

# Pension scheme benefit allowances

The pensions Lifetime Allowance (LTA) was abolished with effect from 6 April 2024. It was replaced by two new allowances which relate to lump sums (rather than pension income) taken from pension schemes:

Lump sum and death benefit allowance (LSDBA) - set at £1,073,100 (unless forms of Protection are in place for the scheme member).

Lump sum allowance (LSA) - set at a maximum of 25% of £1,073,100 i.e. £268,275 (unless forms of Protection are in place for the scheme member).

There is no provision within the pensions legislation for increasing these limits over time.

## Lump sum and death benefit allowance

### Death before the member's 75th birthday:

The LSDBA is effectively an upper limit on the amount of pension scheme monies that can be passed on as a tax-free lump sum to beneficiaries in the event of the member's death before their 75th birthday. Any monies in excess of the LSDBA which are paid as a lump sum death benefit will be taxed at the beneficiary's marginal rate of tax when they receive the benefits. If, however, the beneficiary takes the excess over the LSDBA as beneficiary's income drawdown payments, these payments will be tax free in the hands of the beneficiary.

### Death after the member's 75th birthday:

Once a member has reached their 75th birthday, pension monies passed on are always subject to marginal rate tax in the hands of the beneficiaries - regardless of whether they are paid as lump sums or as income drawdown payments and regardless of whether or not they exceed the deceased member's LSDBA.

The taxation of death benefit payments to trusts, companies and charities is different compared to payments to individuals.

## Lump sum allowance

The LSA is an upper limit on the amount of tax-free lump sum a scheme member can take during their lifetime. Generally speaking, the scheme member will be able to take 25% of their fund value as a tax-free lump sum, assuming that their fund value does not exceed £1,073,100. For example, if the member's fund value is £100,000, the maximum tax-free lump sum payable would be £25,000. If, instead, the member's fund value was £1.5million, the maximum tax-free lump sum would be limited to £268,275 rather than 25% of £1.5million.

Once a member has taken a tax-free lump sum in their lifetime, their LSDBA is reduced by a corresponding amount. For example, if the member has taken a tax-free lump sum of £268,275, their LSDBA would be reduced by £268,275. So, if the member's LSDBA is set at £1,073,100, it would be reduced by £268,275 to £804,825 - and this becomes the maximum tax-free amount that can be passed on to beneficiaries in the event of the member's death.

Any benefits paid in excess of the member's LSA and LSDBA are taxed at the member's/beneficiary's marginal rate when paid to them.

## Lifetime Allowance Protections

Although the LTA has been abolished, the various forms of LTA Protection that exist are still vitally important - including from 6 April 2024 onwards.

This is because they provide the member with higher LSDBA and LSA amounts than the standard amounts outlined above. For example, a member with Fixed Protection 2014 will have their LSDBA set at £1.5m and their LSA set at £375,000.

The only forms of LTA protection still open for new applications are Fixed and Individual Protections 2016. The closing date for applications for these is 5 April 2025.

## What happens in respect of benefits taken before 6 April 2024?

In broad terms, benefits taken prior to 6 April 2024 will reduce the amounts of LSDBA and LSA the member has available to them from that date.

For example:

- if the member has used up all of their available LTA prior to 6 April 2024, then there will be no LSDBA or LSA available from 6 April 2024.
- If the member has not used any LTA prior to 6 April 2024, then their LSDBA will be £1,073,100 (or higher if Protections apply) and their LSA will be a maximum of £268,275 (or higher if Protections apply).
- If the member has used 50% of their LTA prior to 6 April 2024, their LSDBA from 6 April 2024 is calculated as follows:
  - 50% of £1,073,100 equalling £536,550

It is assumed that the member took maximum available pension commencement lump sum (tax-free cash) when the benefits were taken. The LSA allowance calculation becomes:

- 50% of £1,073,100 and then 25% of the resulting figure i.e. 0.5 times £1,073,100 times 0.25 equalling £134,137.50.

In this example (called the default calculation), it is assumed that the member took a tax-free lump sum of £134,137.50 even if they actually took less than this in practice.

The member's maximum LSA would therefore be reduced to £134,137.50 (£268,275 minus £134,137.50).

If the member did not take the maximum tax-free lump sum at the time, it is possible to apply for a certificate to confirm the actual amount of tax-free lump sum taken prior to 6 April 2024.

### Transitional tax-free amount certificates

To ensure that those members who did not take maximum tax-free cash prior to 6 April 2024 are not adversely affected by this default calculation, they can apply to the pension scheme from which they wish to take their first benefits on/ after 6 April 2024 for a “transitional tax-free amount certificate.” In order to do so, the member will need to supply complete evidence of the retirement benefits they have taken prior to 6 April 2024.

This will confirm the actual amount of tax-free lump sum the member took from that scheme prior to 6 April 2024 - and it is that amount which is deducted from the LSA and LSDBA.

### Case study

Anne crystallised £500,000 from a pension scheme prior to 6 April 2024 when the LTA was £1m. Therefore 50% of Anne's LTA was used up. From this, £125,000 tax-free cash was taken and the balance of £375,000 was designated to income drawdown.

The default calculation to determine the amount of tax-free lump sum to be deducted from Anne's LSA is as follows:

- 0.5 times £1,073,100 times 0.25, equalling £134,137.50.
- Therefore £134,137.50 would be deducted from £268,275 by default.

However, Anne did not actually take that amount of tax-free lump sum - she took £125,000.

Therefore, if she applies for a transitional tax-free amount certificate, this will confirm that Anne took a tax free lump sum of £125,000. In turn, this means that when Anne takes benefits after 6 April 2024, the LSA available will be calculated as:

- £268,275 minus £125,000 (equalling £143,275)

In these circumstances, by applying for a transitional tax-free amount certificate, Anne's available LSA increases from £134,137.50 to £143,275. In addition, Anne's LSDBA increases and is calculated as £1,073,100 minus £125,000 (equalling £948,100).

In order to benefit from a transitional tax-free amount certificate, the member must apply for this PRIOR to taking benefits on or after 6 April 2024 and, once obtained, that certificate must be adhered to - even if it results in a lower LSA.



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