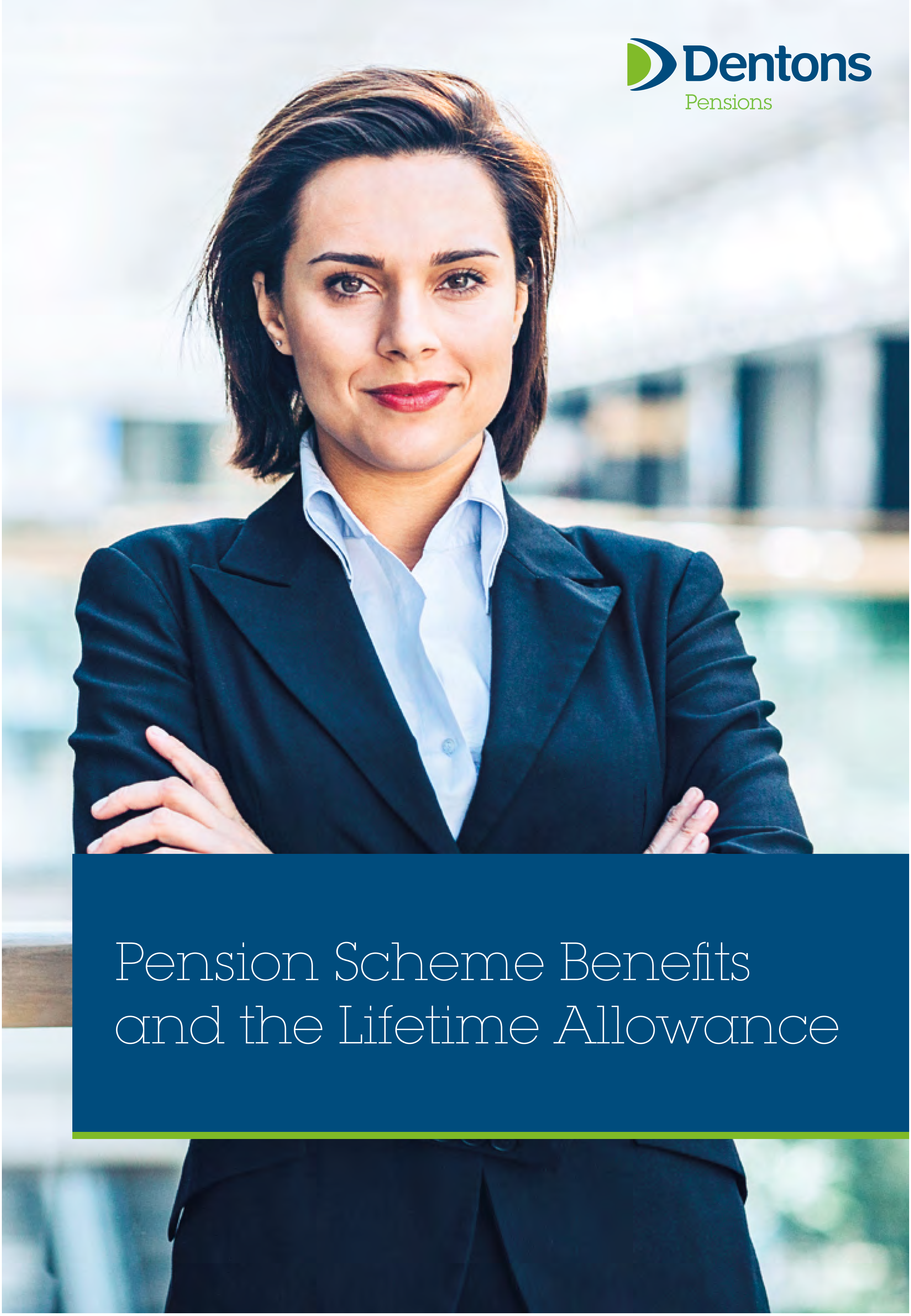


Dentons
Pensions

Pension Scheme Benefits and the Lifetime Allowance

Capability. On every level.

Foreword from Dentons.

This document outlines the main points covering the lifetime allowance and pension scheme benefits. This is a complex area and we have aimed to break it down into various sections covering the different levels of allowance, various protections, benefit crystallisation events (BCE) and how these work in practice.

This guide has been prepared to cover the main points in relation to the lifetime allowance in respect of SIPPs and SSAS. We hope you will find it useful.

Contents.

Dentons is an independent self invested pension provider with over 40 years' experience. Dentons provides administration services for Self Invested Personal Pensions (SIPPs) and Small Self Administered Schemes (SSASs) for over 7,900 SIPPs and nearly 1,400 SSASs, with over £7.5 billion assets under administration and in excess of 3,700 properties.

Our self invested pensions put clients in control, offering considerable flexibility through a wide range of asset choices and retirement benefits. With our personalised and award winning service, we can tailor how we work with advisers and direct clients to achieve client's retirement objectives.

What is the lifetime allowance?

The lifetime allowance is the maximum amount of pension scheme funds that can be, or be deemed to be, 'crystallised' (usually to provide benefits), in relation to all of a pension scheme member's registered pension schemes, without incurring a penalty tax charge.

Whenever pension funds are crystallised (known as a Benefit Crystallisation Event) on or after 6 April 2006, when the current pension tax regime came into effect, their value is tested against the member's lifetime allowance.

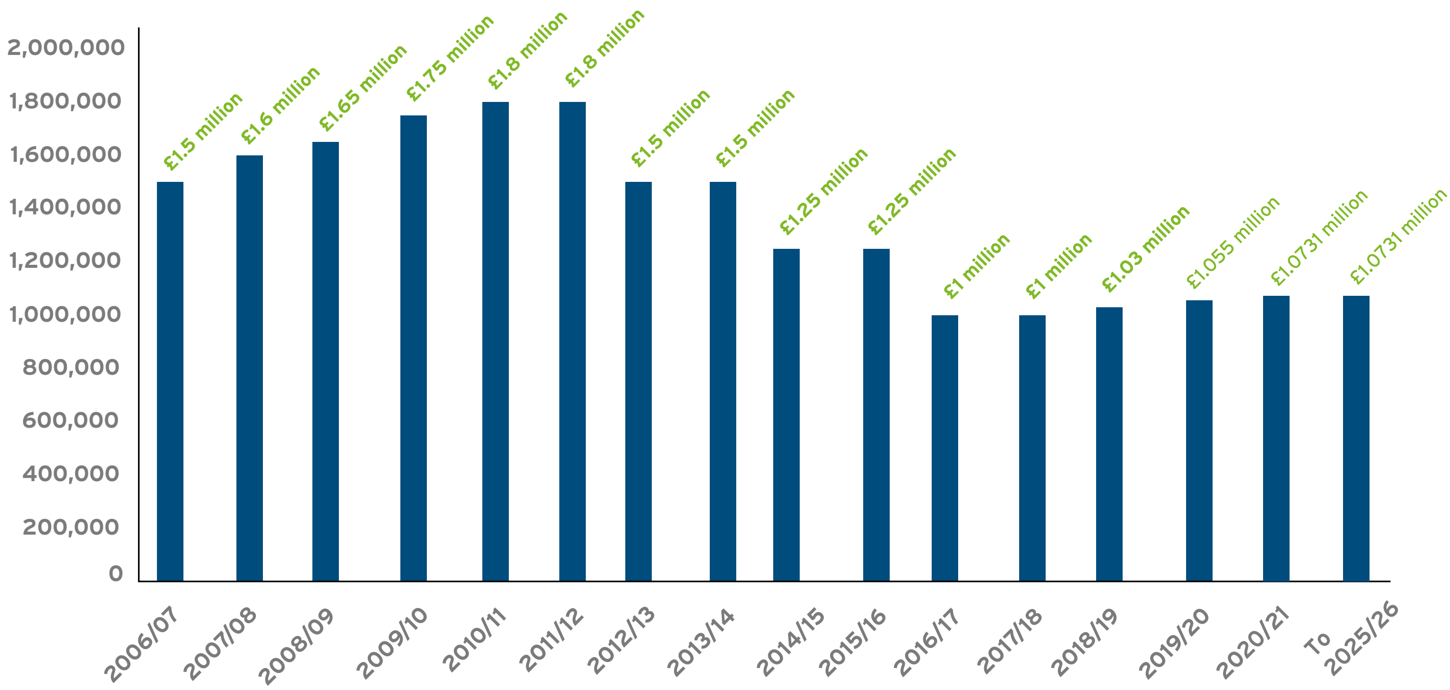
If the amount crystallised exceeds the member's remaining lifetime allowance, the excess is subject to a tax charge of 25%, or 55% if the member takes the excess as a lump sum (an option that is only available up to their 75th birthday).

Until pension scheme funds have been crystallised they are 'uncrystallised funds'.

When introduced on 6 April 2006, it was £1.5 million and increased for each subsequent tax year until 2010/11 when it was £1.8 million before reducing to £1 million for the tax years 2016/17 and 2017/18.

Since the tax year 2017/18, the standard lifetime allowance has increased in line with the Consumer Prices Index. For tax year 2018/19, it was £1.03 million and for tax year 2019/20, it was £1.055 million. For tax year 2020/21 the lifetime allowance is £1.0731 million and is frozen at this limit until April 2026.

Recent changes to the lifetime allowance over time.



The main forms of LTA protection

It has been possible for some pension scheme members to have protection from the standard lifetime allowance, normally by qualifying for and obtaining from, Her Majesty's Revenue & Customs (HMRC) a higher personal lifetime allowance that replaces the standard lifetime allowance when testing their pension funds against the lifetime allowance.

Enhanced protection

Only available to those who had accrued pension benefits up to 5 April 2006 and from that date, had no contributions paid to any registered pension schemes and ceased active membership of any final salary defined benefit pension schemes.

The pension funds of a pension scheme member with enhanced protection are not tested against the lifetime allowance, except where the member's maximum tax-free cash lump sum entitlement in relation to all their registered pension schemes is limited to 25% of the greater of the standard lifetime allowance and £1.5 million.

Primary protection

Only available to those whose pension funds at 5 April 2006 had a total value of more than £1.5 million. It provides them with a higher personal lifetime allowance as a factor of the standard lifetime allowance up to the tax year 2010/11 and since then, as a factor of £1.8 million.

The extent to which the member's rights valued on 5 April 2006 exceeded £1.5 million is expressed as a primary protection factor.

For example, a pension schem member with a primary protection factor of 0.2 would have a personal lifetime allowance of £2.16 million which is calculated as:

- Standard lifetime allowance + (lifetime allowance x enhancement factor). For example: £1.8 million + (£1.8 million x 0.2) = £2,160,000.
- Where the previous BCE was on/after 06/04/2014, apply the % of lifetime allowance used at that BCE to the current standard lifetime allowance (£1,030,000 for tax year 2019/20).

Fixed Protection 2012

Only available to those who had accrued pension benefits up to 5 April 2012 and from that date, had no contributions paid to any registered pension schemes and ceased active membership of any final salary defined benefit pension schemes.

This gives a personal lifetime allowance of £1.8 million.

Fixed Protection 2014

Only available to those who had accrued pension benefits up to 5 April 2014 and from that date, had no contributions paid to any registered pension schemes and ceased active membership of any final salary defined benefit pension schemes.

This gives a personal lifetime allowance of £1.5 million.

Individual Protection 2014

Only available to those whose pension funds at 5 April 2014 had a total value of more than £1.25 million.

This gives a personal lifetime allowance of the lower of the value of their pension funds at 5 April 2014 and £1.5 million.

Fixed Protection 2016

Only available to those who had accrued pension benefits up to 5 April 2016 and from that date, had no contributions paid to any registered pension schemes and ceased active membership of any final salary defined benefit pension schemes.

This gives a personal lifetime allowance of £1.25 million.

Lifetime allowance protection continued

Individual Protection 2016

Only available to those whose pension funds at 5 April 2016 had a total value of more than £1 million.

This gives a personal lifetime allowance of the lower of the value of their pension funds at 5 April 2016 and £1.25 million.

If at any time the standard lifetime allowance exceeds a member's personal lifetime allowance, the standard lifetime allowance will then apply instead.

It is possible for a member to have more than one form of lifetime allowance protection.

Other forms of protection include enhancement factors in respect of pension credits received following a pension sharing order on divorce and transfers received from a qualifying recognised overseas pension scheme (QROPS).

There are currently only two types of protection that you can still apply for. Please see the table below:

Protection	Am I eligible and what does it do?	Can I keep building up my pension?	Other types of protection you can hold at the same time	Other types of protection you cannot hold at the same time
Individual protection 2016	Available provided your pension savings were worth more than £1m at 5 April 2016. Protects your LTA to the lower of: › The value of your pensions savings at 5 April 2016. › £1.25 million	Yes, but when you put benefits into payment and their value exceeds your protected LTA, the excess will be subject to a tax charge	Enhanced protection Fixed protection 2012 Fixed protection 2014 Fixed protection 2016	Primary protection Individual protection 2014
Fixed protection 2016	Available, provided you or your employer haven't added to any of your pension schemes since 5 April 2016 and have opted out of any workplace pension scheme by 5 April 2016. Fixes your LTA at £1.25 million	No, except in limited circumstances. If you do, you will: › Lose your fixed protection 2016 › Pay tax on any excess above the standard LTA when you put benefits into payment.	Individual protection 2014 Individual protection 2016	Enhanced protection Primary protection Fixed protection 2012 Fixed protection 2014

Please note

Individual protection 2016 will remain dormant until the member loses or gives up their previous protections.

Individual protection 2014 will override fixed protection 2016 but any contributions paid after 6 April 2016 will result in fixed protection being lost.

Fixed protection 2016 or individual protection 2016 must be applied for online to HMRC - https://www.gov.uk/guidance/pension-schemes-protect-your-lifetime-allowance

Fixed protection and enhanced protection can be lost on a pension credit if it is paid into a new arrangement.

Pensions or annuities that came into payment before 6 April 2006

These are not tested against a member's lifetime allowance themselves, so cannot give rise to a lifetime allowance charge if their value exceeds the member's lifetime allowance. However, they will use up lifetime allowance, if the member has a Benefit Crystallisation Event (BCE) on or after 6 April 2006.

The test of how much lifetime allowance such pre 6 April 2006 pensions or annuities in payment use up, must take place just before the first post 5 April 2006 BCE is tested.

The value of a pre 6 April 2006 pension/annuity in payment is calculated as 25 times the pension/annuity in payment at the time of the test.

If the pension in payment is a flexi-access drawdown pension that had previously been a capped drawdown pension, its value will be calculated as 25 times 80% of the maximum rate of capped drawdown pension that could have been paid in the year it ceased to be a capped drawdown pension.

Example

In the tax year 2019/20, a member of a SIPP with £500,000 of uncrystallised funds decides to crystallise £400,000 of those funds in order to take benefits. They have no lifetime allowance protection, so they will be subject to the standard lifetime allowance for that tax year of £1.055 million.

The member also has a pre 6 April 2006 annuity in payment of £20,000 p.a., so this will have a value of £500,000, which will use up 47.39% of the standard lifetime allowance.

The member will then have 52.61% of the standard lifetime allowance left for the BCE of £400,000, which will use up 37.91% of the standard lifetime allowance. This leaves the member with 14.7% of the standard lifetime allowance for any future BCEs.

What is a Benefit Crystallisation Event (BCE)?

A BCE is when the pension scheme administrator (or in certain circumstances, the pension scheme member's personal representatives) must test the value of the benefits in a member's pension scheme that are being crystallised, or deemed to be crystallised, against the member's lifetime allowance.

Benefits are tested not only when benefits come into payment before their 75th birthday but also on their 75th birthday. Even if the value of a member's fund was within the lifetime allowance when benefits were first drawn, subsequent investment growth, or the failure to draw income at least equal to the investment growth, could result in a lifetime allowance tax charge at age 75.

The member takes benefits before age 75

- **BCE 1** member designates funds to provide a drawdown pension
- **BCE 2** member becomes entitled to scheme pension
- **BCE 3** scheme pension in payment is increased above the permitted margin
- **BCE 4** member uses funds to buy a lifetime annuity
- **BCE 6** member becomes entitled to a pension commencement lump sum (tax-free lump sum) or an uncrystallised funds pension lump sum

Please note: BCEs 1 and 6, where the member receives a pension commencement lump sum, usually take place at the same time.

On the member's 75th birthday

- **BCE 5A** member reaches age 75 with drawdown pension funds (crystallised funds)
- **BCE 5B** member reaches age 75 with unused uncrystallised funds

On the member's death before age 75

- **BCE 5C** unused uncrystallised funds are designated to a beneficiary's drawdown pension fund
- **BCE 5D** unused uncrystallised funds are used to purchase an annuity for a beneficiary
- **BCE 7** a lump sum paid to a beneficiary from unused uncrystallised funds

When a member transfers pension funds to a qualifying overseas pension scheme (QROPS) before age 75

- **BCE 8** uncrystallised funds and any increase in value of crystallised funds. Any event prescribed in regulations as being a crystallisation event BCE 9 – payment of arrears in pension

Any event prescribed in regulations as being a crystallisation event

- **BCE 9** payment of arrears in pension instalments after death, certain payments of tax-free cash based on pensions errors and tax-free case type payments paid after death.

Examples of Benefit Crystallisation Events

We will now give examples of the BCE events except for BCEs 4 and 5D, which are not common in our SIPPs and SSASs and BCEs 2 and 6 which relate to 'scheme pension' which Dentons does not provide.

Examples of BCEs 1 & 6

Laura is a member of both a defined benefit scheme and a SIPP. She has no lifetime allowance protection.

In the tax year 2007/08, when she was 60 and the standard lifetime allowance was £1.6 million, she started to receive her benefits from the defined benefit scheme.

The value of those benefits (tax-free lump sum and guaranteed annual pension) was £900,000, which used up 56.25% of the then standard lifetime allowance. She had 43.75% of the lifetime allowance left. In the tax year 2018/19, when she was 71 and the standard lifetime allowance was £1,030,000, she decided to crystallise her entire SIPP fund of £450,625, so that she could take her maximum tax-free pension commencement lump sum entitlement (BCE 6) and receive drawdown pension from the remaining funds(BCE1).

This used up the remaining 43.75% of her lifetime allowance. Laura's maximum tax-free pension commencement lump sum is £112,656.25 (25% of £450,625), leaving £337,968.75 from which drawdown pension payments can be made. If Laura's SIPP fund had instead been, say, £550,625, the BCEs would have created an excess above her remaining lifetime allowance of £100,000 and this would have given rise to a tax charge on the excess of 25% (£25,000) if she took an income, or 55% (£55,000) if she took the excess as a lump sum.

Example of BCE 6 for an uncrystallised funds pension lump sum

In the tax year 2019/20, Bill is 58 and is a member of a SIPP, which consists entirely of uncrystallised funds with a value of £400,000. He has previously crystallised funds in other pension schemes and has 40.38% of the standard lifetime allowance left.

He decides to take the entire fund of £400,000 as an uncrystallised funds pension lump sum and this uses up 37.91% of the standard lifetime allowance of £1.055 million.

He has 2.47% of the standard lifetime allowance left for any future BCEs.The SIPP administrator can pay Bill £100,000 (25% of £400,000) tax-free but the other£300,000 is assessable income for tax purposes and the administrator has to pay it through PAYE. The administrator must pay the two amounts at the same time.

Examples of BCEs 5A & 5B

Raj is a member of a SSAS and no other pension schemes.

In the tax year 2019/20, he is aged 75.

He has lifetime allowance protection in the form of Fixed Protection (2012) and he has previously had the following BCEs under the SSAS:

- **BCEs** 1 & 6 in the tax year 2009/10, when the standard lifetime allowance was £1.75 million - he crystallised £800,000, which used up 45.71% of his lifetime allowance. He took a tax-free pension commencement lump sum of £200,000, leaving £600,000 from which he could take drawdown pension.
- **BCEs 1 & 6** in the tax year 2015/16, when his personal lifetime allowance was £1.8 million - he crystallised £600,000, which used up 33.33% of his lifetime allowance He took a tax-free pension commencement lump sum of £150,000, leaving £450,000 from which he could take drawdown pension. He has 20.96% of the lifetime allowance left.

Examples of Benefit Crystallisation Events continued

Raj has received no drawdown pension payments from the SSAS. On his 75th birthday, Raj's share of the SSAS fund is £1.5 million and consists of £1.3 million of crystallised funds and £200,000 of unused uncrystallised funds.

- **BCE 5A** as the value of Raj's crystallised funds on his 75th birthday (£1.3 million) exceeds the total of crystallised funds left after BCEs 1 & 6 in the tax years 2009/10 and 2015/16 of £1,050,000 (£600,000 + £450,000), the excess of £250,000 is tested against his remaining lifetime allowance. This uses up 13.88% of his lifetime allowance. He has 7.08% of the lifetime allowance left.
- **BCE 5B** Raj's unused uncrystallised funds of £200,000 are also tested against his remaining lifetime allowance of 7.08% of £1.8 million, which is £127,440. As the value of his unused uncrystallised funds exceeds this amount, the excess of £72,560 is subject to a tax charge of 25%. The option to take the excess as a lump sum subject to a 55% tax charge is only available at a BCE before a member's 75th birthday.

Raj would still be entitled to a tax-free cash lump sum of £31,860 (25% of £127,440) at any time from his unused uncrystallised funds. However, if he were to die before receiving it, those funds would remain in the SSAS along with the rest of Raj's share of the SSAS fund for the Trustees to distribute at their discretion, to his beneficiaries as taxable death benefits.

Please note

The effect of BCE 5B is ignored for future crystallisations of unused uncrystallised funds beyond the member's 75th birthday. However, any crystallisations of unused uncrystallised funds beyond that point must be taken into account when assessing how much of any available lifetime allowance is used up each time. Please consult HMRC's Pensions Tax Manual for full details.

Examples of BCEs 5C & 7

Sylvia is a member of a SIPP and a defined benefit scheme. She has had BCEs 1 and 6 in both schemes over the years and has 10% of the standard lifetime allowance left. Sadly, Sylvia dies in the tax year 2019/20 aged 71 when the standard lifetime allowance is £1.055 million. Her SIPP has a value of £650,000 and consists of £450,000 of crystallised funds and £200,000 of unused uncrystallised funds.

The SIPP Administrator goes through its procedures for deciding (at its absolute discretion) who should benefit from Sylvia's SIPP funds and decides to follow Sylvia's expressed wishes in the Form of Nomination she lodged with the Administrator. The beneficiaries are her adult grandchildren Kate and Brian and each are to receive benefits from half of the funds. Kate says she wants to keep her share in the SIPP and receive beneficiary's drawdown pension payments as and when she needs them. Brian says he wants his share as a lump sum.

- **BCE 5C** as Kate has designated £100,000 of the unused uncrystallised funds for beneficiary's drawdown pension (along with £225,000 of the crystallised funds), this is tested against Sylvia's remaining lifetime allowance.
- **BCE 7** likewise, the £100,000 of unused uncrystallised funds that is paid to Brian as part of his total lump sum of £325,000, is tested against Sylvia's remaining lifetime allowance.

As Sylvia's remaining lifetime allowance is £105,500 (10% of £1.055 million), the unused uncrystallised funds exceed that amount by £94,500 The excess is allocated equally between Kate and Brian, which results in a tax charge of 25% on Kate's share and 55% on Brian's because he has taken it as a lump sum.

Sylvia's personal representatives are responsible for carrying out the test and the beneficiaries are liable for the tax charge.

As Sylvia died before her 75th birthday, the benefit payments to the beneficiaries will normally be free of any other tax charges provided that within two years of Sylvia's death, the lump sums (from either crystallised funds or unused uncrystallised funds) are paid out and unused uncrystallised funds are designated for a beneficiary's drawdown pension.

Examples of Benefit Crystallisation Events continued

Example of BCE 8

In the tax year 2019/20, Malcolm is 65 and emigrates to Australia. He is a member of a SIPP, which has a value of £1,200,000 and consists of £1,000,000 of crystallised funds and £200,000 of uncrystallised funds. He has Fixed Protection 2016, so he has a personal lifetime allowance of £1.25 million.

He joins an Australian pension scheme that is a QROPS and decides to transfer the full value of his SIPP to it.

He has had two lots of BCEs 1 and 6 in earlier years, which have used up 78% of his lifetime allowance. The amounts of crystallised funds left after each BCE and having taken his tax-free pension commencement lump sum entitlement, together total £950,000.

Therefore, the amounts that need to be tested against his remaining lifetime allowance of £275,000 (22% of £1.25 million) are the £50,000 of growth on the crystallised funds (in a similar way to BCE 5A) and the £200,000 of uncrystallised funds (in a similar way to BCE 5B) – a total of £250,000.

As the amount to be tested is less than his remaining lifetime allowance, there is no excess above the lifetime allowance and no tax charge.

Summary

We hope that you have found this document helpful as a guidance to the lifetime allowance. If you have any further questions around any of the content discussed in this document, please contact your local Dentons Sales team member as outlined below.

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