PENSIONS

UNDERSTANDING YOUR PENSION

LIFETIME ALLOWANCE

Interface

Independent Financial Advisers - Financial Life Planners

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Understanding Your Pension Lifetime Allowance

A common question that clients ask is: "Should I stop paying into my pension if I exceed the pension lifetime allowance limit?"

You should start by understanding your limits: HMRC imposes both annual and lifetime limits on the amount of money you can save into a pension while benefiting from tax relief on contributions. However, it is perfectly legal to exceed those limits, and in some circumstances, it can make good financial sense to do so.

PENSION CONTRIBUTION RULES CAN BE GENEROUS EVEN ALLOWING FOR THE TAX CLAWBACK, YOU ARE STILL BETTER OFF CONTRIBUTING THAN NOT.

The Annual Contribution Allowance

Starting with the annual contribution allowance, most people can currently contribute up to £40,000 into a pension each year and receive tax relief on their contributions. There are two main groups of people who may have a lower annual allowance: higher earners, whose allowance can be 'tapered' to as low as £10,000, and those who have already started to draw taxable cash from their pension pots, who may be limited to £4,000 a year of tax-free contributions.

Although your annual allowance is £40,000, there is nothing to stop you putting more than this into your pension. You simply declare what you are doing on your tax return and pay the resultant tax bill. Suppose, for example, that you put £45,000 into your pension in a given financial year. In general, you will have benefited from tax relief on the full £45,000. But because you are only entitled to tax relief on the first £40,000, HMRC will need to claw back the tax relief on £5,000

The gov.uk website says simply: "The amount you went above the annual allowance is added to your taxable income. You pay income tax on taxable income at the tax rate that applies to you." This means that if you pay tax at 20%, you will have a tax bill of 20% of £5,000, or £1,000; if you pay at 40%, you will have a tax charge of £2,000; and so on. If your allowance has been tapered down to £10,000 or is limited to £4,000 the calculation, simply uses those limits instead.

The Lifetime Allowance

The lifetime allowance is the maximum amount that you are allowed to hold in your pension fund without paying additional tax.

The value of your fund is the equivalent cash value if you are in a defined benefit (final salary) scheme or the cash value of your fund if you are in a defined contribution scheme. If your fund value exceeds your LTA, the tax charge depends on how you withdraw your money. If you take the money out in the form of regular pension payments, you pay a tax charge of 25% on the excess (over and above any other income tax due), and if you take it out as a lump sum, you pay a tax charge on the excess of 55%.

So why would you willingly incur such a tax bill? The short answer is that pension contribution rules can be so generous that, even allowing for the tax clawback, you are still better off contributing than not.

Defined Contribution Example:
Suppose you have a generous employer who puts in £2 for every £1 you pay into your pension. Normally, your £1 only costs you 80p or 60p, because you get tax relief on the contribution. But even if you breach the £40,000 annual limit and have to pay back 20% of £3 in tax, you still end up with £2.40 net for your 80p contribution. Therefore, even allowing for the tax charge, you would be worse off if you decided not to contribute beyond your annual allowance limit.

Defined Benefit (salary-related pension scheme) Example:
The way accruals in salary-related pensions are tested against annual and lifetime allowances is a bit more complex, but the basic principle still applies. When you contribute to a salary-related pension your employer also contributes, often much more than you do. If you opt out, you lose that contribution. Even in cases where you might exceed annual or lifetime limits, opting out could cost you far more than paying a tax charge.

How much is the Lifetime Allowance?

The Lifetime allowance was introduced in 2006 and it has increased and subsequently decreased over the years

The Standard Lifetime Allowance	
Tax year	Amount
2006/07	£1,500,000
2007/08	£1,600,000
2008/09	£1,650,000
2009/10	£1,750,000
2010/11	£1,800,000
2011/12	£1,800,000
2012/13 & 2013/14	£1,500,000
2014/15 & 2015/16	£1,250,000
2016/17 & 2017/18	£1,000,000
2018/2019*	£1,030,000
2019/2020	£1,055,000
2020/2021	£1,073,100
2021/2022	£1,073,100

*From tax year 2018/19 the LTA was to be increased annually by the Consumer Prices Index (CPwI) but it was subsequently frozen

If you exceed the limit, you will pay a tax charge

If the value of your pension exceeds the Lifetime Allowance, you will pay a tax charge, known as the Lifetime Allowance tax charge.

There are several scenarios that trigger a Lifetime Allowance test, and thus a possible tax charge, including taking money out of your pension, transferring your pension overseas, or turning 75 without having taken benefits from your pensions.

The rate of tax you'll pay will depend on how you withdraw your money from your pensions. This tax charge is paid in one of the following ways:

25% **if taken as income**
I.E. if you buy an annuity or take a regular income via drawdown

55% **if taken as a lump sum**
I.E. if you take an uncrystallised fund lump sum

The charge can be applied in either of the two ways or a combination of both depending on how you take the excess benefits above the lifetime allowance.

N.B. *The LTA charge is in addition to income tax charges paid when you withdraw funds from your pension.*

What counts towards your lifetime allowance?

The LTA applies to the value of all your pensions. This includes defined benefit (final salary) pensions and defined contribution pensions. However, the LTA does not include the State Pension.

The amount that counts towards your LTA will depend on the type of pension you have. The below table summarises a defined benefit lifetime allowance calculation and a defined contribution lifetime allowance calculation:

Type of Pension	How it affects your LTA
Defined contribution: Personal, stakeholder, and many workplace pensions	The value of money in your pension plans
Defined Benefit: Final Salary workplace schemes	Usually, 20 times the pension you will receive in the first year plus any tax-free lump sum

Further information is available on the UK Government website www.gov.uk and going to 'Tax on your private pension contributions: Lifetime allowance.'

Additionally, some death-in-service benefits – employee benefits that are paid out as a tax-free lump sum also count towards the LTA.

Is it worth exceeding the lifetime allowance?

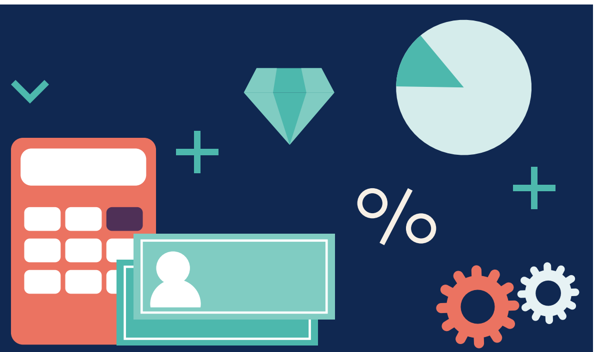
While it may be logical to think that you should avoid exceeding the lifetime allowance there are circumstances where it may make sense to exceed it.

1. Contributing to your workplace pension to receive an employer-matched contribution. Although you will pay a 25% lifetime allowance tax charge, you are effectively getting a 100% return on your contribution (assuming your employer matches the contribution 1:1).
2. Contributing to a pension to avoid a future inheritance tax bill. Pensions are outside of your estate, so you won't pay inheritance tax on them. It may be better to pay the 25% lifetime allowance tax charge than the 40% inheritance tax charge.
3. Contributing to a defined benefit pension. These are very valuable pensions and the income you receive from them is normally worth far more than any tax charge that will apply.

Check if you have exceeded the Lifetime Allowance

You can calculate if you have exceeded the lifetime allowance using the calculators on our website at Interface Financial Planning, Our Financial Pages, Financial Calculators, Lifetime Allowance Calculator

interfacefinancialplanning.co.uk/calculators



A Benefit Crystallisation Event (BCE) applies in circumstances defined by the HMRC

The most common BCEs include:

1. Accessing your pension – by taking a lump sum or income
2. Turning age 75 – and not having drawn pension benefits and having some pension funds in drawdown at age 75
3. Transferring a pension to a qualifying recognised overseas pension scheme (QROPS)*
4. Receiving a lump sum death benefit before age 75

A BCE is the point when the amount of pension benefit is tested against the Lifetime Allowance and there are 13 BCEs in all. Normally BCEs use up an individual's lifetime allowance in the chronological order in which they happen. When BCEs happen simultaneously, the individual must decide the order the BCEs take for the purpose of the lifetime allowance test. The exception to this is where the individual becomes entitled to a PCLS (which is paid free of income tax) and in this case the BCE always happens immediately before the BCE for the associated pension benefit, (which is taxable).

Taking Pensions	
BCE1	Where funds are designated to provide a drawdown pension
BCE2	Where an individual becomes entitled to a scheme pension
BCE3	Where a scheme pension is increased beyond an allowable amount
BCE4	When an individual becomes entitled to a lifetime annuity

Unused funds at age 75 or on earlier death	
BCE5	Where an individual reaches age 75 under a defined benefit arrangement without having drawn all or part of their entitlement as a scheme pension and / or lump sum
BCE5a	Where an individual reaches age 75 with a drawdown pension fund
BCE5b	Where an individual reaches age 75 with unused money purchase funds
BCE5c	Where an individual dies before their 75th birthday and any uncrystallised funds are designated to provide their beneficiaries with a drawdown pension
BCE5d	Where an individual dies before their 75th birthday and any uncrystallised funds are used to provide a purchased dependants or nominees annuity†

Lump Sums	
BCE6	Where an individual becomes entitled to a relevant lump sum

Death	
BCE7	Where a relevant lump sum death benefit is paid on the death of an individual

Transfer to a Qualified Recognised Overseas Pension Scheme (QROPS)	
BCE8	Where an individual's benefits are transferred to a QROPS

Other	
BCE9	Where certain payments are made to in respect of an individual: • Payments of 'arrears' of pension after death • Lump sums based on pension errors • Pension commencement lump sum (PCLS) paid after death

Valuation of Pension Benefits

Money Purchase

The valuation of money purchase pension benefits for the purpose of comparing against the lifetime allowance is based on the actual fund value (market value of the assets) used to secure the benefits. For example, the amount used to buy a lifetime annuity or the value of the drawdown fund.

Benefits that were in payment before 6 April 2006 (when the LTA was introduced) also have to be included when valuing benefits and they are valued at the first crystallisation event after 6 April 2006.

Annuities in payment are valued at 25:1

Capped drawdown benefits are valued at 80% of the Government Actuary's Department (GAD) maximum income valued at 25:1

* For more information about QROPS refer to our QROPS guide

† The death must have happened on or after 03-12-2014 with the entitlement arising on or after 06-04-2015 but before the end of a two-year period

Defined Benefits

The value of the scheme pension paid or bought by the defined benefit scheme is multiplied by a factor of 20:1. This factor is used regardless of the features of the scheme pension, including what level of the attached spouse's pension applies, what rate the pension will increase by, and whether there is any guarantee period. If the pension offers a separate lump sum this is valued under BCE10.

Example Alan

Alan is aged 68. He is retiring from his employment. He has built up 25 years of service and his final salary is £48,000. His pension schemes offer a pension worth 1/80 of final salary for each year of service, and a separate cash sum of 3/80 of final salary for each year of service.

BCE 2: Alan's pension
= 1/80 x 25 x £48,000 = £15,000

Value for the purposes of comparing against the lifetime allowance
= £15,000 x 20 = £300,000

BCE 6: Alan's lump sum
= 3/80 x 25 x £48,000 = £45,000

This is the value to use when comparing against the lifetime allowance

Measuring the amount of lifetime allowance used up

The amount of pension benefits compared at a BCE is measured as a percentage of the current lifetime allowance. (An exception to that would be if the person had applied for transitional protection of the lifetime allowance where a different protected lifetime allowance would be used.) The percentage is always expressed to two decimal places and is rounded down.

This percentage is added to any percentage used up previously under the same or any other registered pension scheme.

Example Tom

Tom is 65 in June 2017. His SIPP is worth £600,000. He takes £400,000 as drawdown, when the lifetime allowance is £1,000,000. There are two BCEs:

BCE5a: £100,000 PCLS
uses up 10% (£100,000 / £1,000,000)

BCE1: £300,000 drawdown
uses up 30% (£300,000 / £1,000,000)

In August 2020, Tom takes his remaining SIPP benefits, which have grown in value to £220,000. The lifetime allowance is now £1,073,100:

BCE6: £55,000 PCLS
uses up 5.12% (£55,000 / £1,073,100)

BCE1: £165,000 drawdown
uses up 15.37% (£165,000 / £1,073,100)

In total, Tom has used up:
40% + 20.49% = 60.49% of the lifetime allowance

The second drawdown BCE

When a person designates funds into drawdown, there is a BCE (BCE1) and a test against the lifetime allowance. There may be a second BCE at age 75 if that person is still in drawdown and the drawdown fund at age 75 is bigger than the drawdown fund at the first BCE. This BCE (BCE5a) measures the investment growth in the drawdown fund against the lifetime allowance.

Example Katie

Katie is 67 in August 2012, when the lifetime allowance is £1.5 million. Her SIPP is worth £1.2 million. She decides to take her PCLS and designate the remainder into drawdown. She doesn't take any income from her drawdown fund.

BCE6: £300,000 PCLS
uses up 20% of the lifetime allowance (£300,000 / £1,500,000)

BCE1: £900,000 drawdown
uses up 60% of the lifetime allowance (£900,000 / £1,500,000) This uses up a total of 80% of her available lifetime allowance, leaving 20% remaining.

In August 2020, Katie turns 75. Her drawdown pot is now worth £1,330,000

BCE5a: £1,330,000 – £900,000
= £430,000 / £1,073,100 = 40.07%

As she only has 20% of her lifetime allowance available, this means she has to pay a lifetime allowance charge on the excess.

Each separate drawdown arrangement has to be considered. So even if the overall drawdown fund has fallen in value since the original designation, if one drawdown arrangement has enjoyed investment growth, then this will result in a BCE for that arrangement and some of the lifetime allowance will be used up.

The lifetime allowance charge

If someone uses up more than 100% of their lifetime allowance, then there is a tax charge on the excess amount. The tax charge is:

- 55% if the excess is paid to the individual as a lump sum; or
- 25% if the excess is retained within the pension.

Example Katie (continued)

In August 2020, Katie uses up 40.04% of the lifetime allowance in a BCE5a. However, she only has 20% of the lifetime allowance available.

Her excess = 40.04% – 20%
= 20.04% x £1,073,100 = £215,049

The lifetime allowance charge is 25% as the benefits remain in the drawdown pot

25% of £215,049 = £53,762

Katie's drawdown pot is now worth:

£1,330,000 – £53,762 = £1,276,238

The scheme administrator and the individual are usually jointly responsible for paying the lifetime charge and in practice the scheme administrator deducts the tax charge before making a 'retirement' payment.

However, if the charge arises on the member's death, the personal representatives are responsible for calculating the charge and the recipient of the payment is liable to pay the charge.

Reporting and monitoring

When an individual crystallises benefits, it's the scheme administrator's responsibility to calculate how much lifetime allowance is used up and if any charge is due. The scheme administrator issues a statement for every BCE showing how much lifetime allowance has been used up, the value of any lifetime charge due and whether the scheme administrator has accounted for the charge due, or intends to.

The individual must, as part of their self-assessment, confirm the value of the benefits in excess of the available lifetime allowance, and the tax charge paid by the pension plan. The scheme administrator also sends out an annual statement showing the percentage of the standard lifetime allowance the individual has used up.

Lifetime allowance planning

Since the lifetime allowance was introduced in 2006, there has been a significant increase both in the number and in the value of lifetime allowance charges that have been paid. HMRC statistics show in 2017–18 tax year £185 million was paid as lifetime allowance charges. This is 30 times the value paid in 2006–07.

Financial planning to address the possibility of paying a lifetime allowance charge now affects far more than a few lucky 'fat cats', and instead it has far-reaching implications for many more thousands of people who are saving for retirement.

Lifetime allowance protections

The lifetime allowance was first introduced in 2006, and on the three occasions the lifetime allowance was reduced (in 2012, 2014 and 2016). If individuals had benefits worth more than, or in some cases they were approaching, the new lifetime allowance, they could apply for protection. This means they are able to take a higher amount of benefits than the new lifetime allowance without paying a lifetime allowance charge.

£185M IN LIFETIME ALLOWANCE CHARGES PAID IN 2017-18. THIS IS 30x THE VALUE PAID IN 2006-07

Pension savers face dilemmas:

Whether to continue pension funding if they are approaching the lifetime allowance
this may depend on how close they are to the lifetime allowance, the amount of additional fund they could build up if they continued funding, and the cost to themselves of doing that. If they are receiving an employer pension contribution, they may want to approach their employer and ask if the remuneration could be paid in a different form – for example a bonus or higher salary.

Whether to crystallise or to remain invested until age 75
this will depend on many factors, including whether the individual expects to live beyond age 75 (based on their own health and their family medical history). If they expect to die before 75, they may want to consider crystallising immediately.

Whether to take a drawdown income to reduce or eliminate any lifetime charge at age 75
by taking a drawdown income, an individual may be able to reduce the size of their drawdown fund to a value similar to or lower than the amount they originally designated, reducing the potential of a charge arising from a BCE5a. This may depend on whether the individual wants to accept an income into their estate which may count for Inheritance Tax (IHT) purposes, and whether instead they can spend the money or gift it to others.

These are complicated decisions for individuals and their financial planners to make. Everyone's circumstances will be different and personal to them, as will be their objectives and wishes.

Example - Lizzie

Lizzie is 60 years old and is about to stop work. She has built up a SIPP fund of £1,273,100 and does not have any lifetime allowance protection. She has other sources of income. She wants to use her PCLS to help her children get on the property ladder.

She places £1,073,100 (the lifetime allowance) into drawdown:

- she takes her maximum PCLS of £268,275, leaving a remaining drawdown fund of £804,825; and
- £200,000 remains uncrystallised.

Lizzie has a choice now whether to:

- **Option 1** – crystallise the £200,000 fund at age 60 (meaning an immediate lifetime allowance charge). She could then withdraw an income from the drawdown fund which will be equal to the investment growth in the fund. This way her drawdown fund at age 75 is equal to the fund at age 60, and she avoids a second lifetime allowance charge at age 75.
- **Option 2** – leave the £200,000 uncrystallised, and not withdraw an income from the drawdown fund. She will then face two lifetime allowance charges at age 75 – one on the uncrystallised SIPP fund, and one on the drawdown fund.

Option 1 – fully crystallise

- 25% LTA charge on remaining £200,000 fund = £50,000
- Total of £954,825 in drawdown (£804,825 + £150,000)
- Need to withdraw income of £38,193 each year to avoid future LTA charge at age 75 (assuming 4% a year net growth over 15 years)

Fund at 75 = £954,825
Plus £572,895 (£38,193 x 15) has been withdrawn
Total = £1,527,720

Option 2 – leave funds invested

- At age 75 (assuming funds are untouched and 4% net growth):
- Drawdown fund = £1,449,000
- SIPP fund = £360,000
- BCEs at age 75:
- **BCE 5A** = £1,449,000 – £804,825 = £644,175 x 25% = £161,044
- **BCE 5B** = £360,000 x 25% = £90,000
- Deduct LTA charge 25%:
- Drawdown = £1,449,000 – £161,044 = £1,287,956
- SIPP fund = £360,000 – £90,000 = £270,000
- Combined fund remaining = £1,557,956

Whether Lizzie chooses option 1 or option 2, she will end up with a very similar fund. However, there are several key factors to consider:

- **Income Tax.**
  If she takes a drawdown income, she will have to pay Income Tax on the withdrawals. If she doesn't need an income, she may decide to leave the funds within the drawdown pot and consider passing to her children.
- **IHT implications.**
  Lizzie needs to consider the value of her estate and whether there are any IHT implications of taking an income from the drawdown fund. She may want to keep the pension fund intact and shielded from IHT.
- **Likelihood of death before 75.**
  If Lizzie believes it's likely she may die before age 75, she may want to consider crystallising all her fund at age 60. There would be no further crystallisation event on death before age 75.
- **Other options.**
  There are different options Lizzie could consider – for example, not crystallising any fund at age 60, or phased crystallisation between 60 and 75

How can I reduce the lifetime allowance charge?

Step 1 – Understand the value of your pensions

The first step in planning for the LTA is to calculate whether you are at risk of exceeding the threshold.

The way you do this is by:

1. Calculating the total value of all your pensions now; and
2. Projecting what the total value could reach when you retire (taking into account future contributions and reasonable investment growth rates)

Remember that for lifetime allowance purposes, the value of your pensions will be calculated differently depending on the type of pension.

If you are still an active member of a defined benefit pension scheme, it will be difficult to predict what your final benefits will be, as they will be linked to your pensionable salary, accrual rate and length of service.

In order to avoid a hefty tax charge on your savings, you'll need to monitor your pensions closely to ensure you don't exceed the LTA.

If you are unsure about how to calculate the total value of your pension accounts, feel free to give us a call and we'll help you do this.

Step 2 – How to protect your lifetime allowance

If you are likely to exceed the lifetime allowance, you should consider whether you are able to apply for 'lifetime allowance protection'.

There are two types of protection you can apply for which have replaced previous versions:

2a. Individual Protection 2016

If your pension(s) were worth more than £1m on 5th April 2016, you can apply for Individual Protection 2016. This protects your lifetime allowance at the value of your pensions on 5th April 2016 or £1.25m, whichever is the lower.

You and your employer can continue paying into your pension; however, a lifetime allowance charge will apply on any value in excess of your protected lifetime allowance amount.

The benefit of doing this is that it increases your lifetime allowance from £1,073,100 currently to up to £1,250,000. This can save you up to £97,295 in lifetime allowance tax charges.

2b. Fixed Protection 2016

This protection fixes your lifetime allowance at £1.25m, regardless of the value of your pensions.

The catch is that you can only apply for fixed protection 2016 if you (or your employer) have not added to your pension since 6th April 2016.

You can't apply for this protection if you have enhanced protection, primary protection, fixed protection or fixed protection 2014.

Step 3 – Pension lifetime allowance strategies

This depends on individual circumstances and need a lot of thought because arriving at the correct route for each individual can be complex.

3a. Use your ISA

You could reallocate contributions you're making into a defined contribution pension that is nearing the LTA into an Individual Savings Account (ISA). ISAs enable you to invest your money tax-free, and any money in an ISA will not count towards your LTA. You can currently contribute £20,000 per year into an ISA.

This strategy is not suited to those in defined benefit pension schemes as these individuals are likely to be better off continuing to accrue benefits within their scheme, even after the lifetime allowance charge.

3b. Use your spouse's pension

If you're approaching the lifetime allowance, it might make sense to redirect contributions into your spouse's pension (this is just one of the four main tax benefits of marriage)

This will need to be in their name of course – and that comes with risks of its own (what happens if you get divorced?).

You each have a lifetime allowance, so by using both allowances you can potentially increase the amount in your pensions by 100% before paying any lifetime allowance charge.

BY USING BOTH SPOUSES ALLOWANCES YOU CAN POTENTIALLY **INCREASE THE AMOUNT IN YOUR PENSIONS BY 100%** BEFORE MAKING ANY PAYMENTS

3c. Retire early

If you have a defined benefit pension, you could consider retiring early.

Most defined benefit pension providers offer a lower level of income if you begin taking benefits before reaching your normal retirement age. As such, retiring early and taking a lower annual income could potentially help you reduce the value of your pension below the Lifetime Allowance.

You could also ask the pension scheme if it offers the option to reduce the way you are accruing future benefits. If it does, you could continue to build up your pension but on a reduced basis.

3d. Phased retirement

If you can afford to do so you could consider delaying retirement or phasing your retirement benefits.

If the LTA was to increase in line with CPI in the future, this strategy could enable you to take advantage of a higher threshold, and, therefore, avoid or reduce tax charges

3e. Withdraw tax-free cash

A common strategy is to withdraw tax-free cash from the pension. This leaves fewer funds in the pension to grow, reducing the potential second LTA charge at age 75.

You should, however, note that any funds withdrawn from a pension will form part of your estate for inheritance tax purposes – whereas funds held in a pension are outside of your estate for inheritance tax.

Financial Planning a time for action

Exceeding your lifetime allowance could make it necessary to stop contributing to your pension and contribute to other investment vehicles instead, or perhaps even take your pension early to avoid being taxed excessively. These decisions require comprehensive financial planning where all of your options and personal circumstances can be discussed and considered.

Even if you're not already breaching the LTA now, if you think that you may do so in the future taking prudent steps in advance is sensible planning.

The tax rules regarding the Lifetime Allowance are complicated, and the cost of getting it wrong could prove to be an expensive mistake. If you would like further help and guidance, please contact us and we will be glad to help.

Disclaimer

This guide has been prepared to help your understanding and it is not to be regarded as giving advice.

This is a complex area, and this guide should demonstrate that you should engage the services and advice from a fully authorised and specialist adviser before your take any action.

We are not responsible for any consequences if you decide to take action as a result of reading this guide without taking the recommended advice and we reiterate that this guide is for your information only and it does not constitute advice.

Furthermore, regulations are always changing in this area and while we will endeavour to keep this guide up to date, it is issued as a statement of what we understand to be correct in September 2021.

If you discover any discrepancies, errors, or changes we would be very pleased to hear from you.

THE TAX RULES REGARDING THE LIFETIME ALLOWANCE ARE COMPLICATED... GETTING IT WRONG COULD PROVE TO BE AN EXPENSIVE MISTAKE

References and Credits

This guide to your Lifetime Allowance has been researched and compiled from many different sources. Acknowledgment and thanks are made to the sources listed below though there are many others and too many to mention individually

Aegon - BCEs and valuing benefits against the lifetime allowance

AJ Bell Invest centre - Adviser Guide

Fidelity - Lifetime Allowance Guide

Managing Your Money: Emma Agyemang

Money Helper – Lifetime Allowance for pension savings

Money Observer Steve Webb

Old Mutual Wealth - Allowance Excess Charge

Old Mutual Wealth - LTA Excess Options to Consider

Pru Adviser – What is pension lifetime allowance

The Pensions Advisory Service – The Lifetime Allowance

Royal London - Good with Money Guide 9

Tilney – How to Avoid breaching the lifetime allowance

Unbiased – What is the Pension Lifetime Allowance

Which – Pension Lifetime Allowance explained

You may like to look these up because they may contain additional information

In addition, if you search Google for 'Pension Lifetime allowance' you will discover many more sources. While the LTA only effects a small percentage of people it is an increasing number and the amount of tax that they have to pay continues to rise.

APPENDIX

Additional notes on your Annual Allowance

The main purpose of this guide is to explain your Lifetime allowance however the annual allowance is often misunderstood and confused with the LTA so further explanation follows.

The pensions annual allowance is a cap on the amount you can save every year, upon which you can earn relief. This has reduced significantly over the years

For the tax year 2021-22 the 'annual allowance' is £40,000, or 100% of your income if you earn less than £40,000. This means that someone paying income tax at the standard rate of 20% would receive a maximum sum of £8,000 of pension tax relief towards their pot. If you pay tax at the higher rate of 40% would get up to £16,000 of tax relief, whilst those in the additional rate band of 45% would currently get £18,000 of tax relief.

Your annual allowance is made up of all contributions to your pension made by you, your employer and any third party (including pension tax relief). For example, say you earn £40,000 a year and you contribute 3% to your company pension and your employer contributes 5%. In addition you have a personal pension, into which you pay a £10,000 lump sum. You would personally pay in a net amount of £8,960, with £2,240 in pension tax relief being added automatically, while your employer would pay in £2,000 gross. Your total contribution is £13,200, leaving £26,800 of your annual allowance unused.

The tapered annual allowance: If you earn more than the threshold income of £200,000 and your 'adjusted income' is more than £240,000, your annual allowance is reduced. Adjusted income is your total taxable income, including salary, dividends, rental income, savings interest, plus employer pension contributions. Your annual allowance reduces by £5,000 for every £10,000 that your income increases above £240,000 up to £310,000 when the annual allowance is £10,000.

Carry Forward unused annual allowance: If you haven't used up your annual allowance from previous years, you can use a process called 'carry forward' which allows you to make pension contributions to fill up any unused allowance you might have from the previous three tax years providing two conditions are satisfied.

- First, you must earn at least the amount you wish to contribute in total this tax year (unless your employer is making the contribution).
- Second, you must have been a member of a UK-registered pension scheme (this does not include the state pension) in each of the tax years from which you wish to carry forward

Annual Allowance charge: If you exceed the annual allowance you are not entitled to receive pension tax relief on any contributions over the cap so you will receive an 'annual allowance charge' which is added to the rest of your taxable income to work out your overall tax liability.

Example: Annual allowance charge

Katie has a 'net income' that is her annual income less personal allowances - of £230,000.

Her total pension contribution for the year is £20,000 over the £40,000 annual allowance.

This puts her total income for these purposes at £250,000.

Katie's total income exceeds higher-rate limit (£240,000) by £10,000, so this is subject to 45% tax = £4,500.

£10,000 of excess pension savings which fall within the band between basic and higher rate limits (£37,500 to £150,000) and is taxable at 40% = £4,000.

Therefore, Katie's annual allowance tax charge is £4,500 + £4,000 = £8,500.

The money purchase annual allowance MPAA: If you've taken money out of your pension, you can still make contributions to a pension and earn tax relief, but you get a lower annual allowance which for 2021-22 is £4,000. It applies to people who have taken money from a money purchase, or defined contribution, pension. The money-purchase annual allowance allows you to receive tax relief on contributions of up to 100% of your earnings or £4,000, whichever is the lower.

The lower money purchase annual allowance is only triggered when: you take a lump sum from your pension called an 'uncrystallised pension lump sum', or you start taking an income from your pension through income drawdown. To retain the full £40,000 annual allowance, you can take a 25% tax-free lump sum and buy an annuity or start a drawdown plan without taking an income. If the MPAA has been triggered, you cannot carry forward any unused allowances from previous years to boost the amount you can pay into your pension.

Final salary pensions and annual allowance charges: There is a more complex calculation required to determine how much of your annual allowance you've used if you are in a final salary scheme because a final salary scheme pays out an income based on your salary while you are working and your length of service.

Each year, the amount put into your pension by your employer will be what's needed to meet the pension guaranteed by the scheme and is not based on a percentage of what you earn. This is referred to as the 'pension input amount' and is the difference between your 'opening value' and 'closing value' of your pension over a set time period (usually the tax year).

The opening value is worked out as the value of your pension at the beginning of the year, multiplied by 16, plus any lump sum you're entitled to and any increases applied so that your pension keeps up with inflation. At the end of the period, the closing value is calculated on the same basis with any pay rises you may have earned.

Final salary annual allowance charge:
an example obtained from the HMRC

Tom is a doctor. He is a member of an NHS pension scheme which provides him with a pension of 1/60th pensionable pay for each year of service. At the start of the year, Tom's pensionable pay is £80,000 and he has 31 years pensionable service.

At the end of the year, Tom's pensionable pay has risen by 5% to £84,000 with 32 years pensionable service.

Tom's opening value calculation:
31 years / 60 x £80,000 = £41,333

Multiply Toms' annual rate of pension by flat factor of 16: £41333 x 16 = £661,328

Add an inflation increase of 3%:
£661,328 x 1.03 = £681,168

Tom's opening value is £681,168

Tom's closing value calculation:
32 years / 60 x £84,000 = £44,800

Multiply as before £44,800 x 16 = £716,800

Tom's closing value is £716,800

The difference between the closing value and the opening value is £35,632

This is less than the annual allowance of £40,000 so Tom does not have to pay the annual allowance charge.

BE SURE TO SEEK PROFESSIONAL INDEPENDENT ADVICE BEFORE YOU DECIDE ON A COURSE OF ACTION

History, structure, and expertise

Interface Financial Planning started providing independent financial advice in 1992. From the beginning it had the aim of providing professional advice and quality service to people with modest income and wealth.

Its key value was putting people before profit, and contribution before reward. This mission statement has been our torch to light the path ahead and has been the reason that we have endured for over 24 years.

Alan has lead the company with his personal values of: Integrity, Compassion, Respect, & Loyalty, and he is proud that over the years he has worked with clients who share similar values. Like him they want to help others and make the world a little better.

Client care and service is important and he is proud that his first two clients from January 1990 remain his clients today.

We believe that every client should have access to highly qualified advice and expertise.

Technology is used to the full to maximise efficiency and engage expertise from throughout the UK. The business has been paperless for 10 years and for over 5 years has been 'cloud' based. This structure reduces costs and allows support staff to operate anywhere - from Colchester to Honiton to Leicester and elsewhere.

Clients are encouraged to access their online account where they can exchange messages and documents securely. They can view their investments and reports, and they have immediate access to their paper file. Clients love the transparency and openness of being able to view and print paperwork going back for years and many clients use it as a source of reference.

Owner, Director
Interface Financial Planning

Alan Moran is one of the most highly qualified advisers in the UK. He became a Certified Financial Planner in 1995 and he was one of the first Chartered Financial Planners in 2005.

He is a Chartered FCSI, a holder of the IMC certificate and member of CFA UK. His expertise has been called upon by The CII, The IFP, The Kinder Institute, and others, where he has trained and examined other financial advisers.

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