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The Abolishment of the Lifetime Allowance

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Hopefully it is not much of a surprise to many when we say that 2023 has been a busy year for pension legislation. On the 15 March 2023, as part of his Spring Budget, Jeremy Hunt announced that lifetime allowance (LTA) was being 'abolished'.

Whilst this is generally good news for pension savers, it has meant that legislation needs to be amended before 6 April 2024. As a result, HMRC issued draft abolition legislation for consultation, which ended on 12 September.

Based on this draft legislation, we have looked at what the changes could mean for pension savers from the 2024/25 tax year in relation to lump sum payments, both in relation to tax-free cash payments and death benefits.

Tax-free cash entitlement

Currently the payment of tax-free cash is based on a two-pronged approach, and is the lower monetary figure of the following:

25% of the amount crystallising "The applicable amount"	25% of the available Lifetime Allowance "The available portfion"

Mrs Jones has a pension valued at £800,000, has not accessed any pension funds previously and does not hold any pension protection.

In the current tax year, her tax-free cash entitlement would be **£200,000.**

This is based on the lower of:

Applicable Amount = £200,000 (£800,000 x 25%)

Available Portion = £268,275 (£1,073,100 x 0.25%)

Result – Mrs Jones would also have used £800,000 of her available LTA.

From 6 April 2024, due to the removal of the LTA, the two-pronged approach above changes to a three-pronged approach with the introduction of two new allowances:

25% of the amount crystallising "The applicable amount".	Available Lump Sum Allowance £268,275	Available Lump Sum and Death Benefit Allowance £1,073,100

So what are these allowances and what do they mean?

Applicable Amount

There is no change here from the current approach and is generally 25% of the amount being crystalised (unless protected tax-free is held or can be different amount for Defined Benefit pensions).

Lump Sum Allowance (LSA)

The Government have effectively said that regardless of your pension value, £268,275 is effectively a line in the sand and is always going to be the maximum amount of tax-free cash which can be taken, effectively this is the LSA. There are currently no provisions for this to increase.

Anybody who holds any form of Lifetime Allowance protection will benefit from a higher LSA in line with their protection level which is as follows:

Protection Type	Protection Level	LSA
Fixed 2012	£1.8 million	£450,000
Fixed 2014	£1.5 million	£375,000
Fixed 2016	£1.25 million	£312,500
None	n/a	£268,275

The available allowance will reduce with any payment of tax-free lump sum payments.

Lump Sum and Death Benefits Allowance (LSDBA)

This new allowance will again have a standard value of £1,073,100, once again with no provisions for this to increase. However, those with LTA protections will have a LSDBA based on their protected LTA (e.g. an individual with Fixed Protection 2016 will have a LSDBA of £1.25 million).

The circumstances in which the LSDBA reduces are slightly wider than the LSA above, it includes any tax-free lump sum payments but also the payment of lump sum death benefits.

So, how does the introduction of these two new allowances impact Mrs Jones' tax-free cash entitlement if she was to take the funds in the 2024/25 tax year?

Mrs Jones has a pension valued at £800,000, has not accessed any pension funds previously and does not hold any pension protection.

In the 2024/25 tax year, her tax-free cash entitlement would still be **£200,000.**

This is based on the lower of:

Applicable Amount = £200,000 (£800,000 x 25%)

Available LSA = £268,275

Available LSDBA = £1,073,100

Result – Mrs Jones will have used £200,000 of her available LSA and LSDBA.

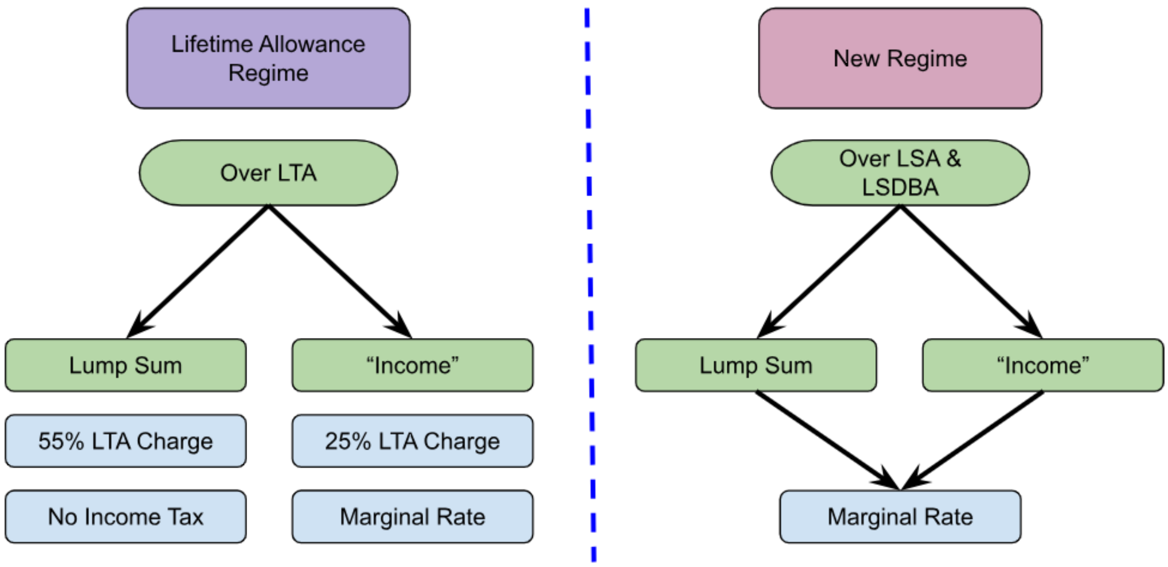
Whilst not relevant for Mrs Jones, the draft legislation has created a situation where some people will be entitled to more and some less tax-free cash entitlements than they would have been able to take prior to the abolition of the LTA. We feel this to be unintended, and therefore feel this could be reviewed and amended before the start of the 2024/25 tax year.

Exceeding the LSA or LSDBA

Previously, if you took any pension funds above your applicable LTA you were faced with a LTA tax charge depending on how these were taken, either a Lump Sum payment or as income. Additionally, if the excess was taken as income, this would also be liable for income tax at your marginal rate.

With the abolition of the LTA, any funds over the LSA and LSDBA, whether taken as income or lump sum will only be taxable at your marginal rate.

The following provides a comparison of the difference in approaches:



Based on current income tax rates, based on the new regime, an individual will only incur a maximum tax charge of 45%, which is collectively lower than the Lifetime Allowance regime.

Lump Sum Death Benefits

The Government have confirmed that the tax treatment of beneficiary drawdown and beneficiary annuities are yet to be confirmed. Therefore, here we focus solely in the treatment of lump sum death benefits.

These death benefits are largely unchanged in the post 5 April 2024 world. Age 75 will still be key as this will be the point where death benefits become taxable. Likewise, if benefits are not set up within 2 years of the scheme reasonably being aware of the members death, then those benefits will be taxable.

Prior to age 75, benefits will still be tax free up to the new Lump Sum and Death Benefit Allowance, with marginal income tax rates applying to any excess funds.

There is one key change caused by the move to only testing lump sums against allowances. Death benefits paid from crystallised funds e.g. drawdown pots, will now be tested against the LSDBA.

Summary

The removal of the Lifetime Allowance is welcomed by many, the draft legislation contains some significant changes to the pension landscape.

Given the potential for some benefits to be tax free and some to be taxable, a review of pension benefit nominations made prior to age 75 may be required.

Whilst we anticipate there may still be further changes before any of the draft legislation is enacted, at least we have an insight on what the future pensions framework for 2024/25 and beyond may look like.

We will continue to monitor developments of this legislation with great interest and will provide further updates with what they might mean for individuals as things develop.

Risk Warning

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