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ABOLITION OF LIFETIME ALLOWANCE AND INTRODUCTION OF NEW TAX-FREE LUMP SUM ALLOWANCES

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ABOLITION OF LIFETIME ALLOWANCE AND INTRODUCTION OF NEW TAX-FREE LUMP SUM ALLOWANCES

The tight timetable for removing the lifetime allowance (LTA) on 6 April 2024 was confirmed at the Autumn Statement. The lengthy and complex legislation required to achieve this, and to introduce two new tax-free lump sum allowances, is included in the Finance Bill which is now making its way through Parliament.

This is a challenging timescale for the introduction of such significant changes, particularly for trustees and their scheme administrators. We are still waiting for guidance from HMRC, and for clarification on some key points, but having regard to the tight timeline, this should not delay preparations. In this Briefing we summarise some of the key points in the draft legislation.

THE NEW "LUMP SUM ALLOWANCES"

Two new lump sum allowances will control the level of tax-free cash that can be paid to or in respect of an individual from 6 April 2024. These will be applied per person and not per scheme:

- **"Lump sum allowance":** a fixed cumulative limit of £268,275 (25% of the current LTA) on the tax-free cash that can be paid to a person as pension commencement lump sums (PCLS) and as the tax-free part of uncrystallised funds pension lump sums (UFPLS). This tax-free cash was previously tested against the LTA.

  The earlier suggestion that tax-free elements of trivial commutation, winding-up and small lump sums would also use up this allowance has been dropped as a result of concerns about the administrative burden. However, individuals will need to have some lump sum allowance available for trivial and winding-up lump sums to be paid.

- **"Lump sum and death benefit allowance":** a fixed cumulative limit of £1,073,100 (the current LTA) on the tax-free elements of lump sums that can be paid in life and death, to or in respect of an individual. In addition to the PCLS and tax free elements of UFPLS, tax free elements of serious ill health lump sums and lump sum death benefits use up this allowance.

Only lump sums will use up these new allowances, not pensions. This is a key difference from the LTA where crystallised pensions and lump sums were all tested. There is a new concept of "*relevant benefit crystallisation events*" when lump sums that are tested against the allowances are paid. There will be no age-related tests.

For both allowances, those with valid LTA protection and/or lump sum protections will retain their rights to the higher protected amounts. Eligible individuals will be given until 5 April 2025 to apply for Fixed Protection 2016 and Individual Protection 2016.

COLLECTING TAX UNDER PAYE

To the extent that payment of a lump sum takes the total over an allowance, individual recipients are taxed on the excess at their marginal rate of income tax. (Under the LTA regime, until 6 April 2023 a 55% charge was payable). The tax on any excess will be collected by pension schemes under PAYE.

In a change from the arrangements for the current tax year, it appears that schemes will be expected to operate PAYE where lump sum death benefits are being paid, rather than HMRC dealing with the tax charges.

Comment: *There is as yet no HMRC guidance as to the processes that schemes should undertake to check capacity under the new lump sum allowances, or what to do if information is not forthcoming. Administrators need to be aware of the PAYE requirements and consider how they would operate them.*

PAYING LUMP SUMS ON RETIREMENT

In a reversal of the drafting in the July version of the Finance Bill, the maximum tax free PCLS will continue to be linked to an “applicable amount”. This permits a PCLS of up to 25% of the value of benefits crystalising, subject to available lump sum allowances, which aligns with the current LTA position. The July drafting had (unintentionally) appeared to give scope for members of DB schemes to have their own version of pension freedoms and take most of their benefit as (taxable) lump sum.

A new “pension commencement excess lump sum” (PCELS) has been introduced. This permits a (taxable) lump sum to be paid where the lump sum allowance has been fully used up (so broadly in the circumstances where a lifetime allowance excess lump sum (LTAELS) can currently be paid). However, unlike the LTAELS, the PCELS has to be paid in connection with a pension and cannot exceed a permitted maximum. The calculation methodology for the “permitted maximum” does not appear to permit full commutation of excess defined benefit pension, or full payment out of excess money purchase benefits.

Comment: *It is currently unclear whether this limit on paying out excess benefits in lump sum form is intentional, or what the policy driver is. This will need to be considered for high value retirements that are due to take place in the new regime and trustees and administrators may also want to give thought to the position of members who are due to retire shortly before or after the new regime comes into force in case the changes will have an impact on them.*

NEW TRANSITIONAL PROVISIONS

Where an individual has already used up all of their lifetime allowance before 6 April 2024, they will not have access to the new allowances.

Where some but not all of the LTA has been used before 6 April 2024, the default position will in most circumstances be that 25% of the total LTA used is set off against the new allowances. Where, before 6 April 2024, either a serious ill-health lump sum entitlement arose for an individual under age 75, or lump sum death benefits were paid where someone died under age 75, 100% of the total LTA used is set off against the new allowances.

Comment: *This deals in a pragmatic way with the administrative issue that tax free cash was not tracked and reported on under the LTA regime. Effectively this assumes that maximum tax free cash has been taken with pension entitlements before 6 April 2024.*

From 6 April 2024, there will be a new process under which, instead of sticking with the default position, an individual can apply to any registered scheme of which they are a member to certify their personal “transitional tax-free amount”. They will have to provide the scheme with complete evidence of their history of taking lump sums previously in all registered pension schemes. The scheme has 3 months to either give the certificate or refuse the application. Similarly, an application can be made after a member’s death by the personal representatives.

Comment: *The details in the legislation are limited and it is currently unclear how HMRC expect schemes to operate this new regime in practice, and the circumstances in which schemes will be able to refuse applications. Hopefully guidance will be issued in this area.*

REPORTING

There are a series of new reporting provisions in the Bill, broadly following the LTA reporting processes but relating to any tax-free lump sums paid. Under Event Reporting, the current LTA related reports are to be removed but a new Event Report currently appears to require all lump sums that are tested against the new allowances to be reported to HMRC.

Comment: *This approach to Event Reporting does not align with the* policy paper *issued in November, which stated that only lump sums in excess of the new allowances would have to be reported. Hopefully this is a drafting error in the Finance Bill, as it would be very burdensome to have to report all lump sums.*

OTHER CHANGES

- HMRC suggested in July that pensions paid from uncrystallised DC funds on death before age 75 would no longer be excluded from marginal rate income tax in the new regime. This has been dropped, so these benefits will remain income tax free and won't be tested against the new lump sum allowances.
- There are detailed provisions relating to international aspects, including a new "overseas transfer allowance" for transfers to QROPS, equal to the level of an individual's lump sum and death benefit allowance. Where the total value of an individual's transfers to a QROPS exceeds their available allowance, the excess will be chargeable to the overseas transfer charge.
- There is a potential override to a scheme's Trust Deed and Rules where a rule relates to a member's entitlement to LTAELS, reading in a reference to PCELS instead "*so far as possible*".

WHAT WASN'T IN THE BILL

- The Bill does not include any legislative overrides or modification powers to assist schemes with hard coded LTA provisions.
- The Bill does not include any free-standing protective provisions for trustees to discharge them from PAYE liabilities, where that step would be reasonable.

NEXT STEPS FOR EMPLOYERS AND TRUSTEES

- Trustees should check in with scheme administrators. Will they be ready to operate the new regime from 6 April 2024?
- Trustees should consider how to deal with the tax changes in member communications, particularly in member retirement packs where the retirement may occur after 5 April 2024.
- Employers/trustees should consider the impact of the removal of the lifetime allowance on the scheme Trust Deed and Rules. For example, are there any hard coded provisions such as benefit caps or conditions that refer to the lifetime allowance, or any references to the LTAELS?
- Employers should check whether there are any top-up pension promises outside the scheme where removal of the lifetime allowance might impact the pension benefit provided by the scheme, or any top up life cover where eligibility criteria link to the lifetime allowance.

AND FINALLY

It is unclear whether the new regime would survive a change of Government, since Labour opposed the abolition of the lifetime allowance when it was first announced in March 2023, saying they would reverse the changes. However, in the meantime, trustees and administrators, and scheme members who are retiring soon, are going to have to get to grips swiftly with these radical changes in the tax treatment of lump sums.

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