

Abolition of the lifetime allowance (Lecture P1397 – 20.28 minutes)

F(No2)A 2023, which received Royal Assent on 11 July 2023, made a number of important modifications to the tax rules for pensions.

In recent years, the lifetime allowance has been frozen at £1,073,100. This represents the maximum amount of tax-relievable pension savings which an individual can accrue over his working life. Where a member's total capitalised pension wealth exceeds this figure, he was subject to a special lifetime allowance charge, the rate of which depended on how he withdrew the excess capital. By virtue of S18 F(No2)A 2023, the lifetime allowance charge has been abolished for 2023/24 onwards.

Pension scheme members have always been able to receive a tax-free lump sum when they become entitled to their pension scheme benefits. This is known as a pension commencement lump sum (PCLS). The maximum amount which individuals could claim as a PCLS was 25% of their available lifetime allowance at the time when the sum was taken. With the lifetime allowance standing at £1,073,100, this set a PCLS upper monetary cap of £268,275 (25% x £1,073,100), unless the member held a higher level of protection. This limit on tax-free lump sums continues to apply following the abolition of the lifetime allowance.

Other significant pension changes in F(No2)A 2023, all of which took effect on 6 April 2023, were:

- an increase from £40,000 to £60,000 in the annual allowance, i.e., the maximum amount of tax-deductible pension savings which an individual can make in any one tax year (S20 F(No2)A 2023);
- a rise from £4,000 to £10,000 in the money purchase annual allowance for those individuals who have already flexibly accessed their pension savings (S21 F(No2)A 2023); and
- an uplift from £240,000 to £260,000 for the 'adjusted income' threshold after which the annual allowance starts to be tapered for high-income individuals (with the minimum tapered annual allowance of £4,000 being pushed up to £10,000) (S22 F(No2)A 2023).

Some immediate planning thoughts

If an individual was close to breaching the lifetime allowance prior to 6 April 2023, he might have chosen to opt out of his company pension scheme. Now that the lifetime allowance charge has been abolished, he can rejoin his workplace scheme and receive the benefit of employer contributions. This, along with the increase in the annual allowance, could give him greater funding for his retirement.

Example 1

Edward is aged 58. He is employed at a senior level in his company and receives an annual salary of £210,000 (plus bonuses). He has a pension pot worth £990,000 but has no form of lifetime allowance protection in place.

In March 2021, Edward opted out of his company pension scheme, given that he was getting close to exceeding the lifetime allowance and was therefore facing a lifetime allowance charge. He plans to retire in early 2024.

In view of the removal of the lifetime allowance charge and the increase in the maximum annual allowance, Edward can rejoin his employer's scheme.

Using the carry-forward of his unused annual allowance relief, he can have a total pension contribution of up to $£60,000 + £40,000 + £40,000 = £140,000$ for 2023/24.

It is now estimated that Edward's pension fund may be worth in the order of £1,200,000 when he retires.

In order to pay off his mortgage, Edward will fully crystallise his pension and then move it into drawdown. His lifetime allowance tax charge is zero, but, if he had completed the same steps in 2022, the excess tax charge could have been as high as £70,000.

When it existed, the lifetime allowance charge was payable by pension scheme administrators out of the individual's pension fund. However, where the pension arrangement was a money purchase scheme, it was only paid when the excess over the £1,073,100 limit was drawn upon. This naturally led many people to keep such excesses in their pension pots so that they did not incur the hefty tax charge. Now that this charge has been abolished, an individual can access the entirety of his pension fund without having to worry about paying a lifetime allowance charge. Accessing this money without being penalised could mean that an individual is able to stop working and retire at an earlier date.

Example 2

Maria is aged 57 and has a money purchase pension scheme valued at £1,600,000. She planned to retire at the age of 60 due to her pension fund being worth more than the lifetime allowance limit.

Prior to 2023/24, Maria's excess of $£1,600,000 - £1,073,100 = £526,900$, if taken as a lump sum, would have been taxed at 55% when she accessed it. This would have reduced the value of her pension fund by $55\% \times £526,900 = £289,795$, i.e., to £1,310,205.

In 2023/24 without the lifetime charge arising, Maria will keep the full value of her £1,600,000 pot. The additional funds mean that she can retire immediately, enjoying a higher level of pension income than she had previously anticipated.

Draft FB 2024 legislation

On 18 July 2023, HMRC published draft legislation which is due to form part of FB 2024 and which will take effect from 6 April 2024. The purpose of these proposals is to tidy up the remaining tax rules for the abolition of the lifetime allowance. It also clarifies that those members who already qualify for one of the special levels of protection will retain their rights to higher benefits and it should be noted that it is possible for taxpayers to make an application for fixed or individual protection 2016 up until 5 April 2025.

A key part of the changes is that, although the lifetime allowance is going, it is being replaced by a new regime. All tax-free lump sums, including tax-free lump sum death benefits, are instead to be tested against a lifetime limit which will be set at £1,073,100. Any lump sums paid above this level will be taxed at the individual's marginal rate of income tax. Within this overall limit, there is to be a tax-free limit for PCLSs and other lump sums. This limit will be known as the 'lump sum allowance' and will be £268,275 (i.e., $25\% \times £1,073,100$) or any higher protected amount.

One of the uncertainties in this regard is that the Labour Party have confirmed that they will reverse these changes if they win the next general election. However, amendments cannot be made to

pension legislation retrospectively. This emphasises the importance, especially for those nearing retirement age, in taking action sooner rather than later.

Contributed by Robert Jamieson