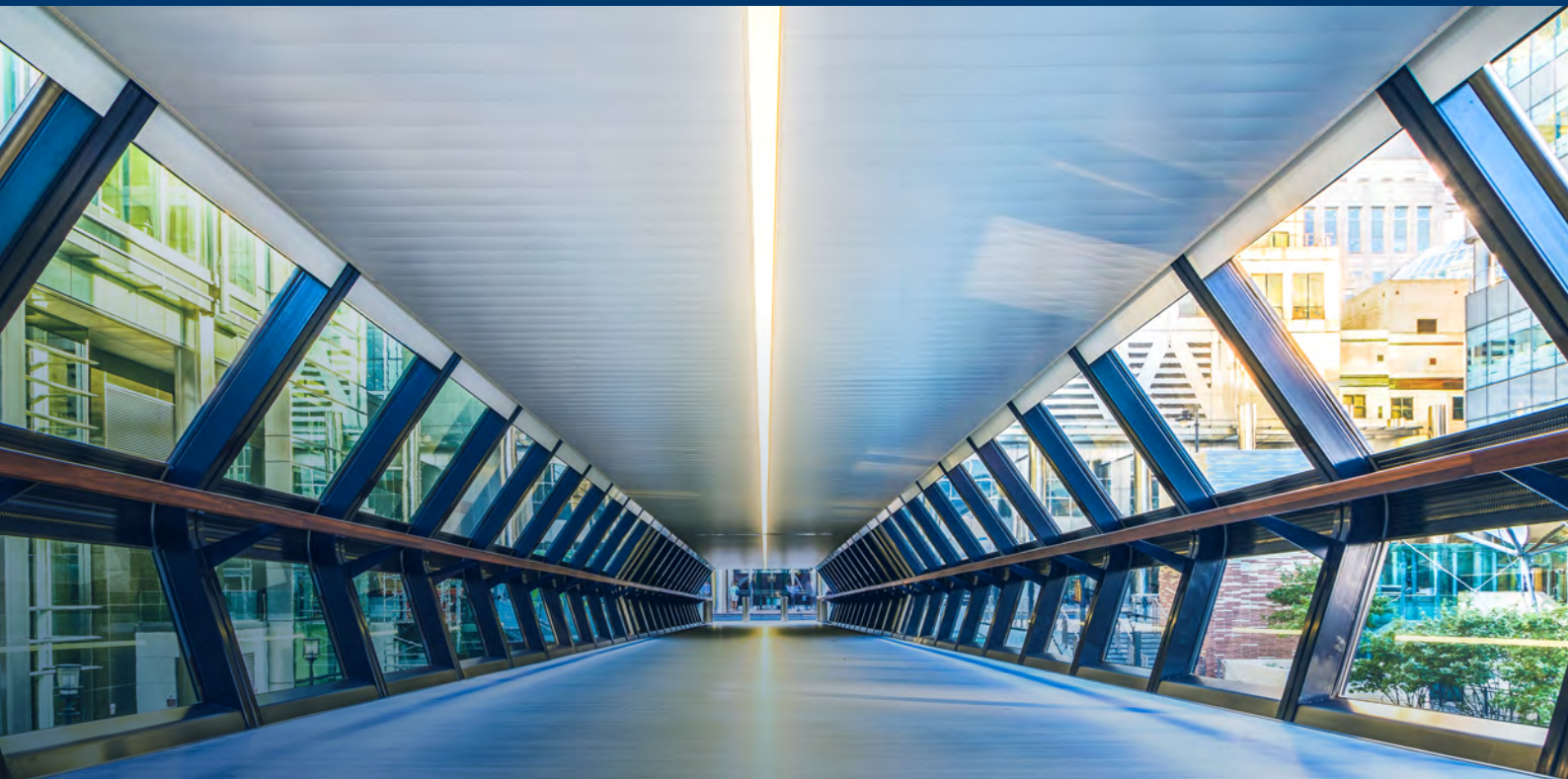


INFORM

Spring Newsletter 2024



Navigating the New
Pension Landscape -
important changes

Special
edition

- › Abolition of pensions lifetime allowance
- › LSDBA & LSA
- › Importance of LTA protections
- › What happens to benefits taken before 6 April 2024
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Budget changes are now **law**

As we reported in Newsletters during 2023, on 15 March 2023 the Chancellor of the Exchequer, Jeremy Hunt, announced in his Spring Budget the abolition of the lifetime allowance (LTA).

This was followed by an HM Revenue & Customs (HMRC) Policy Paper in July 2023 and a consultation period, in which, HMRC sought industry views on the nuts and bolts of removing the LTA from the pensions tax system. The Finance Bill 014 2023-24 received Royal Assent recently – on 22 February 2024 and has therefore been passed into law.



Abolition of the pensions lifetime allowance (LTA)

It has been confirmed that the LTA is indeed being abolished with effect from 6 April 2024. This is despite some industry commentators expressing concerns about this being too soon after the finalisation of the legislation to remove the LTA from the Registered Pension Scheme system.

What does this mean in practice?

Although the LTA is being removed, it is being replaced with two new limits which focus only on lump sums payable from pension schemes and not pension income:

- **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 legislation for increasing these limits over time.

Lump sum and death benefit allowance (LSDBA)

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 will be taxed at the beneficiary's marginal rate of tax when they receive the benefits.

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 payments and regardless of whether or not they exceed the deceased member's LSDBA.

Lump sum allowance (LSA)

The LSA is an upper limit on the amount of tax-free lump sum a scheme member can take in 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.

Abolition of the pensions lifetime allowance (LTA) continued...

Once a member has taken a lump sum in his/her lifetime, their LSDBA is reduced by a corresponding amount. For example, if the member has taken a tax-free lump sum of £268,275, his/her 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.



Importance of LTA Protections

Although the LTA itself is being 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 £1.5million and the LSA set at £375,000. Clearly, these are far more attractive than the standard amounts.

The only forms of LTA protection still open for new applications are Fixed and Individual Protections 2016. There is now a closing date of 5 April 2025 by which to apply for these.

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.

- 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, say, 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
 - and it is assumed that he/she took maximum available pension commencement lump sum (tax-free cash) when the benefits were taken.

Hence, the 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).

But, what if the member did not take the maximum tax-free lump sum at the time?

Transitional tax-free amount certificates

To ensure that those members who didn't take maximum tax-free cash prior to 6 April 2024 aren't adversely affected by this default calculation, it will be possible to 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, you will need to supply "complete evidence" of the retirement benefits you 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

Let's say that the member crystallised £500,000 from a pension scheme prior to 6 April 2024 when the LTA was £1million (hence 50% of the LTA was used up). From this, £125,000 tax-free cash was taken and the balance of £375,000 went into drawdown.

As above, the default calculation to determine the amount of tax-free lump sum to be deducted from the LSA is as follows:

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

However, this member did not actually take that amount of tax-free lump sum - they took £125,000.

Therefore, if he/she applies for a transitional tax-free amount certificate, this will confirm that £125,000 tax free lump sum was taken.

In turn, this means that when he/she takes benefits after 6 April 2024, the LSA available will be calculated as:

- > £268,275 minus £125,000 (equalling £143,275)
- > rather than £268,275 minus £134,137.50 (equalling £134,137.50)

In these circumstances, by applying for a transitional tax-free amount certificate, the member's available LSA increases from £134,137.50 to £143,275.

In addition, the member's LSDBA increases and is calculated as £1,073,100 minus £125,000 (equalling £948,100) rather than £1,073,100 minus £134,137.50 (equalling £938,962.50).

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. Consequently, it is important to be sure that such a certificate will be to the member's advantage before applying for one.

Commentary

There is undoubtedly some complexity in the changeover from the Lifetime Allowance (LTA) to the new lump sum and death benefit allowance (LSDBA) and lump sum allowance (LSA) and we would recommend that you speak to your financial adviser, if you have one, for further detail and advice/guidance.

For those scheme members who have not crystallised (taken) any benefits prior to 6 April 2024, the new allowances are broadly the same as has applied up to then and it's important to note once again that testing of benefits against limits from 6 April 2024 applies to lump sums and not pension income.

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Dentons Pension Management Limited
Sutton House, Weyside Park
Catteshall Lane, Godalming
Surrey GU7 1XE

T 01483 521 521
F 01483 521 515
E enquiries@dentonspensions.co.uk
W www.dentonspensions.co.uk

CONTACT US

For more information about any of the subject matters raised in this Update, please contact us.

Tel 01483 521 521 **Fax** 01483 521 515
enquiries@dentonspensions.co.uk
www.dentonspensions.co.uk

  @DentonsPensions

Dentons Pension Management Limited
Sutton House, Weyside Park
Catteshall Lane, Godalming
Surrey GU7 1XE

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