

Pension Tax Guide

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3. The lifetime allowance

3.1 Introduction

One of the more radical changes to the taxation of pension schemes in the 2004 *Finance Act* was the introduction of the lifetime allowance. The lifetime allowance is one of the pillars of the registered pension scheme regime and would not have been viable without the other changes made by the Act that brought all types of registered scheme within one code.

For tax purposes it matters not whether the scheme is a personal pension scheme or an occupational scheme, or whether it is a defined contribution scheme or a defined benefit scheme; all retirement and all lump sum death benefits from registered schemes are subject to the same control on output that is the lifetime allowance.

Once again, the approach of the legislation is not to prohibit behaviour or limit benefits, rather to impose higher tax charges when output exceeds the allowance. Those tax charges are intended to recover tax relief in respect of the wrongly paid or overpaid output.

A test against the lifetime allowance is triggered by a “benefit crystallisation event” (BCE). If aggregate crystallised amounts in respect of an individual either immediately or over a period of time exceed the lifetime allowance, the lifetime allowance charge is payable.

There are other controls on output that we will examine elsewhere. The main alternative control is the regime dealing with authorised and unauthorised payments and in respect of which there is a range of possible tax charges. The distinguishing feature of the lifetime allowance is that its rules only apply when there is a BCE.

The lifetime allowance was introduced on 6 April 2006. It replaced a disparate set of rules:

- Occupational schemes (whatever their design) were, in effect, limited to providing benefits measured as a proportion of final remuneration. Most widely understood

was the headline maximum pension of two-thirds of final remuneration after the member had completed at least 20 years' service by normal retirement date.

- In respect of personal pension schemes, relievable contributions were limited, but the pension was not otherwise limited.

Life became complicated for the individual who accrued benefits typically under a range of schemes, some of which were limited by output and some by input, especially as benefit "limits" under the occupational scheme had to take "retained" and "aggregable" benefits into account. So, for example, the apparently simple two-thirds pension limit had to include benefits from all previous schemes and from all schemes in respect of the same employment.

Radical change therefore came with a sigh of relief. However, by setting a new "limit" in the form of the lifetime allowance, there would inevitably be a group of individuals who would be exposed to a tax charge that would not have applied under the rules on which they based their retirement planning. The introduction of the lifetime allowance was therefore accompanied by a detailed set of relieving transitional provisions which also extended to the pension commencement lump sum. These are described in detail in **Chapter 11**.

Law: FA 2004, s. 214

3.2 What the lifetime allowance is and how it works

The lifetime allowance is expressed as a capital value. In its first tax year of implementation (2006-07) it was set at £1.5 million. Over a period of five years, the allowance increased in stages to £1.8 million in 2010-11.

Benefits paid within the allowance are subject to the usual range of taxes described elsewhere in this book. So, for example, the pension is taxed as non-savings income and generous tax-free lump sums are payable on death and retirement.

If the lifetime allowance is exceeded, the excess will be subject to a lifetime allowance tax charge which is 55% if the excess is withdrawn from the scheme as a lump sum or 25% if it is retained in the scheme, transferred to a qualifying recognised overseas

pension scheme or paid as an income. The member and the scheme administrator are joint and severally liable for the charge except in circumstances where a charge arises after the death of the member or when the benefit payable is a death benefit lump sum. In those circumstances, the recipient of the lump sum is liable for the charge and the personal representatives (rather than the scheme administrator) are responsible for determining if a charge is due.

On the other hand, if the payment falls into an unusual category of lump sum payable after death, and includes certain arrears of instalments, liability will be shared between the personal representatives and the scheme administrator.

If the administrator is liable, he or she will usually deduct the charge from benefits before they are paid. However, there may be circumstances when the charge will be waived if the administrator acted in good faith. The member may then be charged directly.

If a consequence of the benefit crystallisation event is that “excess” funds are retained or paid as income, that excess is likely to be taxed in addition to the lifetime allowance charge. By way of example, an excess pension would be taxed at 25% before being subject to the usual income tax charges of 40% and/or 45%. The combined tax rate would therefore be 55% or 58.75% in 2016-17.

In measuring the value of benefits crystallised against the allowance, the value of crystallised benefits is accumulated during the member’s lifetime. The following is a simple example:

Example

Joe crystallised a money purchase fund of £750,000 in 2006-07 when the lifetime allowance was £1.5 million.

This represented 50% of his lifetime allowance.

In 2010-11 he wished to crystallise further benefits, but the lifetime allowance had increased to £1.8 million. He wanted to know how much he could crystallise without incurring the lifetime allowance charge.

The remaining allowance was (100% available – 50% used) x the current lifetime allowance = £900,000.

The history of the lifetime allowance and its proposed future are:

Tax year	Lifetime allowance
2006-07	£1.5 million
2007-08	£1.6 million
2008-09	£1.65 million
2009-10	£1.75 million
2010-11	£1.8 million
2011-12	£1.8 million
2012-13	£1.5 million*
2013-14	£1.5 million*
2014-15	£1.25 million**
2015-16	£1.25 million
2016-17	£1 million***
2017-18	£1 million***

From 2018-19 the figure increases with the CPI rounded up to the nearest £100. The increase in CPI is measured to the previous September (as with DWP benefit increases).

*those members who had already accumulated large funds were able to protect themselves from the lifetime allowance charge that might otherwise have been prompted by the reduction in the allowance (fixed protection).

**this reduction appeared in FA 2013, s. 48, and again there are protections proposed for those who might otherwise be adversely affected, fixed protection (Sch. 22) and individual protection (FA 2014, s. 44 and Sch. 6).

***this reduction appeared in FA 2016, Part 1. The member may claim fixed or individual protection under FA 2016, Sch. 4.

Law: FA 2004, s. 214-219

3.3 Benefit crystallisation events

3.3.1 Table of amounts crystallised

Measurement against the lifetime allowance (or that amount that has not been exhausted) is prompted by a benefit crystallisation event or BCE. The list of BCEs has been extended since FA 2004. They do not all refer to taking benefits.

Benefit crystallisation events and amounts crystallised, as described in FA 2004, s. 216, are as follows.

Benefit crystallisation events	Amount crystallised (edited)
<p>1. The designation of sums or assets held for the purposes of a money purchase arrangement under any of the relevant pension schemes as available for the payment of drawdown pension to the individual.</p>	<p>The aggregate of the amount of the sums and the market value of the assets designated. Effective date is the date of designation.</p>
<p>2. The individual becoming entitled to a scheme pension under any of the relevant pension schemes.</p>	<p>$RVF \times P$, where: RVF is the relevant valuation factor (described below); and P is the rate of pension paid in the first year from crystallisation. Effective date is the date the entitlement is acquired.</p>
<p>3. The individual, having become so entitled, becoming entitled to payment of the scheme pension, otherwise than in excepted circumstances, at an increased annual rate which:</p> <ol style="list-style-type: none"> a. exceeds the threshold annual rate, and b. exceeds by more than the permitted margin the rate at which it was payable on the day on which the individual became entitled to it. 	<p>$RVF \times XP$, where: RVF is the relevant valuation factor (described below) XP is generally the amount by which (a) the increased annual rate of the pension, exceeds (b) the rate at which it was payable on the day on which the individual became entitled to it, as increased by the permitted margin. Effective date is the date the entitlement is acquired. (This will be described later.)</p>
<p>4. The individual becoming entitled to a lifetime annuity purchased under a money purchase arrangement under any of the relevant pension schemes.</p>	<p>The aggregate of the amount of such of the sums, and the market value of such of the assets, representing the individual's rights under the arrangement as are applied to purchase the lifetime annuity and any related dependants' annuity. Effective date is the date the entitlement is acquired.</p>

Benefit crystallisation events	Amount crystallised (edited)
<p>5. The individual reaching the age of 75 when prospectively entitled to a scheme pension or a lump sum (or both) under a defined benefits arrangement under any of the relevant pension schemes.</p>	<p>(RVF x DP) + DSLS, where: RVF is the relevant valuation factor (described below). DP is the annual rate of the scheme to which the member would be entitled if, on reaching age 75, he acquired an actual right to receive the pension. DSLS is so much of any lump sum to which the individual would be entitled (otherwise than by way of commutation of pension) as would be paid to the individual if, on that date, the individual acquired an actual (rather than a prospective) right to receive it.</p>
<p>5A. The individual reaching the age of 75 having designated sums or assets held for the purposes of a money purchase arrangement under any of the relevant pension schemes as available for the payment of drawdown pension to the individual.</p>	<p>The aggregate of the amount of the sums and the market value of the assets representing the individual's drawdown pension fund under the arrangement, less the aggregate of amounts crystallised by benefit crystallisation event 1 in relation to the arrangement and the individual.</p>
<p>5B. The individual reaching the age of 75 when there is a money purchase arrangement relating to the individual under any of the relevant pension schemes.</p>	<p>The amount of any remaining unused funds.</p>

Benefit crystallisation events	Amount crystallised (edited)
<p>5C. The designation, on or after 6 April 2015 but before the end of the relevant two-year period, of relevant unused uncrystallised funds as available for the payment, to a dependant or nominee of the individual, of (as the case may be) dependants' flexi-access drawdown pension or nominees' flexi-access drawdown pension.</p>	<p>The aggregate of the amount of the sums and the market value of the assets designated.</p>
<p>5D. A person becoming entitled, on or after 6 April 2015 but before the end of the relevant two-year period, to a dependants' annuity or nominees' annuity in respect of the individual if:</p> <ul style="list-style-type: none"> (a) the annuity is purchased using (whether or not exclusively) relevant unused uncrystallised funds, and (b) the individual died on or after 3 December 2014. 	<p>The aggregate of:</p> <ul style="list-style-type: none"> (a) the amount of such of the sums, and (b) the market value of such of the assets, applied to purchase the annuity, as are relevant unused uncrystallised funds.
<p>6. The individual becoming entitled to a relevant lump sum under any of the relevant pension schemes.</p>	<p>The amount of the lump sum paid to the individual. Usually the date of entitlement. However, if the actual payment is not made until after age 75 is attained, there is no BCE (because the funds will have been measured under BCE 5B). Note that the lump sum is not confined to the pension commencement lump sum and from 6 April 2015 includes an uncrystallised funds pension lump sum to the extent of both taxed and untaxed portions.</p>

Benefit crystallisation events	Amount crystallised (edited)
7. A person being paid a relevant lump sum death benefit in respect of the individual under any of the relevant pension schemes.	The amount of the lump sum death benefit.
8. The transfer of sums or assets held for the purposes of, or representing accrued rights under, any of the relevant pension schemes so as to become held for the purposes of or to represent rights under a qualifying recognised overseas pension scheme in connection with the individual's membership of that pension scheme.	The aggregate of the amount of any sums transferred and the market value of any assets transferred.
9. If regulations under FA 2004, s. 164(1)(f) so provide, the happening of an event prescribed in the regulations in relation to a payment prescribed in the regulations.	An amount determined in accordance with the regulations. This may include a lump sum overpaid in error (to the extent of the overpayment). It may also include certain lump sums paid after death.

Law: FA 2004, s. 164(1)(f), 216

Guidance: PTM 088100

The relevant valuation factor (RVF) is used to convert a benefit expressed as an income to a capital sum for the purposes of measuring its value against the lifetime allowance. It will usually be 20, but rarely may be higher by agreement with HMRC (when the rate of pension increase in the scheme rules is set at more than 5% a year).

Law: FA 2004, s. 276