Think Ahead ACCA

Technical factsheet

Pension scheme lifetime allowance protection

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LIFETIME ALLOWANCE

This area requires careful consideration by individuals and has been written to provide facts for that purpose. It may be advisable for an individual to take independent financial advice when considering the options available and suitability for their circumstances.

It is an individual's responsibility to consider that their single lifetime allowance (from April 2019 £1,055,000), in relation to the value of any authorised benefits paid out in excess of their allowance, is subject to a tax charge known as the lifetime allowance charge.
It applies to all pension receipts, whether from a defined contribution or defined benefit scheme, and also where life insurance is paid from a registered scheme.

The lifetime allowance

There is no limit on the total amount of authorised benefits a registered pension scheme can provide to its members. However, an individual has a single lifetime allowance in relation to the value of tax-privileged benefits they can draw from such schemes; the value of any authorised benefits paid out in excess of their allowance is subject to a tax charge known as the lifetime allowance charge. This applies to all types of registered pension schemes equally.

For most people the standard lifetime allowance applies. However, there are a number of different forms of lifetime allowance protections which increase an individual's lifetime allowance.

An individual will use part of their lifetime allowance most commonly when they start to draw a pension but there are also other occasions that trigger a test of pension benefits against the lifetime allowance. An event that could result in lifetime allowance being used up is called a benefit crystallisation event (BCE). If the pension benefits being tested exceed the member's available lifetime allowance at that point, a lifetime allowance charge will be due on the excess.

BCEs include the following:

- taking a pension
- taking a lump sum
- reaching age 75
- death
- transferring funds to a qualifying recognised overseas pension scheme.

The lifetime allowance for recent years has been as follows:

From 6 April 2019	£1,055,000
From 6 April 2018 to 5 April 2019	£1,030,000
From 6 April 2016 to 5 April 2018	£1,000,000
From 6 April 2014 to 5 April 2016	£1,250,000
From 6 April 2012 to 5 April 2014	£1,500,000
From 6 April 2010 to 5 April 2012	£1,800,000

WHO IS LIABLE TO PAY THE LIFETIME ALLOWANCE CHARGE?

Where the lifetime allowance charge arises on the payment of a relevant post-death BCE, the liability for the charge falls on the recipient. With all other BCEs where a lifetime allowance charge arises, the member and the scheme administrator of the scheme where the chargeable amount arises are jointly and severally liable to the lifetime allowance charge due on that amount.

Joint and several liability means that both the scheme administrator and the member are equally and separately liable to the whole charge, and that payment by one will discharge the liability of the other(s), to the extent of the amount paid.

To meet their obligation, the scheme administrator must pay and account to HMRC for any lifetime allowance charge that arises in respect of any scheme member at a BCE taking place under their scheme. They do this through online quarterly scheme returns. But if they fail to do this because they have acted on incomplete or incorrect information provided by the member, they may be discharged from their liability to the tax charge where they can show and HMRC accepts that it would not be just or reasonable for them to be liable for it. In that case, liability for the charge would fall solely on the member.

LIFE INSURANCE

The Finance Act 2004 introduced a lifetime allowance that restricts the tax-free lump sum benefits that can be paid from a life insurance scheme that is registered.

Where a person has lump-sum benefits above the lifetime allowance or has enhanced protection, fixed protection 2014 or fixed protection 2016, an excepted group life policy may be in place.

LIFETIME ALLOWANCE CHARGE

The lifetime allowance charge applies when, at a BCE, the value crystallising in an individual's pension scheme is worth more than their available lifetime allowance:

- If the excess is a pension, there's a 25% charge.
- If the excess is a lump sum, there's a 55% charge.

It is the scheme administrator who must establish whether a chargeable amount arises at a BCE in a member's lifetime. But responsibility for paying any lifetime allowance charge is a joint one between the scheme administrator and the member.

As can be seen from the above, the lifetime allowance reduced over the past few years to April 2018, after which it has increased slightly for two years, it is due to increase in the future in line with the consumer prices index. Individuals can choose to retain a previous limit but there are some consequences of making such an election. The options available and the deadlines for application to HMRC are as follows:

- fixed protection 2014 (applications were made by 5 April 2014)
- fixed protection 2016 (no current end date)
- individual protection 2014 (applications were made by 5 April 2017)
- individual protection 2016 (no current end date)

FIXED PROTECTION 2014

This enabled the individual to retain a lifetime allowance of £1.5m.

The following conditions need to be met to maintain fixed protection (FP) 2014:

1. No new contributions can be paid into a money purchase scheme after 5 April 2014.
2. No new pension arrangement may be started, other than to receive a transfer of rights from an existing pension scheme.
3. The amount of benefits an individual can build up each year under a defined benefit scheme (or a cash balance scheme) after 5 April 2014 will be limited to the ‘relevant percentage’, which is either:
    a. an annual rate used to increase rights and which was specified in the scheme’s rules on 11 December 2012 or, if no such increases,
    b. the percentage by which the consumer prices index (CPI) increased in the year ending in September of the previous tax year. The percentage will be nil if there is no increase in the CPI or there is a fall in the CPI.
4. If an individual’s employer is subject to automatic enrolment, the individual will be automatically enrolled into the employer’s scheme. If the employee has FP 2014, that employee will have one month to opt out of the auto-enrolment scheme, otherwise FP 2014 will be lost.

INDIVIDUAL PROTECTION 2014

An individual with individual protection (IP) 2014 will have their lifetime allowance fixed at an amount known as the ‘relevant amount’. This is equal to the value of their pension rights on 5 April 2014 provided that these were more than £1.25m. However, the ‘relevant amount’ cannot be larger than £1.5m. So IP 2014 allowed individuals to crystallise benefits worth between £1.25m and £1.5m (depending on their value on 5 April 2014) without paying a lifetime allowance charge.

The following conditions needed to be met to apply for IP 2014:

1. They must have one or more ‘relevant arrangement’ on 5 April 2014.
2. Their relevant amount on 5 April 2014 is more than £1.25m.
3. They do not have primary protection (whether active or dormant).

An individual could apply for IP 2014 even if they already have enhanced protection, fixed protection or fixed protection 2014.

Once HMRC has accepted and processed the application, it sends a certificate to state that the individual has IP 2014 with the amount protected. The member should keep this so that the relevant information can be provided to their pension scheme(s) if they want to rely on this protection when taking their benefits from the scheme(s).

Where the member's IP 2014 is dormant because they have one of enhanced protection, fixed protection or fixed protection 2014, then HMRC will write to confirm that the IP 2014 application has been accepted. As these other protections are more favourable than IP 2014, the IP 2014 certificate won't be issued unless and until the member's IP 2014 becomes active because they have lost the other form of protection and notified HMRC of this, as they are required to do.

It had been possible to protect pre-6 April 2006 benefits from the lifetime allowance charge using primary and enhanced protection.

An individual has 'relevant arrangement' if on 5 April 2014:

- they are a member of one or more registered pension schemes and/or
- they are a 'relieved member' of a 'relieved non-UK pension scheme.

The relevant amount is the total value on 5 April 2014 of the member's pension rights in all relevant arrangements.

FIXED PROTECTION 2016

It was not possible to claim this before 6 April 2016 because as part of the application, members must provide information as at 5 April 2016. FP 2016 fixes your lifetime allowance to protect your pension savings at £1.25m after 5 April 2016. However, the savings in any of your pension schemes cannot be increased without consequences, except in limited circumstances. The consequences if pension savings are increased are:

- loss of FP 2016 and

- pay tax on any pension savings above the standard lifetime allowance when benefits are withdrawn.

Whether or not the individual can apply for FP 2016 will also depend on any other protection they already have as follows:

Protection	Can I get fixed protection 2016?
None	Yes
Primary protection	No. If you have lost your primary protection you should tell HMRC in writing
Individual protection 2014	Yes, but fixed protection 2016 will be dormant until you lose your protection. If you lose IP 2014 you should tell HMRC in writing
Individual protection 2016	Yes
Enhanced protection	No. If you have given up your protection you should tell HMRC in writing
Fixed protection 2012	No. If you have lost your protection you should tell HMRC in writing
Fixed protection 2014	No. If you have lost your protection you should tell HMRC in writing

There is currently no application deadline for these protections. However, individuals will need to apply for protection before they take their benefits as they will need the HMRC reference number if they want to rely on the protection. This means that those wanting to rely on IP 2016 or FP 2016 should apply before they take any benefits on or after 6 April 2016. This is so that those benefits can be tested against the higher lifetime allowance provided by these protections rather than the current £1,055,000 standard lifetime allowance. This applies even when the benefits being taken are worth less than £1,055,000.

If the individual doesn’t have the reference number, then the amount of the BCE will be expressed as a percentage of £1,055,000, rather than the higher protected lifetime allowance.

INDIVIDUAL PROTECTION 2016

As with FP 2016, it was not possible to claim this before 6 April 2016 because, as part of the application, members must provide information as at 5 April 2016.

An individual can apply for IP 2016 if their pension savings were more than £1m at 5 April 2016. This protects their lifetime allowance to the lower of:

- the value of their pension savings at 5 April 2016 and
- £1.25m.

The individual can continue to pay into their pension but when they take the benefits they will pay tax on the savings above the protected lifetime allowance.

Whether or not the individual can apply for IP 2016 will also depend on any other protection they already have as follows:

Protection	**Can I get individual protection 2016?**
None	Yes
Primary protection	No. If you have lost your primary protection you should tell HMRC in writing: bit.ly/hmrc-ps
Individual protection 2014	No
Enhanced protection	Yes, but IP 2016 will be dormant until you give up your protection. If you give up your protection you should tell HMRC in writing
Fixed protection 2012	Yes, but IP 2016 will be dormant until you lose your protection. If you have lost your protection you should tell HMRC in writing
Fixed protection 2014	Yes, but IP 2016 will be dormant until you lose your protection. If you have lost your protection you should tell HMRC in writing
Fixed protection 2016	Yes, but individual protection 2016 will be dormant until you lose your protection. If you have lost your protection you should tell HMRC in writing

SUMMARY

As can be seen from the above, individuals or their independent financial advisers must obtain the values and information that are required to obtain the pension value information from pension providers.

Examples have been provided below to illustrate the impact of the allowance, lifetime charge and protection applied for and used. It is a choice that some individuals will need to consider.

EXAMPLES OF LIFETIME ALLOWANCE CHARGE

The following examples illustrate the impact of the allowance and lifetime allowance charge.

Example 1

Mr Smith has been contributing to a defined contribution pension scheme for many years and this is the only pension scheme he is a member of. He has not elected for any lifetime allowance protection and he has not made any withdrawals from the pension scheme. On 31 May 2019 Mr Smith is 75 years old and the value of his pension scheme at that date is £1,500,000.

Reaching age 75 with a defined contribution pension scheme is a benefit crystallisation event

	£
Amount crystallised	1,500,000
Individual’s lifetime allowance as at 31 May 2019	1,055,000
Excess	445,000
Lifetime allowance charge at 25%	111,250

Example 2

Situation is similar to example 1 above, except Mr Smith has applied for IP 2014. The value of his pension scheme as at 5 April 2014 was £1,300,000.

Reaching age 75 with a defined contribution pension scheme is a benefit crystallisation event

	£
Amount crystallised	1,500,000
Individual's lifetime allowance as at 31 May 2019	1,300,000
Excess	200,000
Lifetime allowance charge at 25%	50,000

In this example, the lifetime allowance was fixed at an amount known as the 'relevant amount', being the value of the fund on 5 April 2014. This value needs to be more than £1.25m and if it is over £1.5m the relevant amount is £1.5m. By making this election for individual protection 2014, a tax saving of £61,250 has been made ((£1,300,000 less £1,055,000) at 25%).

Example 3

Charles died on 8 July 2019 aged 68, leaving a widow, Mary. Charles had been a member of three registered pension schemes in his lifetime: schemes A, B and C.

Charles was taking all his benefits from scheme A as flexi-access drawdown pension and from scheme B as a scheme pension. Charles has taken no benefits from scheme C. The funds remaining in scheme A are used to provide Charles's son with a flexi-access drawdown fund lump-sum death benefit. Scheme B provides Mary with a dependants' scheme pension. As neither of these death benefits are within BCE 5C, BCE 5D or BCE 7, they do not affect the lifetime allowance position following Charles's death.

Scheme C pays Mary a £395,000 defined benefit lump-sum death benefit on 9 November 2019. This is a relevant lump sum death benefit falling within BCE 7. Scheme C tells Mary that there is a possibility that she will become liable to a lifetime allowance charge on the payment.

As the amount of £395,000 is less than 50% of the standard lifetime allowance for the 2019-20 tax year of £527,500 (50% of £1,055,000 = £527,500), the scheme administrator does not have to make a report to HMRC.

- Scheme A says Charles had used up 50% of the standard lifetime allowance under its scheme. (This related to a pension commencement lump sum and designation to drawdown during Charles's lifetime.)
- Scheme B says Charles had used up 40% of the standard lifetime allowance under its scheme. (This related to a pension commencement lump sum and the scheme pension.)
- Scheme C says Charles had used up no lifetime allowance under its scheme prior to the payment of the defined benefit lump sum death benefit.

Therefore, Charles had used up 90% of the standard lifetime allowance (his lifetime allowance entitlement) when he died. So he had 10% available. This equates to £105,500 at 8 July 2019, the effective date of BCE 7, when the standard lifetime allowance is £1,055,000. A chargeable amount of £289,500 crystallised through BCE 7 in relation to the £395,000 defined benefit lump sum death benefit paid (being £395,000 less £105,500). HMRC will assess Mary for the £159,225 lifetime allowance charge due (55% of the chargeable amount of £289,500).

Mary has 30 days from the date of the assessment to account for the due charge.

Example 4

John is a member of a defined benefits arrangement. He decides to take his benefits in the tax year ended 5 April 2020 when the standard lifetime allowance is £1,055,000. John has already used up 90% of his lifetime allowance and is subject to the standard lifetime allowance.

John is entitled to a scheme pension of £11,250 per annum and a lump sum of £75,000. Before paying out the benefits, the scheme administrator calculates the amount that would crystallise for lifetime allowance purposes if those entitlements were drawn. This comes to £300,000; the scheme pension would crystallise £225,000 through BCE 2 (£11,250 x a relevant valuation factor of 20 added to the £75,000 that would potentially crystallise through BCE 6 on the payment of the lump sum benefit). So the amount crystallising would be 28.4% of the £1,055,000 standard lifetime allowance.

Once the scheme administrator has written to John telling him the above and has received back details of his available lifetime allowance, the scheme administrator establishes that only the first £105,500 crystallising will be covered by the available lifetime allowance (10% of £1,055,000). The remaining £194,500 would fall as a chargeable amount, if paid as anticipated by the scheme administrator as a scheme pension/lump sum combination.

Using the 20:1 relevant valuation factor, the scheme administrator establishes that a scheme pension of £3,956.25 (which represents a crystallised value of £79,125 through BCE 2), with the maximum permitted pension commencement lump sum of £26,375, would take John up to his 100% lifetime allowance level of £105,500. The remaining lump sum entitlement of £48,625 (£75,000 less £26,375) will still be paid, but as a lifetime allowance excess lump sum.

John is given the option of giving up the remaining £3,956.25 scheme pension in return for a further lifetime allowance excess lump sum. However, the scheme uses a commutation factor of 15:1 to give John £59,343.75 (£3,956.25 x 15) in return for giving up this part of his pension entitlement.

John decides to take the lump sum option giving a total (gross) lifetime allowance excess lump sum of £107,968.75 (£48,625 + £59,343.75). This is the chargeable amount for the purposes of the lifetime allowance charge. After the scheme administrator deducts the 55% lifetime allowance charge due from this payment John gets a net lump sum of £48,586 (£107,968.75 less £107,968.75 x 55%). This net lump sum is the amount which crystallises for lifetime allowance purposes through BCE 6.

The amount actually crystallising for lifetime allowance purposes is £154,086 (£105,500 + £48,586). This is made up of the following elements:

- the maximum pension commencement lump sum payment of £26,375 crystallising through BCE 6. This is ranked as the first BCE that occurs

- the reduced scheme pension entitlement of £3,956.25 per annum crystallises £79,125 through BCE 2. This is ranked as the second BCE that occurs
- a lifetime allowance excess lump sum payment of £48,586 crystallising through BCE 6. This is ranked as the third BCE that occurs.

So the chargeable amount arising is actually only £107,968.75, not the £194,500 (£300,000 less £105,500) amount anticipated originally, based on John's full scheme pension entitlement.