

Lifetime allowance abolition – an update

January 2024

Introduction

The abolition of the Lifetime Allowance (**LTA**) is being undertaken in two stages. The first was the removal of the LTA tax charges from 6 April 2023. The second will be the abolition of LTA itself from 6 April 2024. Rather than a simple abolition, the LTA is in effect being replaced by lump sum allowances which will still control the level of tax-free cash that an individual can receive from registered pension scheme arrangements. On 4 January 2024, HMRC published an updated newsletter providing further guidance on the how this will work in practice.

The LSA and LS&DBA

Two new lump sum allowances will be introduced as follows: the "**lump sum allowance**" (**LSA**) and the "**lump sum and death benefit allowance**" (**LS&DBA**), together referred to in this note as the "**Lump Sum Allowances**".

The standard LSA will be 25% of the current LTA, which is **£268,275**. Anyone with LTA protection or lump sum protection will, however, benefit from an increased LSA. For example, a member with Fixed Protection 2014 and a personalised LTA of £1.5m, will have a LSA of £375,000 (25% of £1.5m).

The standard LS&DBA will be the current LTA, which is **£1,073,100**. Again, though, anyone with LTA protection will have a LS&DBA that reflects this personalised protection.

Any lump sum which must be taken into account for the Lump Sum Allowances and is paid in excess of the relevant entitlements, will be subject to income tax at the member's marginal rate. This reflects the LTA regime under which benefits paid in excess of the LTA were subject to a tax charge.

There are some key differences between the old and new regimes, though, including the fact that under the LTA regime, lump sums paid in excess of the LTA were subject to a 55% LTA charge, whereas payments in excess of the Lump Sum Allowances are subject to marginal rate income tax. Importantly too, the Lump Sum Allowances are relevant only to the payment of lump sums; a payment of pension income will not (unlike under the LTA regime) "use up" a member's Lump Sum Allowances. Further, tax charges by reference to the Lump Sum Allowances will arise only when a lump sum is paid and not on the occurrence of events such as reaching age 75 or death.

Pension commencement lump sum (PCLS)

Prior to the changes, broadly, the standard PCLS entitlement is the lesser of (i) 25% of the value of the member's pension rights and (ii) 25% of their available LTA. Under the new regime, a PCLS will be the lesser of (i) (broadly) 25% of the value of the member's pension rights; (ii) the available LSA; and (iii) the available LS&DBA. This amount can be taken tax free.

Where a member has used up all of his or her LSA, a new **authorised lump sum** will be introduced, known as the "pension commencement excess lump sum", which can be paid where scheme rules allow a member to take a lump sum on pension commencement that is more than the PCLS, provided certain conditions are met. This lump sum is broadly similar to the current LTA excess lump sum but will be taxable at the member's marginal rate rather than the LTA 55% lump sum charge. Any lump sum that does not fulfil the conditions for a pension commencement excess lump sum will be an unauthorised payment.

Other lump sum payments

Providing an individual has all or part of the lump sum allowance available, the payment of a trivial commutation lump sum, a winding up lump sum, or a small lump sum will not reduce the member's available Lump Sum Allowances.

Overseas transfer allowance

An "overseas transfer allowance" (**OTA**) will be introduced at the same level as the individual's LS&DBA. If the amount transferred from a UK registered scheme to a QROPS is more than the OTA, the excess will be subject to the 25% overseas transfer charge (where previously it would have been subject to a 25% LTA charge). However, if the 25% overseas transfer charge already applies (because there is no exclusion available), the OTA will not be levied. Overseas transfers will not affect the availability of the Lump Sum Allowances.

Transitional provisions

- Where an individual has used some of his LTA before 6 April 2024, there will be transitional provisions to ensure this is reflected in his Lump Sum Allowances. These provisions assume that he has taken his full tax-free cash entitlement (i.e. 25% of his lifetime allowance). If, however, the individual can evidence that he has not used taken the maximum tax-free amount, his Lump Sum Allowances will be amended accordingly.
- An individual who used all of his LTA before 6 April 2024 will not be entitled to any Lump Sum Allowances.
- The government had previously indicated that a dependant's or nominee's flexi-access drawdown pension or annuity would become taxable on death before age 75, but this change in taxation is no longer going ahead.

Enhancement factors

Enhancement factors for the Lump Sum Allowances will be available where an individual:

- has Primary Protection from the LTA;
- is entitled to a pension credit under a registered scheme;
- was a relevant overseas individual while also a member of a UK registered pension scheme; or
- has transferred rights from a QROPS.

The application deadline for Fixed Protection 2016, Individual Protection 2016, and pension credit enhancements is **5 April 2025**.

The application deadline for **international enhancements** for relevant overseas individuals with UK registered pension scheme accrual is 5 April 2025 even if under the current rules the application deadline is later than 5 April 2025.

Other considerations

Scheme administrators will need to provide members with "**relevant benefit crystallisation event**" statements which notify an individual of how much of the Lump Sum Allowances have been used on payment of a lump sum. Administrators will also need to report any lump sums that exceed the Lump Sum Allowances to HMRC.

Changes will be made to the **member payment provisions** in Schedule 34 of the Finance Act 2004 so that the Lump Sum Allowances will apply to RNUKS benefits, and so that they do not become tax-free as a result of the abolition of the LTA.

Comment

The new regime is complex and runs to 100 pages of legislation. There is a tight window for the industry, employers, trustees and individuals to get to grips with the changes. In advance of 6 April 2024, the key action points for trustees and employers are as follows:

1. Check that the scheme administrator is fully prepared for the changes, in particular with regards reporting to HMRC, operating the new PAYE rules, and providing statements to members.
2. Check the scheme trust deed and rules for explicit references to the LTA and to determine whether any changes need to be made.
3. Consider member communications (including member booklets and employment handbooks), which may need updating to reflect the changes. It may also be necessary to consider how any alternative to pension accrual (such as cash in lieu) offered in connection with the LTA may be impacted by the abolition of the LTA.

To make matters even more complex, Labour has previously stated that if they win an election they will re-instate the LTA. As we can see from the new regime, this is unlikely to be a simple task and makes it tricky for trustees to know how to communicate with members or amend scheme rules with this possibility a few months down the line.

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