Broadstone

Budget 2023:

The rise, fall and disappearance of the Lifetime Allowance

March 2023

Introduction

Pensions have been a relatively quiet place at Budget time for the past few years and so it looks like we've been overdue some turmoil.

The headline, which we'll provide some analysis on below, is that the Lifetime Allowance (LTA) is no more. Gone are the days of debating why it is so low and whether it should apply only to defined benefit pensions and not defined contribution savings. The challenge faced by the Chancellor was large numbers of people leaving the workforce for fear of breaching the Lifetime Allowance and incurring the associated tax charges. As always it remains a complex picture, but on the face of it facilitates a massive boost to retirement incomes.

In addition, the Annual Allowance will be increased to £60,000 from £40,000, reducing the number of people likely to exceed the allowance. The Tapered Annual Allowance remains but with some changes; more on that below too.

In an additional response to the challenge of people returning to work but yet restricted in future pension saving by the Money Purchase Annual Allowance of £4,000, the chancellor has increased this to £10,000.

Lifetime Allowance Abolished

Our biggest news is that the Lifetime Allowance is to be abolished; what are the impacts of this?

- From April 2024 members will be able to receive the full value of their pension without restriction on size.
- However, there is a transitional period. For the tax year 2023/24 the Lifetime Allowance will remain in place. However, any excess will be taxed on the recipient's marginal rate only, with the effective LTA charge being set to 0%. This means Lifetime Allowance Excess Lump Sums will still be calculated but taxed differently. From April 2024 the Lifetime Allowance will be removed completely.
- With the Lifetime Allowance came a cap on the pension commencement lump sum or tax-free cash. With the current Lifetime Allowance of £1,073,100 this gave a cap of £268,275. This particular cap is to remain and be frozen until further notice.
- However, members can take a higher tax-free cash if they benefit from one of the other forms of tax-free cash protection:
    - Fixed Protection 2016 - £312,500
    - Fixed Protection 2014 - £375,000
    - Fixed protection 2012 - £450,000
    - Individual Protection 2014 or 2016 – maximum of the equivalent Fixed Protection or based on the member's pension size at the time.
    - Primary Protection – set at the time of application.
    - Enhanced Protection – set at the time of application.
    - Scheme Specific Tax-Free Cash – as per benefits and the scheme's rules.
    - Standalone Lump Sum Rights – entitlements retained.
- Members of defined contribution schemes who wanted more cash, e.g., tax-free cash plus their excess over the Lifetime Allowance (currently taxed at 55%) will now be able to take the fixed sum of £268,275 as tax free cash, with any additional sums withdrawn being taxed at the individuals marginal tax rate. Essentially treated in the same way as any other withdrawals, say under flexible drawdown or UFPLS (Uncrystallised Funds Pension Lump Sum – 'cashing out').

- For defined benefit scheme members, the situation is a little less clear as full guidance has not been issued.
  - For the 2023/24 tax year as the Lifetime Allowance will still exist members will have the option of taking excess over the LTA taxed at their marginal rate.
  - For the 2024/25 tax year and beyond it is less clear, as without the LTA there is no excess to convert to cash. This could limit the level of lump sum payable. We will update further when we have the clarity on this.
- From 6 April 2023, individuals will be able to continue to contribute to pensions and still benefit from any protected tax-free cash – provided they had protection before 15 March 2023 – this is notable and a real benefit to those who may previously have curtailed their accrual for fear of losing protections.
- Employers who had worked with employees to provide cash in lieu of pension contributions should reconsider this option now that the key driver for opting out has been removed. Pension savings are more attractive again for earners who previously were deterred or excluded from further accrual.
- Staff may want to benefit from enrolment into a workplace pension scheme and an employer pension contribution. Employers may need to enrol individuals previously excluded from auto-enrolment on the basis of LTA protections.
- Schemes where members opted out may find people requesting to re-join and should ensure processes are in place to handle such requests.
- Members who did cease pension savings due to Annual Allowance and LTA issues may now also be able to take advantage of any carry forward they've accrued over up to the previous three tax years in order to make a lump sum contribution to their pensions. Individuals who may wish to take advantage of this should seek specialist financial advice.
- The abolishment of the LTA removes the need for employers to operate more complex excepted life schemes for higher earners or those with high levels of pension savings. This will Increase the appeal of standard group life insurance policies.

The removal of LTA reduces many of the complications that employers have had to navigate and tough decisions they have had to make when placing cover for higher earners in their workforce. It also benefits those that have historic defined benefit pensions, and largely renders needless the added complexity of implementing excepted life policies.

Indeed, those who may not have addressed this issue previously can breathe a sigh of relief, as can their members and employees, safe in the knowledge that a relatively lesser-known issue has been removed.

It will be interesting to see if the Government can go a step further and de-link registered group life from pensions altogether – given the few connections that remained were the reporting of lump sum benefits over curtained levels to HMRC.

Businesses will need to review what they've done for group life provision including a review of eligibility criteria.

Annual Allowance increases

There are three areas to consider here:

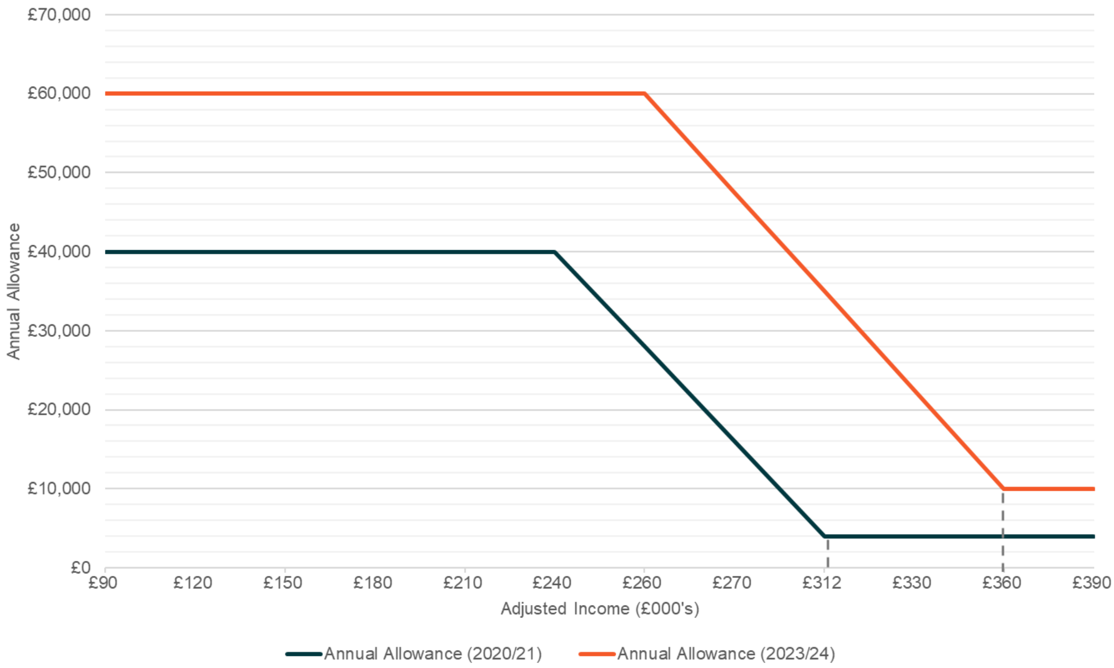
Annual Allowance

Starting with the simplest, the Annual Allowance for the 2023/2024 tax year will be £60,000. This represents a 50% uplift on the current annual limit and will provide more opportunity for individuals to contribute to pensions. This boosts savings potential and reduces the complexity for those that may currently be on course to exceed the current limit. For those currently saving and able to save substantial sums they should be sure they use their allowances in full.

Tapered Annual Allowance

This was introduced to reduce the Annual Allowance for very high earners. Originally set to reduce to £4,000 each tax year, this floor has now been increased to £10,000. The adjusted income threshold is also increased from £240,000 to £260,000. For every £2 of income over the £260,000 the annual allowance is reduced by £1 in a tapered fashion. This would result in a maximum reduction of £50,000 as income reaches £360,000. The table overleaf shows this in effect.

Tapered Annual Allowance Changes



Money Purchase Annual Allowance

This was introduced along with freedom and choice changes in 2015 in order to reduce the temptation to take money tax free from your pension and pay it back into a pension (tax free cash recycling). This is triggered if you take your pot as cash or flex-access drawdown but not if you take only tax-free cash, or if you buy an annuity. The MPAA was originally set at £10,000 but was subsequently reduced to £4,000. This was seen as too low by many in the industry and so has been increased again to £10,000.

This means someone in a 5% matched workplace pension scheme could now continue normal contributions up to a salary of £100,000, rather than those earning over £40,000 per annum being caught (people who are still very firmly in the basic rate tax band). In an environment where an increasing number of older workers expect to retire on a phased basis, re-instating this allowance to its original level significantly reduces how onerous it can be to those who start to access pension monies but continue to work.

Other measures

Defined Contribution Investments

There had been speculation in the lead up to the Budget that the Chancellor should mandate schemes to invest in tech and green start up. The Chancellor has not pledged to do this but has pledged to build upon work already announced to remove barriers to defined contribution schemes investing in these assets.

ISA Limits

All annual subscription limits frozen again. Junior ISA and Child Trust Fund accounts will remain at £9,000, and for adult ISAs will remain at £20,000.

Help to Save

This scheme will be extended until April 2025, a further 18 months, on its current terms. The Government will also launch a consultation to seek views on longer term options to support low-income savers.

Returnerships

To support those over 50 to remain active participants in the workforce, the Government announced it would introduce Returnerships, a new initiative promoting existing skills interventions to over-50s. As part of a broader skills package over the next 2 years, an extension of Midlife MOT coverage, and pension measures (covered within this briefing note) these aim to support ‘experienced’ workers and resolve the c.1million vacancies within the UK economy.

Broadstone comment

There is a lot here to talk about and I am sure the industry will continue the conversation over the coming weeks and months. However, while the abolition of the Lifetime Allowance rightly gets the headlines, indeed it gets ours, it is the construction of a maximum tax-free cash lump sum that will perhaps be the most lasting impact. This is set to be frozen and so will erode in real terms value over time. It also becomes a beacon for future Chancellors to look at and perhaps consider that it needs reducing in order to increase income and tax take. Indeed, it has been mooted over recent years if National Insurance was to apply to pension income, this could well help the Exchequer's coffers.

We should also be mindful of the meddling ways of politicians and the demise of the Lifetime Allowance may yet be exaggerated. A different government may yet reinstate some kind of limit on large pension savings.

We would urge all those who think they're impacted by this to speak to financial adviser as the implications of this are emerging slowly and the action required not always obvious.

Broadstone

Find out more.

For more information on how Broadstone can help you, please contact your Broadstone consultant or use the details below.

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