

Finance Bill 2023 - Pension changes (Lecture P1372 – 12.44 minutes)

Lifetime allowance (LTA) charge

If the value of total tax-relieved pension rights exceeds the LTA at certain 'benefit crystallisation events' (e.g. when benefits are first taken from the fund, or aged 75), the excess has been subject to a LTA tax charge of:

- 25% if the excess is left in the fund to be drawn as taxable income, or
- 55% if it is drawn out as a lump sum.

The LTA was introduced in 2006 at £1.5 million, had risen to £1.8m by 2012, but was subsequently reduced 3 times before rising again to £1,073,100. Various types of 'protection' have been available, both on the introduction of the LTA and whenever it has been cut. So some taxpayers can have a higher value of pension rights before incurring a LTA charge.

Clause 18 abolishes the lifetime allowance (LTA) charge for pension purposes for 2023/34 and any subsequent tax year.

The lifetime allowance still exists for 2023/24 but the government intends to abolish it in a subsequent Finance Bill.

Clause 19 confirms that certain lump sums paid out in excess of the LTA in 2023/24 (or until the LTA is abolished) will be subject to the recipient's marginal rate of income tax. The lump sums caught are:

- A serious ill-health lump sum
- A lifetime allowance excess lump sum
- A defined benefits lump sum death benefit and
- An uncrystallised funds lump sum death benefit

All of these are defined in Part 4 FA2004.

These provisions effectively mean that rather than attracting the LTA charge in 2023/24 (at a rate of 55% if taken as a lump sum or 25% if taken as a taxable income stream), any value in excess of the LTA will be taxed at the individual's marginal rate of tax. For those who are taking the money out as a lump sum, the immediate impact will be a reduction of 10% (for those who are paying additional rates of tax) but possibly more. The real reduction arises from those who choose to withdraw money as income, since there will be no upfront 25% charge; the income will just be taxed as it is withdrawn.

In these provisions, reference to the lifetime allowance will either be the standard lifetime allowance (currently £1,073,100) or an enhanced value if this has been protected previously.

Individuals who have protected their LTA in the past may have been restricted from adding new funds to their pot as a condition of obtaining protection (e.g. if claiming 'fixed protection'). From 6 April 2023, it appears that individuals who held protection for their pension rights before 15 March 2023 will be able to accrue new pension benefits, join new arrangements or transfer their savings without losing the protection (although the protection will only apply for the purposes of the tax-free pension commencement lump sum in any case). This tax-free amount is 25% of the LTA figure (25% x £1,073,100 = £268,275), unless the person has 'protection'.

Annual allowance

Clause 20 increases the pension annual allowance to £60,000 (from £40,000) for 2023/24 onwards. This is the maximum amount of pension inputs permitted each year without the annual allowance charge being triggered, although there is carry forward of unused allowances for up to three years where a pension fund is already in existence. An individual cannot input more than their net relevant earnings (if gross contributions exceed £3,600), although where payments are made by the employer this cap does not apply. There is no change in the method of calculating pension input amounts for defined benefit schemes, which is not based not on the cash input to a scheme in the year, but instead looks at the increase in the member's pension rights for the year, applying a factor of 16 to the CPI-adjusted increase in benefits. Thus, a relatively small increase in salary, or working a lot of overtime, can result in a high pension input, as eventual benefits are linked to salary.

Clause 21 increases the money purchase annual allowance (MPAA) to £10,000 (from £4,000) for 2023/24 onwards. The MPAA applies when you have started to drawdown from your pension, other than where you have just taken the tax-free lump sum or where you have taken the lump sum and used the balance to buy an annuity, which cannot reduce. It does not affect those who have benefits from a defined benefit scheme. There is no carry forward of unused MPAA.

Clause 22 amends the provisions relating to the tapering of the annual allowance, so that the adjusted income for the purposes of calculating the tapered allowance increases to £260,000 (from £240,000) and the minimum rate of allowance increases to £10,000. For every £2 that is earned over the threshold, the annual allowance reduces by £1.

Adjusted income includes employer pension contributions. 'Threshold income' (which excludes employer pension contributions) remains at its previous level of £200,000 as it is set at the adjusted income (now £260,000) less the annual allowance (now £60,000). An individual's income must exceed both these limits if tapering is to apply.

The combination of these changes means that the £10,000 minimum amount will apply for anyone who has income over £360,000, as opposed to £312,000, at which the £4,000 minimum previously applied.

Other matters

Enhanced lifetime allowance

Clause 23 protects the position of those individuals who have an enhanced lifetime allowance as at 5 April 2023, as it states that they will not lose their protection. It will also give entitlement to a higher lump sum, with the maximum lump sum (which can be paid tax-free) being whatever this would have been if this had been paid on 5 April 2023.

This clause reflects the announcement (to be legislated in a future Finance Bill) that once the lifetime allowance is abolished, the maximum tax-free lump sum will be limited to 25% of the current figure. This will be £268,275 for anyone with a standard lifetime allowance or a higher figure where the lifetime allowance stands at a higher protected figure.

Collective Money Purchase pension schemes

Clause 24 introduces additional measures relating to Collective Money Purchase pension schemes, which were enabled in the Pension Schemes Act 2021.

This is a new type of pension scheme that allows a combined money purchase type scheme to be set up by a group of individuals so that they can benefit from scale of investment. This clause makes some amendments to the provisions as they apply for tax purposes so:

- A CMP scheme may make payments of periodic income when it is in the process of being wound up;
- A CMP scheme may transfer assets used to pay periodic income to another registered pension scheme, so that a drawdown pension may be paid from the new scheme;
- When a member dies over the 75 during the winding up period, any income which becomes payable to dependents is ignored for some purposes.

Net pay arrangements

Clause 25 brings into legislation provisions, which have previously been announced, relating to pension contributions paid under net pay arrangements. If an individual is making pension contributions under a net pay arrangement but their total taxable income is below the personal allowance, they will not benefit from any tax relief on those contributions. In contrast, those paid under a 'net pay' arrangement (where the pension scheme claims a 20% top-up on contributions made net of basic rate tax) still get the benefit of this basic rate top-up, even though they are a non-taxpayer. From 2024/25, top-up payments will be made to those individuals in relief at source schemes to compensate them for the lost tax relief.

If the income exceeds the personal allowance but income tax relief has not been achieved on the whole contribution, then a proportionate payment will be made. The payments will be made as soon as is practicable after the end of the tax year and the individual can decline the payment. It will be treated as employment income for the relevant tax year.

The guidance notes to the FB state that HMRC will notify those who are eligible and invite them to provide the details such that the top-up can be paid directly to their bank account. Note that the top-up payment will not be paid into their pension scheme.