Cantab
ASSET MANAGEMENT

'Replacement' of the Lifetime Allowance

6 February 2024

Key points

- **Good news for all:** the Lifetime Allowance is to be fully abolished from 6 April 2024 – to encourage continued working and pension saving.
- **But be careful:** the draft legislation provides HM Treasury with the power to amend primary legislation up to 6 April 2026.
- New regulations, if made after 5 April 2024, will have effect for the tax year in which they are made – any 'loopholes' will likely be closed.
- Pension contributions can recommence without loss of pension protection – except for those with FP 16 or IP 16 applied for after March 2023 budget, whose protection will be lost if contributions are made after 15 March 2023.
- Tax-free cash for the vast majority will remain the same – fixed at £268,275 or at protected tax-free cash amount.
- Those concerned about a policy reversal under a new government could consider crystallising their benefits under the current rules.
- Those considering a transfer of their pension overseas to a Qualifying Recognised Overseas Pension Scheme (QROPS) should consider whether action is needed prior to 5 April 2024 (excess over Overseas Transfer Allowance to be charged at 25%).
- **The new legislation brings with it some quirks: we recommend taking advice before undertaking action. The above is based on draft legislation that has not yet been enacted. Therefore, this Briefing Note may not be relied upon in any way as advice – the Finance Bill, when finalised with Royal Assent, may have changed.**

The new rules from 6 April 2024

In March 2023, alongside his Spring Budget, Jeremy Hunt announced plans to scrap the Lifetime Allowance (LTA). Its removal is aimed at encouraging workers considering retirement to remain in employment and retirees to re-enter the workforce.

The LTA acts to limit the value an individual can accrue in pension savings without further LTA tax charges. The LTA, first set at £1.5m in 2006, reached a high-water mark of £1.8m in 2012, and was £1,073,100 at the time of Mr Hunt's inaugural Budget.

The LTA is set to be removed in two stages:

1. Removal of the LTA tax charge in the current 2023/24 tax year; the crystallisation mechanisms and reporting requirements have not changed per se, but the LTA tax charge has been reduced to 0%, for all intents and purposes removing this charge.
2. Removal of the LTA altogether in the 2024/25 tax year.

Step one, the removal of the LTA charge, was delivered by The Finance Act (2) 2023, which received Royal Assent on 11 July 2023.

Step two, the removal of the LTA entirely from pensions legislation, is set to be delivered by The Finance Bill, which is currently working its way through parliament and is expected to receive Royal Assent in March 2024.

Legislation abolishing the LTA and introducing new lump sum allowance and lump sum and death benefit allowance

The Finance Bill abolishes the LTA from pension tax legislation. With the LTA removed, it also sets out the new tax treatment of lump sums and lump sum and death benefits paid from registered pension schemes. The changes are to have effect on or after 6 April 2024. The legislation introduces an individual's 'Lump Sum Allowance' (LSA), which is set at £268,275, and an individual's 'Lump Sum and Death Benefit Allowance' (LSDBA), set at £1,073,100. Transitional rules for those who have already taken pension benefits prior to 6 April 2024 are also contained in the legislation.

The key points are summarised in the following sections.

Benefit Crystallisation Events

With the removal of the LTA, all current Benefit Crystallisation Events (BCEs) will be removed. Relevant Benefit Crystallisation Events (RBCEs) will be introduced to cover the payment of relevant lump sums and lump sum death benefits.

A pension commencement excess lump sum will be introduced, which will be taxed at the individual's marginal rate. This will apply where tax-free cash paid is greater than the member's available LSA. This is expected to be relevant for pension schemes that provide a right to tax-free cash greater than the member's available LSA.

Lump Sum Allowance

It will still be possible to take 25% of a pension as a Pension Commencement Lump Sum (PCLS). However, the member must have sufficient lump sum allowance for it to be tax free. The LSA will be reduced by the monetary amount of tax-free lump sums taken. The tax-free element of Uncrystallised Funds Pension Lump Sum (UFPLS) payments will be deducted from an individual's LSA. The LSA is also reduced by a transitional amount reflecting benefits paid prior to 6 April 2024. Transitional rules are outlined in the section below.

There are no provisions for increasing the LSA.

Lump Sum and Death Benefit Allowance

This second allowance combines the LSA mentioned above, tax-free benefits paid on death, and serious ill-health lump sums. It has been introduced to limit how much can be paid as a tax-free lump sum – in the individual's lifetime and on death. As it is a combined allowance for both lifetime tax-free lump sums and tax-free death benefits, the amount available for lump sum death benefits will be reduced by any tax-free cash amounts the member had taken during their lifetime. The LSDBA is also reduced by a transitional amount reflecting benefits paid prior to 6 April 2024. Transitional rules are outlined in the section below.

Testing against this allowance will only apply to lump sums paid on death before age 75. This includes lump sums paid from previously crystallised funds.

Lump sum death benefits paid from funds crystallised before 6 April 2024 will not be tested against the LSDBA.

Protection

Eligible individuals will have until 5 April 2025 to apply for Fixed Protection (FP) 2016 and Individual Protection (IP) 2016. Those applying for FP 2016 after 15 March 2023 will lose this protection if further contributions are made. Individuals with protected tax-free cash rights under Enhanced Protection will have their LSA limited to what could have been paid out on 5 April 2023. Those with Enhanced Protection will have their LSDBA set to the value of their pension as at 5 April 2024. Those with Primary Protection will have their LSDBA set to £1.8m increased by the Primary Protection factor. If they have registered tax-free cash rights, their LSA will be set to their uncrystallised A-Day rights, increased by the Primary Protection factor. Those with FP or IP will have their LSDBA set to their protected LTA, and their LSA will be 25% of their protected LTA.

Excess above lump sum

Any excess above the LSA will be taxable at the recipient's marginal rate of income tax. This provides scope for individuals to utilise income tax reducers against any excess. Under previous rules, there was nothing an individual could do to reduce the impact of a LTA excess charge on their tax bill.

Transitional rules

Where benefits have previously been taken, there are two possible methods of calculating the available LSA.

The standard calculation:
25% of the LTA used prior to 6 April 2024 will be deducted from the member's LSA.

The alternative method:
If a member can evidence how much tax-free cash they have taken previously, they can apply for a transitional tax-free amount (TTFA) certificate. This will confirm the monetary amount of tax-free cash previously received, to be deducted from the member's LSA. Therefore, some may be able to receive more tax-free cash post 6 April 2024 by utilising the alternative transitional method.

To take full advantage of the alternative method using the TTFA certificate, the individual will need sufficient uncrystallised funds to take the tax-free cash available post 6 April 2024. Importantly, the certificate is required before the first RBCE from 6 April 2024, otherwise the standard calculation will apply.

There is an equivalent deduction to the LSDBA using the methods described above. However, where some of the previously used LTA is in respect of a Serious Ill Health Lump Sum (SIHLS), the amount deducted is 100% of the SIHLS.

Overseas Transfer Allowance

A transfer to a QROPS will be tested against the Overseas Transfer Allowance (OTA). Any excess over the allowance will be subject to the overseas transfer charge of 25%. The OTA is set at the same level as the LSDBA.

The transfer overseas does not use up the LSA or LSDBA, and the overseas benefits taken do not use them either.

Scheme specific tax-free cash

The new legislation contains a change to the formula for calculating the tax-free cash entitlement for those with scheme specific tax-free cash. As a result, those with FP or IP will receive more if they wait until 6 April 2024. When paid, 25% of the amount crystallised will be deducted from the LSA, rather than the monetary amount of the scheme specific lump sum.

Pre-75 and post-75 death benefits

Prior to 75, death benefits will continue to be paid tax free up to the LSDBA. Marginal rate tax will apply to any excess. Testing against the LSDBA will not apply if benefits are be paid via beneficiary's drawdown as this avoids the payment of lump sum death benefits. To ensure beneficiary's drawdown is available, death benefit nominations need to be in place and the scheme must offer beneficiary's drawdown as an option.

Post-75 death benefits are taxable at the beneficiary's marginal rate.

Pre-commencement pensions

Where benefits were taken before 6 April 2006, but there have not been any subsequent benefit crystallisation events, these will need to be tested to see how much of the LSA has been used up. 25% of an individual's pre-commencement pension rights is to be deducted from their LSA and LSDBA.

Right to make further provision

The legislation provides HM Treasury with the power to amend primary legislation through regulations where necessary, following the abolition of the Lifetime Allowance, up to 6 April 2026.

Next steps

Whilst many individuals with substantial pension savings stand to benefit from the more favourable tax treatment, the new rules will introduce other financial planning considerations – particularly regarding pension tax-free cash and death benefits. As always, we recommend seeking specialist advice for a tailored recommendation.

Please note: The Finance Bill is expected to receive Royal Assent in late March 2024. It is possible that the draft legislation may have changed in the period between this Briefing Note being issued and Royal Assent being received.

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