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THE PENSION LIFETIME ALLOWANCE EXPLAINED

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The pension Lifetime Allowance (LTA) applies to all of us that hold private pensions and is simply the maximum amount of pension savings that you are allowed to hold before incurring extra tax when you draw the pension.

The calculation of the Lifetime Allowance includes any personal pensions or pension benefits from your employer but it doesn't include your state pension.

Could the pension Lifetime Allowance affect you?

In the 2022/23 tax year the Lifetime Allowance is £1,073,100. Anybody with pension savings that are over or are likely to approach this maximum allowance in the future should take financial advice to reduce the tax they might have to pay.

The pension Lifetime Allowance increased in April 2018 for the first time in several years and was previously as high as £1,800,000. Many people who are not even actively paying in to their pensions will be affected in the future as their investments grow in value.

How the pension Lifetime Allowance works in numbers

Let's assume your current pension Lifetime Allowance is £1,073,100. If, for instance, you had reached age 55 and decided to use £107,310 of your pension fund to buy an annuity and take tax-free cash then you would have used 10% of your overall Lifetime Allowance. As such, you will have £965,790 (90%) of your allowance left. You will not incur an immediate tax penalty even if your pension fund is worth over the Lifetime Allowance unless the total amount you have actually drawn is over the Lifetime Allowance or you have reached age 75 when there is an automatic check to see if you are over the maximum.

If at any point the pension benefits you take go over the £1,073,100 Lifetime Allowance, you will incur extra taxes on the excess. The tax you pay is highlighted below.

What taxes will you pay if you exceed the pension Lifetime Allowance?

If you exceed the Lifetime Allowance then you could be subjected to additional tax. The level you pay depends on how you choose to take your pension benefits:

1. Withdrawing lump sums - Anything that is drawn as a lump sum and which exceeds your Lifetime Allowance will incur a 55% tax charge.
2. Receiving a regular income - Any regular pension payment which is bought with savings in excess of **your** Lifetime Allowance will incur a 25% tax. You may also have to pay Income Tax depending on your position.

How are my pensions valued for the Lifetime Allowance?

Many of us will have pension savings in more than one type of pension. Remember that your State Pension is completely ignored. Working out whether you might exceed the pension Lifetime Allowance can be tricky and you should seek advice. Usually, you will fall into one of the following three categories:

1. You don't have a defined benefits/final salary scheme

If you don't hold a defined benefit scheme then you just need to add together the value of all your retirement savings – whatever combination of personal pension savings and employers defined contribution pension schemes (sometimes referred to as money purchase) that might be. You also need to take account of any pension savings that you have already taken and the proportion of the Lifetime Allowance they took at the time. If it looks like the total value of all your pension savings might exceed the Lifetime Allowance then it is time to consider your options.

2. You only have a defined benefits scheme and no other pension savings

If you have final salary/defined benefit pensions, you calculate the value for Lifetime Allowance purposes by multiplying your expected annual pension by 20. You also need to add the amount of any tax-free cash lump sum if it is paid on top of the pension. For the tax year 2022/23 if you are on track for a final salary pension (with no separate lump sum) of more than £53,655 a year you are likely to exceed the Lifetime Allowance.

3. You have a mixture of defined benefit and other types of pension scheme

If you have a mix of benefits you have to calculate the value of each type of benefit and add them together.

This is a very rough guide and in all cases we recommend that you seek our advice.

Could you be protected from the pension Lifetime Allowance?

If your pension savings already exceeded the Lifetime Allowance at the time it was introduced, you could claim a kind of exemption – known as 'protection' which **protects** your existing savings from tax. As further changes have been introduced to the Lifetime Allowance new forms of protection have followed.

Working out exactly what 'protection' you could be entitled to is complex and you should speak to us.

Some of the most common questions about Lifetime Allowance

Most of these questions focus on ways of avoiding the Lifetime Allowance – the answer is generally no….

What if I withdraw money from my pension early?

You cannot usually draw a pension prior to age 55 and whenever you withdraw money from your pension savings it will count towards the overall Lifetime Allowance.

Can I avoid the Lifetime Allowance if I don't draw my pension savings?

Some people are wealthy enough that they might not need to draw their pensions to support themselves. However, HMRC have thought of this and wish to ensure they will receive their tax. So, there is an automatic Lifetime Allowance review at your 75th birthday (nice birthday present…). If your savings exceed your remaining Lifetime Allowance then there will be an immediate tax charge.

Can I avoid the Lifetime Allowance if I die?

Sorry, but not even death can beat HMRC. If you die there is an immediate check of the value of your pension benefits against the Lifetime Allowance.

How about if I transfer my pension abroad?

People have gone to some lengths to try and avoid the Lifetime Allowance charge over the years but the loopholes have been closed. There is an immediate Lifetime Allowance check and charge upon transfer to an overseas pension/QROPS.

Is the pension Lifetime Allowance a new thing?

No. The Lifetime Allowance was initially introduced by the government in 2006. Back then, the allowance was set at £1.5 million. However, it subsequently rose to £1.8 million in 2012, before falling to a low of £1 million in the 2016/17 tax year.

Is the Lifetime Allowance likely to go down again?

The pension Lifetime Allowance is set at the government's discretion. As such, nobody can be sure what it will be in the future. When it was first introduced back in 2006 it was set at the much higher level of £1.5 million and was eventually reduced to a low of £1 million. From April 2018 to April 2020 the allowance had risen in line with the consumer price index (CPI) although it was unchanged in April 2021 and April 2022.

What Should I Do If I Have Lifetime Allowance Concerns?

A lot of people will have a Lifetime Allowance issue in the future even if they do not pay anything further into their pensions. This is quite a complex area and taking good advice early can reduce the pain. We can help clients consider their strategy in a number of ways including

Should pension contributions be continued?

We will consider a client's Lifetime Allowance exposure both now and in the future before reaching a decision whether to maintain pension payments or stop them.

What other savings strategy should be adopted?

Increasing numbers of people will find they cannot save in pensions in the future. We can provide unbiased, independent counsel on tax effective alternatives including ISAs, VCTs and EIS.

Is Protection Attractive?

Some people should consider applying for protection. We can help identify whether protection will be helpful and assist you in claiming it.

Future Pensions Investment Strategy?

If a person is likely to breach the Lifetime Allowance in the future they may lose 55% of the excess fund in tax. Bearing this in mind, many clients may wish to reduce the amount of risk their pension fund takes if the majority of profit is going to be lost in any instance.

Tax Strategy When Drawing Pension

The rate of tax applied will be determined by whether the excess is taken as a lump sum or income. We can help you arrive at the best approach for your position. Tax on the excess can be as low as 25% if a client's other income is low so by planning ahead we may be able to avoid tax.

Defined Benefit Decisions

Clients with defined benefit entitlements may face different amounts of Lifetime Allowance tax according to whether they transfer their pension to a money purchase or keep it as defined benefit. The tax bill can also be affected by whether the pension is taken as lump sum or income. We can help a client reach the best solution for their circumstances.

How Can We Help?

If you would like to talk through your position please contact us on 01273 711811 or ion@roxboro.uk.com. We will be happy to discuss your situation without cost or obligation. If we think we can help you we can then agree to meet. If you decide that you wish for us to work together you will be sent a service proposal setting out what we will do for you and our fees.

This document is intended for discussion purposes and should not be regarded as advice. Full advice will be given to you in writing if you decide to proceed further. We cannot be held responsible for any action that you or any other party may take or fail to take as a result of this document.

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