

## ADVISER GUIDE

---

# Transitional arrangements and transitional tax-free amount certificates

### In this guide:

Background	2
Standard transitional calculation	2
Transitional tax-free amount certificates	3
Who could benefit from a certificate?	3
Example scenarios	4
Calculations where protection is held	7
Pre-commencement pensions	7
Applying for the certificate	7



**Transitional tax-free amount certificates can put clients in a worse position than under the standard transitional calculation. Scheme administrators cannot ignore a certificate once issued.**

**Do not apply for a certificate unless you have checked that it puts your client in a better position.**

## 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.

## Background

From 6 April 2024 pension benefits are only tested when lump sums are taken. These are known as relevant benefit crystallisation events (RBCEs).

There are two main allowances:

- **Lump sum allowance (LSA)** set at £268,275; and
- **Lump sum and death benefit allowance (LSDBA)** set at £1,073,100.

Tax-free lump sums that will be tested against the LSA are:

- Pension commencement lump sums (PCLS); and
- Tax-free part of uncrystallised funds pension lump sums (UFPLS).

Lump sums that are tested against the LSDBA are:

- Pension commencement lump sums (PCLS)
- Tax-free part of uncrystallised funds pension lump sums (UFPLS)
- Serious ill-health lump sums
- Defined benefits lump sum death benefits
- Pension protection lump sum death benefits
- Uncrystallised funds lump sum death benefits
- Annuity protection lump sum death benefits
- Drawdown pension fund lump sum death benefits
- Flexi-access drawdown lump sum death benefits

Importantly there are no tests for accessing pensions as income, be that for the member, or for their beneficiaries following their death. This means that provided death benefits can be paid as income then the available LSDBA is irrelevant (except for serious ill-health lump sums).

## Standard transitional calculation

Where benefits have been taken before 6 April 2024 there is a standard transitional calculation that reduces the available LSA and LSDBA. This will be calculated at the first RBCE after 6 April 2024. The calculation is based on the lifetime allowance (LTA) previously used.

If 100% of the LTA has been used the available LSA will be nil (but applications can still be made for certificates – see below).

Otherwise, the LSA will be reduced by 25% of the LTA used.

How to calculate available LSA at first RBCE under standard transitional calculation:

**Step 1: Calculate the equivalent amount (E)**

$$25\% \times (\% \text{ LTA used}) \times \pounds 1,073,100 = E$$

**Step 2: LSA is reduced by equivalent amount**

$$\pounds 268,275 - E = \text{LSA available at first RBCE}$$

For example, if 40% of the LTA has been used, the equivalent amount is  $25\% \times 40\% \times \pounds 1,073,100 = \pounds 107,310$ .

The LSA ( $\pounds 268,275$ ) is reduced by the equivalent amount ( $\pounds 107,310$ ) to give available LSA of  $\pounds 160,965$ .

The LSDBA will be reduced by an amount equal to the appropriate percentage of LTA used:

- 100% LTA used when the member has taken a serious ill-health lump sums (SIHLS) pre age 75;
- 100% LTA used when a lump sum death benefit has been paid in relation to member who died pre age 75; or
- 25% of LTA used.

In most cases where no SIHLS or death benefit lump sums have already been paid the reduction for the LSDBA will therefore be the same as for the LSA. So, using the example above, the LSDBA would also be reduced by  $\pounds 107,310$  to leave  $\pounds 965,790$  available.

On death after 6 April 2024, any lump sum death benefits paid from funds that were crystallised before 5 April 2024 are not tested against the LSDBA.

### Transitional tax-free amount certificates

If less than the equivalent amount (as calculated under the standard transitional calculation above) has been taken as a tax-free lump sum, then the available LSA may be increased by applying for a certificate.

The certificate replaces the standard transitional calculation and instead of deducting the equivalent amount from the standard LSA, it deducts actual tax-free lump sums taken.

**Certificates use the amount of tax-free lump sums actually taken to calculate the available LSA.**

### Who could benefit from a certificate?

Anyone who has taken tax-free lump sums that total less than the equivalent amount under the standard calculation could potentially benefit from a certificate.

This is most likely for clients in the following scenarios:

- those who have taken less than 25% PCLS;
- over 75s who have not taken all PCLS; and
- those who took PCLS when LTA was less than  $\pounds 1,073,100$ .

Maximum PCLS is restricted to the lower of:

- one third of the funds used to provide pension income;
- available LSA; and
- available LSDBA.

Having a higher LSA will not increase PCLS if there are not enough uncrystallised funds to be used to provide pension income.

## Example scenarios

Before applying for a certificate, a comparison with the standard calculation should be carried out.

The scenarios below demonstrate that whilst some clients may be better off with a certificate, others would lose out when compared to the standard calculation.

### Less than 25% PCLS taken



#### Raheem

- 80% LTA used in January 2014 (LTA was £1.5 million)
- Only took 20% PCLS (£240,000)
- Still has £400,000 uncrystallised

#### Raheem's standard calculation

- Equivalent amount =  $25\% \times 80\% \times £1,073,100 = £214,620$
- Remaining LSA =  $£268,275 - £214,620 = £53,655$

#### Raheem's available LSA under certificate

- Remaining LSA =  $£268,275 - £240,000 = £28,275$

If Raheem applied for a certificate his LSA would be £28,275, whereas under the standard calculation it is £53,655. This is despite him only taking 20% PCLS.



Raheem should **not** apply for a certificate



#### Rachel

- 80% LTA used in January 2016 (LTA was £1.25 million)
- Only took 20% PCLS (£200,000)
- Still has £400,000 uncrystallised

#### Rachel's standard calculation

- Equivalent amount =  $25\% \times 80\% \times £1,073,100 = £214,620$
- Remaining LSA =  $£268,275 - £214,620 = £53,655$

#### Rachel's available LSA under certificate

- Remaining LSA =  $£268,275 - £200,000 = £68,275$

If Rachel applied for a certificate her LSA would be £68,275. As she has sufficient uncrystallised funds to support a larger PCLS payment than under the standard calculation (£53,655) she would be able to take higher PCLS with a certificate.



Rachel should apply for a certificate

## Over 75s who have not taken all PCLS



### Dominic

- Turned 75 before 6 April 2024
- 40% LTA used in January 2020 (LTA was £1,055,000)
- Standard 25% PCLS taken (£105,500)
- Used further 50% LTA at age 75 test
- Still has £500,000 uncrystallised.



Dominic should apply for a certificate

#### Dominic's standard calculation

- Equivalent amount =  $25\% \times 90\% \times £1,073,100 = £241,447.50$
- Remaining LSA =  $£268,275 - £241,447.50 = £26,827.50$

#### Dominic's available LSA under certificate

- Remaining LSA =  $£268,275 - £105,500 = £162,775$

Under the standard calculation Dominic would only have £26,827.50 PCLS available. If he applied for a certificate his LSA would be £162,775. This would allow him to take £125,000 PCLS (with £375,000 used for pension income).



### Deborah

- Turned 75 before 6 April 2024
- 40% LTA used in January 2020 (LTA was £1,055,000)
- Standard 25% PCLS taken (£105,500)
- Used further 50% LTA at age 75 test
- Still has £100,000 uncrystallised.



Deborah does **not** need to apply for a certificate

#### Deborah's standard calculation

- Equivalent amount =  $25\% \times 90\% \times £1,073,100 = £241,447.50$
- Remaining LSA =  $£268,275 - £241,447.50 = £26,827.50$

Under the standard calculation Deborah has £26,827.50 LSA available. If she applied for a certificate her LSA would be higher, but this would not give her any more entitlement to PCLS as the maximum she can take from her £100,000 uncrystallised fund is £25,000. Her fund would need to be above £107,310 at her first RBCE for her to benefit from having the certificate.

## 25% PCLS taken when LTA below £1,073,100



### Louis

- 60% LTA used in May 2018 (LTA was £1,030,000)
- 25% PCLS taken (£154,500)
- £500,000 uncrystallised

#### Louis' standard calculation

- Equivalent amount =  $25\% \times 60\% \times £1,073,100 = £160,965$
- Remaining LSA =  $£268,275 - £160,965 = £107,310$

#### Louis' available LSA under certificate

- Remaining LSA =  $£268,275 - £154,500 = £113,775$

If Louis applied for a certificate his LSA would be £113,775, whereas under the standard calculation it is £107,310. As Louis has £500,000 uncrystallised, he could take the full £113,775 as PCLS if he applies for the certificate. This is £6,465 more than under the standard calculation.



Louis should apply for a certificate



### Avril

- 60% LTA used in May 2018 (LTA was £1,030,000)
- 25% PCLS taken (£154,500)
- £100,000 uncrystallised

#### Avril's standard calculation

- Equivalent amount =  $25\% \times 60\% \times £1,073,100 = £160,965$
- Remaining LSA =  $£268,275 - £160,965 = £107,310$

The standard calculation gives Avril LSA in excess of her entire uncrystallised fund. There is no benefit in applying for the certificate if she has her first RBCE when her fund is valued at £100,000 as the permitted maximum PCLS is only £25,000, which is well below the available LSA.



Avril does **not** need to apply for a certificate

## Calculations where protection is held

Where any of the fixed or individual protections are held, the client's LSA will be equal to the protected pension commencement lump sum amount, and the LTA used in the standard calculation will be equal to the protected lifetime allowance amount.



### Olga

- 45% LTA used in 2018
- No PCLS taken
- IP2014 of £1.5 million held
- £1.8 million uncrystallised

#### Olga's standard calculation

- Equivalent amount =  $25\% \times 45\% \times \text{£}1,500,000 = \text{£}168,750$
- Remaining LSA =  $\text{£}375,000 - \text{£}168,750 = \text{£}206,250$

#### Olga's available LSA under certificate

- Remaining LSA =  $\text{£}375,000 - \text{£}0 = \text{£}375,000$

Olga can apply for a certificate to get entitlement to her full protected PCLS of £375,000.



Olga should apply for a certificate

## Pre-commencement pensions

Where the member started taking pension benefits before the introduction of the LTA on 6 April 2006, they may have pre-commencement pensions still in payment. If this is their only pension, they cannot apply for a certificate. After 6 April 2024 these client's LSA and LSDBA will be reduced by 25% of the total capital value of the pension (capital value is defined as 25 x pension in payment, for those in drawdown it is 25 x 80% of the capped drawdown maximum).

For those that also had a benefit crystallisation event (BCE) in the period 6 April 2006 to 5 April 2024, they are permitted to apply for a certificate. However, the pre 6 April 2006 lump sum will always be calculated as 25% of the LTA reduction calculated at the first BCE, even if no lump sum was taken. This will reduce the number of clients with pre-commencement pensions who would be better off with a certificate.

## Applying for the certificate

Under the legislation it is possible to apply for a certificate from the scheme administrator of any scheme of which the client is a member. In practice, HMRC expects the application to be made to the scheme where the first RBCE takes place after 6 April 2024.

**Applications for certificates must be made before the first RBCE after 6 April 2024**

To obtain a certificate complete evidence of all the following lump sums that have been paid between 6 April 2006 and 5 April 2024 must be provided:

- PCLS (tax-free)
- UFPLS (25% tax-free)
- SIHLS paid before age 75 (tax-free)

AJ Bell will accept evidence in the form of the letter received from the scheme at the time the lump sum was paid. If that is not available, then a more recent letter or email from the scheme administrator is an alternative option. The letter or email must state the pension scheme, policy number or reference (where applicable), the type of lump sum, amount of lump sum, and date paid.

Where no lump sum was taken (for example where a scheme pension was taken from a defined benefit scheme with no lump sum), then the letter or email should confirm this in some way.

For age 75 tests there is no evidence as such, other than date of birth and confirmation from the member that no lump sum has been taken.

We will also need evidence of the lifetime allowance reduction in respect of any pre-2006 pensions. This information should be on the confirmation letter received at the first BCE on or after 6 April 2006.

The application will also need to confirm total lifetime allowance used in percentage terms.

We have a standard application form to complete and submit along with the appropriate evidence.

There is no need to provide evidence relating to AJ Bell pension schemes as we will already have this on file, but details do need to be added to the form.

The legislation allows scheme administrators to determine what is “complete evidence”, so what is acceptable may vary from scheme to scheme.

Once complete evidence is submitted, schemes have three months to issue the certificate. The certificate must be issued before the first RBCE takes place. It is not possible to take a lump sum, get the certificate, and later use it to get extra lump sum allowance.

The legislation also states that once a scheme is aware of a certificate it cannot ignore it and revert to the standard transitional calculation. This means it is very important that a comparison is made between the equivalent amount under the standard calculation and the actual tax-free lump sums taken. If the actual lump sums taken are higher than the equivalent amount, then no application should be made.

**Scheme administrators cannot ignore a certificate, even when it puts the member in a worse position.**

The certificate will state the member’s name, address, NI number, LTA usage (%) and both the lump sum transitional tax-free amount to be deducted from the LSA and the lump sum and death benefit transitional tax-free amount to be deducted from the LSDBA. Once issued this certificate can be presented to any other scheme of which your client is a member.