ADVISER GUIDE

Lifetime allowance 2023/24

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IMPORTANT

This information is based on current understanding of current pension tax rules. This is provided for information only; we do not provide advice.

Tax rules may change in the future and the tax treatment depends on personal circumstances. This guide and the included case studies are provided for professional advisers' use only.

Lifetime allowance background

Back in 2006, when sweeping changes were made to the UK pensions regime, the lifetime allowance was introduced as part of the simplification process.

This was introduced as a maximum on all pension savings accumulated in a lifetime, with a tax charge applying on any excess. Pension savings are tested against the lifetime allowance at certain points in time. These relate primarily to accessing pension benefits, but can also apply at age 75, on death, and in limited circumstances to increases in scheme pensions.

Spring Budget 2023

In the Spring Budget on 15 March 2023 it was announced that the lifetime allowance would be abolished from 6 April 2024. The maximum Pension Commencement Lump Sum (PCLS) for those without protection will remain at £268,275 and will be frozen thereafter.

As an interim measure in the 2023/24 tax year the Lifetime Allowance Charge (LTAC) has been removed. There are also changes to the conditions for Enhanced and Fixed Protections, and changes to how PCLS is calculated for those who hold Enhanced Protection with a protected lump sum, and to how stand-alone lump sums are treated.

The changes relating to the 2023/24 tax year were confirmed in the Finance (No.2) Bill published on 23 March 2023, which has now received Royal Assent and forms Finance (No.2) Act 2023. This guide explains those changes.

Benefit Crystallisation Events

The lifetime allowance remains in place at £1,073,100 for the 2023/24 tax year. This means that pension scheme administrators must still report Benefit Crystallisation Events (BCEs) to HMRC as previously.

We will continue to ask for information on any earlier crystallisation events and details of any protections held by the member. We will still issue benefit statements which say how much of the lifetime allowance has been used.

Tax treatment of funds above the lifetime allowance

Where the lifetime allowance is exceeded, there is no longer any LTAC to pay. However, depending on how the excess is dealt with, there may still be income tax to pay.

In circumstances where the excess is used to provide an income – i.e. designated to drawdown, used to buy an annuity, or used to provide a scheme pension – then the 25% LTAC no longer applies. As usual these funds will still be subject to income tax when withdrawn.

If the excess is taken as a lump sum which would previously have been subject to the LTAC at 55%, then these funds will now be subject to income tax instead. This includes serious ill-health lump sums, uncrystallised funds lump sum death benefits, defined benefits lump sum death benefits and lifetime allowance excess lump sums.

In relation to the death benefit lump sums, it is the responsibility of the personal representative of the deceased to report the lifetime allowance usage to HMRC. HMRC will then charge income tax as appropriate on beneficiaries in receipt of lump sums (this is the same process as previously – all that is changed is that it is income tax that will be charged not the LTAC at 55%).

Pension Commencement Lump Sums

In 2023/24 the maximum PCLS will remain as 25% of the lifetime allowance – i.e. £268,275. From 2024/25 onwards when the lifetime allowance is removed the maximum amount of PCLS will be frozen at this level.

However, see below regarding those who hold protection.

Enhanced Protection with lump sum protection

The Finance (No.2) Act 2023 confirms that anyone who held valid Enhanced Protection on 15 March 2023 can make contributions or start benefit accrual from 6 April 2023 and keep their right to higher PCLS.

For members with Enhanced Protection with a protected lump sum the maximum amount of PCLS they are entitled to will be capped at the maximum that would have been payable on 5 April 2023.

It is possible to hold Enhanced Protection with lump sum protection if the individual's lump sum pension rights were more than £375,000 on 5 April 2006. These lump sum rights will be expressed as a percentage. When this percentage is stated on the protection certificate the member will now be entitled to that percentage of their fund as PCLS up to the maximum calculated on 5 April 2023. The percentage can be more or less than 25%.

Example

Fund value at 5 April 2006 = £2 million
Lump sum rights at 5 April 2006 = £400,000
Protected lump sum rights = 20%

Fund value at 5 April 2023 = £4.5 million
Lump sum rights at 5 April 2023 = £900,000
Fund value when crystallised = £5 million
Lump sum rights capped at £900,000

Stand-alone lump sums

For those that hold stand-alone lump sum protection in relation to rights held on 5 April 2006, the maximum amount that can be paid out tax-free will be capped at the value as at 5 April 2023. Any amount above this level will be subject to income tax.

Other protections and lump sums

There are no changes in 2023/24 as to how maximum PCLS is calculated for those that hold Enhanced Protection (no lump sum protection), Primary Protection, any of the Fixed Protections, or either of the Individual Protections.

The only change in the rules for those with Enhanced or Fixed Protection is that where these protections had been applied for before 15 March 2023, then making contributions from 6 April 2023 onwards will not break the protection.

For anyone holding Enhanced, Primary or Fixed Protection 2014, their maximum PCLS will be 25% of the fund crystallised up to a maximum of £375,000 (i.e. based on lifetime allowance of £1.5 million).

For Fixed Protection 2012 the maximum PCLS is £450,000 (based on lifetime allowance of £1.8 million), for Fixed Protection 2016 the maximum is £312,500 (based on lifetime allowance of £1.25 million), and for either of the Individual Protections the maximum will be 25% of their protected lifetime allowance value.

Late applications

It is still possible to apply for Fixed or Individual Protection 2016, if the conditions are met.

To be eligible for Fixed Protection 2016 then no contributions or relevant benefit accrual can have been made on or after 6 April 2016. If an application for Fixed Protection 2016 is successful then the holder will be entitled to PCLS of 25% of their fund up to a maximum of £312,500. However, if the application is made on or after 15 March 2023 then making any contributions will invalidate the protection. This is different to where protection was held prior to 15 March 2023.

To apply for Individual Protection 2016 the fund value on 5 April 2016 had to be over £1 million. The protected PCLS will now be 25% of the 5 April 2016 value subject to a maximum of £312,500 (25% of £1.25 million).

Regulations allow for late applications for Primary and Enhanced Protection where:

- there is a reasonable excuse for not giving the notification by the closing date; and
- the notification is completed without unreasonable delay once the reasonable excuse has ceased.

If HMRC refuses to consider the late application an appeal process through the tax tribunals is available.

There is no such provision for late applications relating to any of the closed Fixed or Individual Protections.

If a successful late application for Enhanced Protection was made after 15 March 2023, then any contributions would invalidate the protection.

Enhancement factors

There are certain circumstances when individuals may be entitled to one or more lifetime allowance enhancement factors (LAEF). Generally these relate to pension rights held that have already been tested against the lifetime allowance, or to benefits that have not had the benefit of receiving tax relief in the UK. Although technically it is still possible to apply for these, there is little point in doing so as they only protect from the lifetime allowance charge, which no longer applies; they do not enhance PCLS.

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