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Making the lifetime allowance easier

May 2016

Introduction

The lifetime allowance is the maximum amount an individual can build up in all of his registered pension schemes without incurring a tax charge. The amount of the lifetime allowance fell on 6 April 2014 from £1.5 million to £1.25 million. It will fall again on 6 April 2016 to £1 million.

9 steps to understanding the lifetime allowance

1. Where an individual's benefits under his registered pension schemes exceed the lifetime allowance, a tax charge, known as the lifetime allowance charge, becomes payable.
2. Scheme administrators need to test whether a member has exceeded the lifetime allowance only when a 'benefit crystallisation event' occurs. That usually means when the member starts drawing his pension benefits. Scheme administrators must ask the member about his other pension savings since he may already have used up some of his lifetime allowance.
3. Pensions payable under a defined benefit scheme are converted into a cash value in accordance with HMRC guidance. A conversion factor of 20 is generally used: a pension of £10,000 a year would have a cash value for lifetime allowance purposes of £200,000.
4. When excess over the lifetime allowance is used to provide a pension, it is taxed at 25%. If used to provide a lump sum, the excess is taxed at 55%. Scheme rules usually allow members to take the excess as a lump sum, but legislation prevents contracted-out benefits being paid out in this way.
5. Usually, the scheme administrators deduct any lifetime allowance charge payable from the scheme member's benefits and pay HMRC on his behalf. The member will still need to report this in his self-assessment tax return.
6. Some individuals benefit from non-standard lifetime allowances. On the introduction of the lifetime allowance on 6 April 2006, individuals were able to apply for an increased lifetime allowance based on their then pension savings (primary protection) or they could take themselves outside the lifetime allowance regime (enhanced protection). Similarly, individuals were able to retain a lifetime allowance of £1.8 million after 5 April 2012 by applying for fixed protection. And individuals were able to retain a lifetime allowance of £1.5 million after 5 April 2014 by applying for fixed protection 2014. They also have until 6 April 2017 to apply for individual protection 2014, which would give them a lifetime allowance based on their pension savings on 5 April 2014 (up to £1.5 million). Similar protection will be introduced in relation to the further drop in the lifetime allowance on 6 April 2016 to £1 million. There will be no application deadline, but applications must be made before individuals take their benefits.
7. The important point to remember is that fixed protection, fixed protection 2014, fixed protection 2016 and enhanced protection are lost if the individual builds up any additional benefits under any registered pension scheme.
8. Between October 2012 and February 2018 employers will need to start automatically enrolling certain workers into a pension scheme. Employers may auto-enrol workers who have fixed protection, fixed protection 2014, fixed protection 2016 or enhanced protection. Those workers should opt out of the pension scheme within the one month deadline to ensure they do not lose the protection. Employers can decide not to auto-enrol workers with relevant protection, assuming those workers can be identified.
9. Trustees and employers will not necessarily know whether their scheme members are affected by the lifetime allowance. This is because members may have pension savings under schemes provided by previous employers. Trustees should therefore make generic information about the lifetime allowance available to their members so that the members themselves can decide whether the lifetime allowance is relevant.

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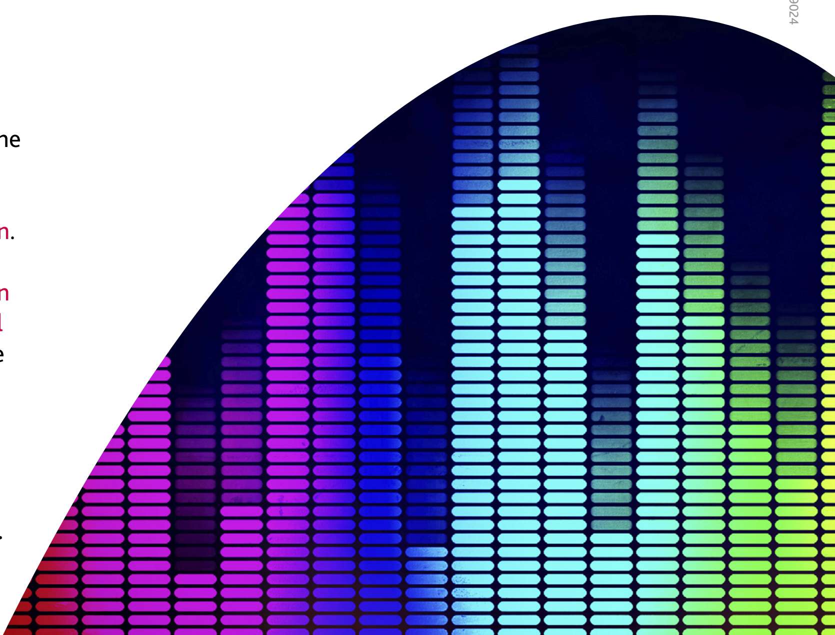

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Further reading

HMRC has published guidance on the lifetime allowance.

Pensions law can be tricky… but it doesn't have to be. These 'making it easier' guides explain key issues in simple terms, giving practical help to trustees and employers.

The series is growing; additional copies can be downloaded from www.pinsentmasons.com

Current topics include: Using advisers; Scheme changes and Becoming a trustee

Comments and ideas for further topics are welcome…

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