The lifetime allowance and the Spring Budget

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What does it all mean?

It is fair to say that it is not unusual for there to be speculation on changes to the lifetime allowance (LTA) in the weeks before a Budget. However, the Spring Budget was different as there was a real expectation – not mention the odd leak – that things were about to change. What was announced though, caught everyone by surprise – including myself. The announcement was not that the lifetime allowance would be increased, but that it would be abolished completely! In the words of the Chancellor, this was a move to incentivise older workers to remain in work and would 'simplify our tax system'.

After reading the Budget report and the pension schemes updates from HMRC over the following two weeks, it was clear there was going to be quite a bit to unpick from this new simplified system before the start of the new tax year. What was immediately apparent was, while the proposal is to fully the remove the lifetime allowance, this will not be until the 2024/25 tax year (through a later Finance Bill). In the meantime, what we would see is the removal of the lifetime allowance tax charge from 2023/24. One could naturally assume this would achieve the same outcome, but there are aspects of the lifetime allowance system that need further examination.

Administering the LTA

First, as the lifetime allowance will remain in place for this tax year, pension scheme administrators will need to continue to operate lifetime allowance checks when paying benefits – for example, assessing whether an individual has available lifetime allowance. They will also need to continue issuing benefit crystallisation event certificates.

Furthermore, the calculations for establishing the maximum amount of available Pension Commencement Lump Sum (PCLS) will continue to be linked to the individual's available lifetime allowance. It will be paid as a proportion – usually 25% – of the amount of pension benefits being crystallised.

In essence, this means the maximum PCLS payment will be £268,275, unless the member has a protected right to a higher amount. This will include individuals with protected lump sum rights as well as those with certain LTA protections. Where Enhanced Protection and protected lump sum rights are held, the maximum PCLS rights will be capped at the value of the rights as of 5 April 2023.

Comment

The removal of the lifetime allowance tax charge but with the continuation of other LTA workings – particularly those that link available LTA to PCLS – means that careful consideration may be required when deciding upon the order of benefit crystallisations where the total value of pension savings exceeds the lifetime allowance.

To give a simple example, consider an individual who has money purchase pension savings of £1 million, a DB pension of £50,000 per annum and a protected LTA of £1.25 million. The individual therefore has total pension savings of £2 million – 20 x £50,000 (DB) plus the money purchase value of £1 million. This is £750k higher than the individual's LTA.

Prior to the changes, one of the main considerations would be where the LTA tax charge falls. As the LTA is used in chronological order, it would have been the scheme that crystallised benefits in excess of the LTA that would have suffered the tax charge and reduction in benefits. As such, if the member wished to keep their DB pension income fully intact, this would have needed to be crystallised first. The LTA tax charge would then have fallen on the money purchase scheme either on taking the benefits, death before age 75, or when they reached age 75.

Now there is no lifetime allowance tax charge, one of the main considerations could be whether or from where the individual is intending to take any PCLS. If the individual is planning to take full PCLS from their money purchase arrangement but none from the DB scheme, they would need to consider taking the PCLS from the money purchase arrangement before becoming entitled to the DB pension. The result would be the DB pension is in excess of the LTA – but as there is no longer an LTA charge, the benefits would not be reduced.

The next point to consider is that, although the LTA tax charge has been removed, this will be effectively replaced with an income tax charge where the LTA tax charge would have otherwise been levied at 55%. As such, this will have an impact on any (pre-age 75) member benefits in excess of the lifetime allowance for:

- Serious Ill Health Lump Sums
- lifetime allowance Excess Lump Sums
- Uncrystallised Funds Lump Sum Death Benefits
- Defined Benefits Lump Sum Death Benefits.

At the moment, there has been no corresponding legislation for pension death benefits paid as Beneficiary Flexi-Access Drawdown (BFAD) or where the benefits have already been crystallised.

Comment

This appears to create a disparity in the tax treatment of death benefits – depending on the contract type, whether the benefits are crystallised or uncrystallised, and whether benefits are paid as lump sum or BFAD. It will be interesting to see whether additional legislation is introduced in the coming weeks and months to address this.

LTA protections

The final point for consideration is where individuals hold Enhanced Protection or any of the Fixed Protection regimes where they have previously been unable to accrue any further pension benefits since the date of their protection. Provided the protection was applied for before 15 March 2023 – and the protection is still valid – these individuals will be able to accrue new benefits from 6 April 2023 without losing their protection. They will also be able to transfer benefits and join new arrangements without losing their protection.

Anyone who does not hold Fixed Protection 2016 as at 15 March, but is eligible to apply can still do so (effectively for higher PCLS protection) but will not be able to accrue benefits, join new arrangements or conduct certain transfers without losing their protection.

Comment

The ability to make pension contributions previously prohibited by LTA protection legislation will mean that some individuals could potentially contribute up to £180,000 in the current tax year by utilising carry forward. However, it should be remembered that while the LTA tax charge has been removed, the maximum available PCLS will not change. It should also be noted that these changes are based on HMRC guidance only at this time and will not be confirmed by legislation until the Finance Bill receives Royal Assent, which is expected in summer 2023.

Conclusion

In summary, the removal of the LTA tax charge can only be good news for pension savers. However, as we have seen, there are still planning considerations around the continued existence for now of the LTA. We will have to see what the proposals are for the Finance Bill later this year and whether the legislation changes anything.

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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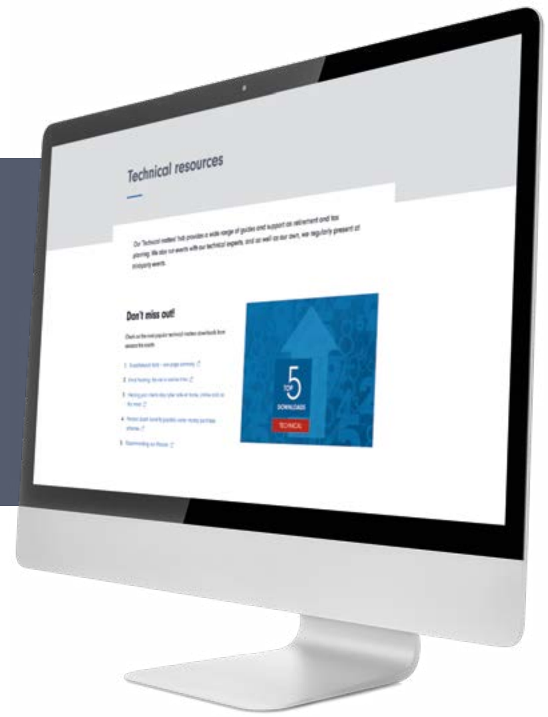

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