Broadstone

Lifetime Allowance abolition

Some detail at last

December 2023

Introduction

We have known since the Budget that the Government's intention is to remove the Lifetime Allowance from 6 April 2024. A consultation was held over the summer with industry and the latest set of regulations were laid as part of the Finance Bill 2023/2024, bringing forward changes to tax legislation announced at the Autumn Statement.

A brief read of our note should give you a sense of direction. However, there are still areas missing clarity and we need more from the Government on precisely how the new method will work before we can fully implement the changes.

What is the high level change?

The regulations remove the Lifetime Allowance as a test for scheme administrators to undertake from 6 April 2024 and replace them with two new allowances for lump sum benefit payments to avoid additional tax charges.

- The lump sum allowance – when the Lifetime Allowance was in force rules already restricted the maximum amount of benefits that could be paid as a tax-free cash lump sum. The new lump sum allowance effectively hard-codes 25% of the Lifetime Allowance as tax-free cash at retirement. This is £268,275 and will be used up by members as they take a pension commencement lump sum and/or the tax-free elements of an uncrystallised funds pension lump sum (UFPLS). An UFPLS is when a member takes a lump sum payment directly from their defined contribution pension fund, of which 25% would be tax free.
- Furthermore, there is a lump sum and death benefit allowance of £1,073,100, equal to the current Lifetime Allowance. This will account for the tax-free elements of the above plus serious ill health lump sums and tax-free payments on death, e.g. 5 year guarantee, return of defined contribution fund or death in service lump sums. It doesn't count ALL tax-free elements of lump sums and so the tax-free element of a trivial commutation payment is not included.

Note that there are no clauses providing for increases to the allowances over time and so any changes to these allowances will have to be announced by the Government of the day.

If a benefit payment exceeds one of these allowances then the excess will be taxed at the marginal income tax rate of the recipient.

Some details to consider

Transitional protection – as we know, over many years there have been a raft of Lifetime Allowances protections aimed at reducing the tax impact of the introduction of the Lifetime Allowance and its subsequent reduction. The previous protections still exist and will provide higher lump sum allowances.

Exceeding the lump sum allowance – it is interesting that the regulations allow for an excess lump sum, but only if a pension commences as well. This may restrict the option to take all benefits over the allowance as a lump sum in a defined benefit scheme.

Winners or losers – in general members could expect to pay lower levels of tax than under the old rules (i.e. pre-6 April 2023). However, this may come at the expense of the option to “cash-out” all excess that exists before 6 April 2024.

What about pre-6 April 2024 benefits – the regulations try to deal with scenarios where members have benefits not yet in payment as at 6 April 2024. The general rule of thumb is that a reduction is made equal to 25% of the Lifetime Allowance already used up. There are some exemptions to that, including death lump sums or serious ill health lump sums (SIHLS) where the full percentage used up is recognised. Alternatively, members can provide a certificate of the exact lump sums they have taken and administrators will need to calculate their remaining lump sum allowance on request.

There is also a requirement for schemes to write to members who have no retained pension rights but have previously taken benefits which used up some of their Lifetime Allowance (such as a SIHLS, an UFPLS which represented all of their benefits in the scheme, or an overseas transfer) to confirm the amount of the new lump sum allowance they have used up.

Tests and checks – it was trailed that there would be a requirement for a member to have some lump sum allowance remaining to be able to take a winding up lump sum, trivial commutation lump sum or small pot lump sum. However, this requirement only materialised for the first of these two lump sums in the legislation. Checks against the lump sum death benefit allowance must now also be undertaken by the scheme, whereas it was previously the responsibility of the deceased member’s personal representatives to test against the Lifetime Allowance.

Reporting requirements – we note that as drafted ALL lump sum payments will need to be reported to HMRC via the annual event report; currently we only report in limited circumstances e.g. where benefits are paid over the Lifetime Allowance. Unless HMRC are going to start tracking member events we anticipate this falling away.

Lifetime Allowance gone but not forgotten – it should be noted that, while the Lifetime Allowance will be removed for future events, benefit corrections, such as those caused by GMP equalisation, will still need to consider the Lifetime Allowance as it was to ensure the correct taxation of benefits.

Broadstone comment

We, like the rest of the industry, are getting to grips with over 100 pages of new draft regulations and their impact on our administration processes, communications with members and interactions with HMRC. It is incredibly frustrating that trustees and their administrators have only 3 months to understand and implement changes of this magnitude and complexity.

The industry has already made representations on some of the technical challenges thrown up by the regulations and we will provide an update in the new year as further details and expected, and much needed, guidance emerges. It is also highly likely that further regulations will be issued after 6 April 2024 to deal with technicalities as they arise.

Actions needed

There are some things that trustees and sponsors may need to consider even while the regulations are in draft.

- Do your rules refer to the Lifetime Allowance directly as part of benefit design? If they do, you should liaise with your legal adviser to ensure that there are no unintended consequences of its removal from the regulations.
- Are there any ongoing projects that would benefit from an implementation delay until after 6 April 2024, for simpler and lower tax implications on members? Of course, it is possible the opposite is true and completing a project before 6 April 2024 could be beneficial.
- Keep an eye on views from the Labour Party, as they may yet reintroduce the Lifetime Allowance if returned to power.

Find out more

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