) would be 'abolished'. However, given the close proximity to the start of the new 2023/24 tax year, this was achieved by reducing the LTA tax charge to zero for 2023/24 and applying Income Tax to LTA excess benefits previously taxed at 55%. The legislation received Royal Assent on 11 July 2023.

At the time of the initial announcement, the longer-term plan for the 'replacement' of the lifetime allowance (from 6 April 2024) was to be delivered through further legislation. True to the government's word, we received an initial Policy Paper announcement and Draft Finance Bill measures on 18 July 2023.

Following a period of consultation, further draft legislation was released by HMRC after the Autumn Statement in November 2023, which provided further clarity on the rules for transitional arrangements. The new legislation is not expected to receive Royal Assent until Easter 2024 – one week before the start of the new tax year! However, the draft legislation contains pertinent information for financial planners as we approach the end of the current tax year.

In this postcard, I summarise some of the announcements made in the draft legislation.

The rules outlined in this document apply to any benefit paid on or after 6 April 2024. To be clear, this looks at the date the Relevant Benefit Crystallisation Event (RBCE) – defined below – occurs. Normally the RBCE is deemed to occur on the date the lump sum is paid, although for payments of death benefits this may not be the case (covered below).

The legislation introduces three new allowances:

- The lump sum allowance.
- The lump sum and death benefit allowance.
- The overseas transfer allowance.

I will now look at each of these in turn.

The lump sum allowance

An individual's lifetime 'tax-free' lump sum allowance (LSA) will be £268,275, unless they hold LTA protection. The LSA is used up by Relevant Benefit Crystallisation Events (RBCE), which are:

- Pension commencement lump sum ('PCLS') payments.
- The tax-free portion of uncrystallised funds pension lump sums ('UFPLS').

As such, the LSA essentially replaces the PCLS rules, although the reference to crystallising benefits is maintained. In other words, unless PCLS protection exists, the LSA will be limited to the lower of:

- 25% of the pension benefits coming into payment.
- The remaining lump sum allowance.
- The remaining lump sum and death benefit allowance.

Disqualifying pension credits will continue to be excluded from the amount crystallised for the purposes of calculating the maximum tax-free element.

Where an individual has a scheme-specific lump sum protection and they take a PCLS, their lump sum allowance will not be reduced by the total tax-free amount of the PCLS. It will be reduced by 25% of the lump sum and arising pension.

The definition of 'availability of lump sum allowance' can broadly be described as the full allowance, less any RBCEs previously taken (whether PCLS or the tax-free element of UFPLS payments, for example).

The individual's LSA as of 6 April 2024 may be lower, or even zero, where benefits have been crystallised prior to this date. Further details can be found in the 'Transitional arrangements' section of this postcard.

Comment

At first glance, the rules may appear similar to the previous LTA rules. However, under the previous legislation, the maximum PCLS permitted was generally governed by the availability of the lifetime allowance. The new definition of available lump sum allowance may, in certain circumstances, permit tax-free payments where they were previously unavailable. For instance, a client that claims a DB scheme pension (with no PCLS) post-April 2024, which would have used up all of their lifetime allowance under the current regime, will still have full entitlement to their Lump Sum Allowance for other (e.g. Defined Contribution) pension benefits under the new rules. This may well encourage further or additional pension contributions for many individuals.

Lump sum and death benefit allowance

An individual will have a lump sum and death benefit allowance (LSADBA) of £1,073,100, except where LTA protections apply. Where individuals have taken benefits prior to 6 April 2024 that have used some or all of their LTA, the LSADBA may be reduced. I cover this under 'Transitional arrangements' below.

The LSADBA is used when any of the following events occur:

- Pension commencement lump sum payments (PCLS).
- The tax-free portion of uncrystallised funds pension lump sum (UFPLS).
- Serious ill-health lump sums.
- Defined benefit lump sum death benefits.
- Pension protection lump sum death benefits.
- Uncrystallised funds lump sum death benefits.
- Annuity protection lump sum death benefits.
- Drawdown pension lump sum death benefits.
- Flexi-access drawdown lump sum death benefits.

The important point to note from this list is it is lump sum payments that are tested against the LSADBA. I cover Beneficiary Drawdown and annuity below.

Treatment of amounts crystallised to drawdown

Where a member designates amounts to drawdown before 6 April 2024

Any remaining amounts so designated when the member dies do not count towards the deceased member's LSADBA if they are paid as lump sums to the beneficiaries. As such, any pre-6 April 2024 designations will need to be separately identified from any post-6 April 2024 designated benefits.

Death benefits and transitional rules

Notwithstanding the rules for death benefits where amounts were crystallised before 6 April 2024, how other (uncrystallised) death benefits are treated on deaths before 6 April 2024 – and which rules will apply – will depend upon both the date of death and the number of beneficiaries, as outlined below.

Where the death occurred prior to 6 April 2024:

- Where there is a single beneficiary and the payment is made before 6 April 2024 – the old LTA rules will apply as the effective date is driven by the date of the payment.
- Where there is a single beneficiary and payment is made on or after 6 April 2024 – the new LSADBA rules will apply as the effective date is driven by the date of the payment.
- Where there are multiple beneficiaries irrespective of when the payment is made – the old LTA rules will apply as the effective date is driven by the date of death.

The new LSADBA rules will apply where the death occurs on or after 6 April 2024.

If you require any clarification, please refer to the effective date rules in the Pension Tax Manual (PTM088680). This defines the rules relating to existing BCE 7 crystallisations, which are being carried over into the new rules for death benefit RBCE lump sums.

Beneficiary drawdown and beneficiary annuity

Following consultation, the government has confirmed that individuals will still be able to receive the benefits that are currently tested against the LTA under BCEs 5C and 5D (beneficiary drawdown and beneficiary annuity). Their values will continue to be excluded from income tax, maintaining the current treatment.

Payments in excess of LSA or LSADBA

With the exception of PCLS and pension commencement excess lump sums (PCELS are not covered in this postcard), payments can be made in excess of the allowances. Where allowances are exhausted, the excess payments will be taxable at the recipient's marginal rate.

Comment

The announcement to continue with the current treatment of beneficiary drawdown and beneficiary annuity benefits is a welcome relief for many who were concerned by the initial draft legislation in July 2023. As such, it is more important than ever to review existing arrangements to ascertain what options are available on death.

Overseas transfer allowance

A member's overseas transfer allowance (OTA) starts as an amount equal to the member's LSADBA. The following events will reduce the OTA:

- PCLS from 6 April 2024 (in line with the reduction to the LSADBA).
- Serious ill-health lump sum from 6 April 2024 (in line with the reduction to the LSADBA).
- The tax-free portion of an UFPLS from 6 April 2024 (in line with the reduction to the LSADBA).
- A transfer to a qualifying recognised overseas pension scheme at any time – this includes where such a transfer is subject to the overseas transfer charge (OTC) due to the residency rules.

Where benefits are transferred in excess of the OTA, the tax charge will be 25% of the excess benefits, except where these benefits are already subject to the OTC.

LTA protections and enhancements

In simple terms, clients with Fixed, Individual or Primary Protection will have their allowances capped at the level of protection they built up under the Lifetime Allowance. For example, a client with Fixed Protection 2014 will have their LSA set at £375,000 and their LSADBA set at £1.5m.

Enhanced Protection

For clients with Enhanced Protection, the maximum amount of tax-free cash payable as PCLS is the amount that could have been paid on 5 April 2023. The maximum amount of tax-free cash payable under UFPLS is the amount that could have been paid on 5 April 2024. For benefits tested against the LSADBA only, the LSADBA is set at the value of the uncrystallised rights on 5 April 2024.

Fixed Protection 16 and Individual Protection 16

There was no time limit placed on applications when these two types of protection were introduced. As such, they could be applied for retrospectively provided the member was eligible. However, the legislation has provided a deadline of 5 April 2025 for both Fixed and Individual Protection 16, meaning applications will not be possible after this date.

As you may recall, the general conditions for Fixed Protection included a proviso that further benefit accrual could not occur post-5 April 2016 (i.e., from the 2016/17 tax year). The Spring Finance Bill relaxed this condition, provided the member held valid protection as of 15 March 2023. While it is still possible to apply for FP16 (until 5 April 2025), the protection will be lost on further benefit accrual if an application is made after 15 March 2023.

Lifetime allowance enhancements

Following consultation, the government have confirmed that individuals who hold a valid LTA enhancement factor for the following, will have their LSADBA values increased:

- The recognised overseas pension scheme transfer factor.
- Non-residence factor.
- Pension credit factor.

Where an individual qualifies for an enhancement factor but has not yet applied, they have up to five tax years from the event or 5 April 2025 (whichever is sooner) to apply.

Comment

The ability to accrue further benefits is welcome news for clients with existing Fixed and Enhanced Protection (as of 15 March 2023) who have previously not been able to make further contributions to their pensions. For those who are eligible to apply retrospectively for Fixed Protection 16, although further benefits cannot be accrued, it may still be prudent to consider applying for protection where this will afford greater PCLS entitlement or provide greater tax-free death benefits.

Age 75

Under the draft legislation, the age 75 LTA test is removed and is not replaced. However, all other rules relating to age 75 in terms of contributions and taxation of benefits remain in place. HMRC have indicated they will review the appropriateness of using age 75 going forward, but that will form a separate reform exercise. For clarity, there have been no changes announced to the treatment of pension death benefits post-75.

Trivial commutation lump sums, winding up lump sums and small pots

Trivial commutation lump sums, winding up lump sums and small pots can continue to be paid and will not use up the LSA or LSADBA. However, the member must have available allowance to be able to take trivial commutation or winding up lump sums. In schemes newsletter 155, HMRC confirmed that individuals would not need any available Lump Sum Allowance for small pot payments.

Transitional arrangements

The following 'default' rules apply where a transitional tax-free certificate (details below) has not been issued and the individual has utilised some, or all, of their lifetime allowance.

Lump sum allowance

- **Where the individual has no LTA remaining as of 5 April 2024**

The starting LSA is zero.

- **Where the individual has LTA remaining as of 5 April 2024**

The starting LSA is set as the applicable LSA for the individual less 25% of the LTA amount used prior to 6 April 2024 (standard or protected).

Lump sum and death benefit allowance

- **Where the individual has no LTA remaining as of 5 April 2024**

The starting LSADBA is zero.

- **Where the individual has LTA remaining as of 5 April 2024, and takes a serious ill-health lump sum before 6 April 2024 while under the age of 75**

The starting LSADBA is set as the applicable LSADBA for the individual less 100% of the LTA amount used prior to 6 April 2024 (standard or protected).

- **Where the individual has LTA remaining as of 5 April 2024, and dies before 6 April 2024 while under the age of 75 and a lump sum death benefit is paid before 6 April 2024**

The starting LSADBA is set as the applicable LSADBA for the individual, less 100% of the LTA amount used prior to 6 April 2024 (standard or protected).

- **In all other cases where the individual has LTA remaining as of 5 April 2024**

The starting LSADBA is set as the applicable LSADBA for the individual, less 25% of the LTA amount used prior to 6 April 2024 (standard or protected).

If any of these figures – either LSA or LSADBA – produces a negative amount, the relevant allowance is set as zero.

Transitional tax-free amount certificates

Where an individual or their personal representatives (where they have died) successfully applies for a transitional tax-free amount certificate, it will override the default rules and allow them to take a bespoke approach to the availability of their remaining LSA and LSADBA post-6 April 2024. However, importantly, **this certificate must be obtained before the first RBCE to occur post-6 April 2024**, after which they lose the right to apply. A certificate should only be applied for where individuals can provide complete evidence that they have received, as of 6 April 2024, a lower amount as tax-free lump sums than that provided for by the standard transitional calculation (default position).

A transitional tax-free amount certificate is issued by a registered pension scheme to a member on application. It certifies that the scheme administrator is satisfied as to the amount of the member's:

- LSA transitional amount.
- LSADBA transitional amount.

Where an individual holds a certificate, their LSA will be calculated at their applicable rate, less the actual amounts of PCLS and tax-free portions of UFPLS payments received. The LSADBA will be calculated at the applicable rate, less the tax-free payments received (as for the LSA) and any tax-free serious ill health or lump sum death benefits.

This could be of obvious benefit to any individual that has utilised their LTA, but have not taken their full PCLS entitlement (e.g. scheme pensions without PCLS).

To apply for a certificate the member (or PR):

- In [PSN155](#), HMRC state that they expect the member to apply to the scheme from which the first lump sum is being paid post 6 April 2024. However, they also confirmed in a more recent update, that the member can apply to any pension scheme of which they are a member.
- Must supply clear and accurate records of ALL the previous amounts paid (crystallised) and which were tax-free. In other words, this is not just the benefits where less than the permitted amount of tax-free lump sum was paid. This would also include any UFPLS payments.

The scheme then has up to three months to supply the certificate or to state why they are unable to provide it (such as inaccurate or unclear information). Please note, multiple providers cannot be involved with the issue of the certificate.

Comment

It would appear that transitional tax-free certificates may boost the LSA and LSADBA for many individuals. As currently drafted, the legislation states that it is the monetary amount of any previous tax-free payments, without adjustment for LTA changes that is used, and could therefore be of benefit to individuals that took benefits when the LTA was below the current limit. Conversely, individuals who took benefits when the LTA was higher (with no LTA protection) may be better suited by the default calculation. What is important is that the individual's personal situation is considered before the first RBCE after 6 April 2024. It should also be noted that certificates cannot be applied for until after 6 April, and that the scheme administrator has up to three months to respond to an application. So, this could possibly delay payments that are needed urgently in the new tax year.

HMRC are expected to issue further guidance and clarification on transitional tax-free amount certificates in the coming weeks.

Summary

The removal of the LTA tax charge and the replacement legislation will be welcome news for many pension savers. For someone who hasn't taken any benefits before 6 April 2024, the new legislation is relatively straightforward. However, as is always the case with pension legislation changes, it is the transitional arrangement provisions that will prove to be the most challenging in the coming months. I will look forward to further legislation and the final rules in due course, and will keep you informed as we learn more.

Important information

This document provides information and is only intended to provide an overview of the current law in this area and does not constitute financial advice, tax advice or legal advice, or provide any recommendations. Tax treatment depends on individual circumstances and all tax rules may change in the future. Withdrawals from a pension will not normally be possible until a client reaches age 55 (57 from 2028). Different options may have different effects for tax purposes, different implications for pension provision and different impacts on other assets and financial planning.

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