Pensions Tax

Changes to the Annual Allowance and Lifetime Allowance

The information in this document is based on Aon's understanding (as at March 2024) of the changes to the pensions tax regime announced in the Budget on 15 March 2023, **and the subsequent Finance (No. 2) Act 2023 and Finance Act 2024,** plus supporting regulations and additional guidance from HMRC. Some of the detail still requires further clarification. Therefore, the comments below might be subject to change.

At a glance…pension tax allowances from 6 April 2024

- **The Annual Allowance** (the limit on the amount of pension benefits you can build up in a tax year, above which additional tax applies) is £60,000.
- **The tapered Annual Allowance** applies to those with an 'adjusted income' in excess of £260,000 p.a. - the minimum tapered Annual Allowance is £10,000 and, applies to those with an 'adjusted income' in excess of £360,000.
- **The Money Purchase Annual Allowance** (the limit on the amount of money purchase contributions you can make in a tax year, after you have "flexibly accessed" any money purchase pensions savings, above which additional tax applies) is £10,000.
- **The Lump Sum Allowance (LSA)** is the limit on the total amount of tax-free lump sums (or tax free element of lump sums) payable to members. This applies to pension commencement lump sums (PCLS) or the 25% tax free part of a lump sum from a DC Plan. For those without earlier protections the LSA is £268,275 (although, as before 6 April 2024, a further limit broadly of 25% of the value of pension benefits put into payment also applies).
- **The Lump Sum and Death benefit allowance (LSDBA) is a limit on the total amount of tax-free lump sums payable to or in respect of members.** It applies to PCLS and the 25% tax free part of a lump sum from a DC Plan PLUS serious ill-health lump sums and lump sum death benefits (other than lump sums on death from funds designated for drawdown before 6 April 2024, or trivial or charity lump sums). The LSDBA is £1,073,100.
- **The Lifetime Allowance** has been removed from legislation.

Why bring you this information

This document is intended to give you a high level overview of the pension taxation allowances from 6 April 2024. Please visit here for information on how the allowances were set in prior tax years.

This communication is provided for information only, it is not a recommendation to take a particular course of action(s). Saving for your retirement is one area of consideration and you need to be comfortable how this may impact other areas of your personal finances. If you are at all uncertain about making any decisions to do with your finances and benefits, please take advice. Please see later in this document for more details on getting financial advice.

Lump Sum Allowances

Pension Commencement Lump Sums

A Pension Commencement Lump Sum (PCLS) is often referred to as a tax-free lump sum. Since 2006, the maximum PCLS has been set equal to 25% of the value of an individual's pension benefits at retirement, and, prior to 6 April 2024, subject to an overall maximum of 25% of the standard Lifetime Allowance (or in circumstances where an individual has retired or taken pension benefits from another scheme already, 25% of an individual's remaining Lifetime Allowance).

Some individuals, with certain pension protections, may have been able to protect a higher PCLS.

From 6 April 2024, the overall maximum PCLS for those without protections is £268,275 – this is defined as a "Lump Sum Allowance". There has been no indication that the Lump Sum allowance is expected to change over time.

Pension Commencement Excess Lump Sums

A new Pension Commencement Excess Lump Sum, or PCELS, is introduced from 6 April 2024, potentially allowing for the payment of an additional lump sum on retirement, although one which is not tax free. It is payable in similar circumstances to a PCLS but can only be paid when all of your Lump Sum Allowance has been used up. Where individuals are allowed to and choose to take a PCELS, it will be subject to income tax at your marginal rate.

The detailed rules for taking a PCELS are complex and therefore are outside the scope of this document.

Lump Sum and Death Benefit Allowance

A new Lump Sum and Death Benefit Allowance (LSDBA) is introduced from 6 April 2024 and is set at £1,073,100. The LSDBA is the total amount of tax-free lump sums (including the PCLS and tax-free lump sum death benefits) that can be paid to you or in respect of you, before taxation at your marginal rate applies. Serious ill-health lump sums can also be paid within this allowance.

It is important to note that the allowance will only be used up by tax free lump sums, not lump sums subject to tax or pensions. Any lump sums paid within the LSDBA will reduce the available amount of that allowance for benefits payable at a future date.

There has been no indication that the Lump Sum and Death Benefit Allowance is expected to change over time.

Lifetime Allowance Protections remain relevant for lump sums

A number of protections have been made available in the past allowing certain individuals to limit their exposure to the Lifetime Allowance and boost their tax-free lump sum entitlement. These include Fixed Protections, Individual Protections, Enhanced Protection and Primary Protection.

Despite the abolition of the Lifetime Allowance, the protections will remain relevant to the extent that they provide members with a protected right to a higher LSA or LSDBA.

Members who hold a valid enhanced protection or any valid fixed protections, where this protection was applied for before 15 March 2023, have from 6 April 2023 been able to accrue new pension benefits, join new arrangements or transfer without losing this protection.

Adjusting the LSA for benefits brought into payment before 6 April 2024

If you have received a lump sum or started receiving a pension before 6 April 2024, your LSA will be assumed to be lower than £268,275. You will need to provide details to the scheme you are retiring from on how much LTA you had used up immediately prior to 6 April 2024.

The LSA would be reduced by 25% of the LTA used immediately before 6 April 2024, unless a transitional tax-free amount certificate is applied for. A transitional tax-free amount certificate may be of value if before 6 April 2024 you took a PCLS less than 25% of the value of the benefits being taken*.

To apply for a transitional tax-free amount certificate, you would typically need to supply information to the first scheme you are retiring from after 6 April 2024, providing details of the amount of tax free lump sum (PCLS) you have taken before 6 April 2024. You would need to provide this information ahead of your retirement date to give the administrator time to process and provide a certificate.

Example

A member has used 50% of the standard LTA before 6 April 2024.

By default, the member would only be able to take a maximum PCLS of £268,275 – 25% x 50% x £1,073,100 = £134,137.50

However, the member provides information that they have only taken £50,000 as PCLS before 6 April 2024. The member can apply for a certificate that would allow their remaining LSA to be £268,275 - £50,000 = £218,275

*Obtaining a certificate might increase or **reduce** the PCLS an individual can take. If a PCLS was taken when the LTA was significantly higher than £1,073,100 obtaining a certificate could reduce the available LSA (even if the PCLS taken was lower than 25% of the LTA used at the time) and care should be taken before deciding whether to apply for a transitional tax-free amount certificate.

Adjusting the LSDBA for benefits brought into payment before 6 April 2024

A similar process is applied to the LSDBA, for testing an authorised lump sum death benefit, PCLS, UFPLS or SIHLS after 6 April 2024.

The available LSDBA is reduced by 25% of LTA used before 6 April 2024 (or 100% of any tax free serious ill health lump sums and lump sum death benefits used before 6 April 2024).

If a member/representative has applied for a transitional tax-free amount certificate, that amount will be used. If the member used the entire LTA before 6 April 2024 there would be no available LSDBA (unless there is a transitional tax-free amount certificate to use).

Annual Allowance

The Annual Allowance is the maximum amount of pension saving you can make, or have made for you by your employer, in a single year, that will receive full tax relief

Pension savings tested against the Annual Allowance

For a defined contribution arrangement, these pension savings are equal to the total contributions credited to **all** your UK pension arrangements over the tax year. For a defined benefit arrangement (also known as a 'final salary' arrangement), the pension savings are equal to the pension input amount for the year - broadly 16 times the new pension accrued over the year, net of an allowance for inflation.

Annual Allowance from 6 April 2023 onwards

From 6 April 2023, the standard Annual Allowance is £60,000, but will taper down to as low as £10,000 for higher earners. Prior to April 2023, a lower allowance applied (see below).

The point at which the Annual Allowance starts to taper down, in line with an individuals' 'adjusted income', is £260,000 (see the next page for what is included in your ‘adjusted income’).

If you have adjusted income of £260,000 or less, you will have the standard Annual Allowance of £60,000.

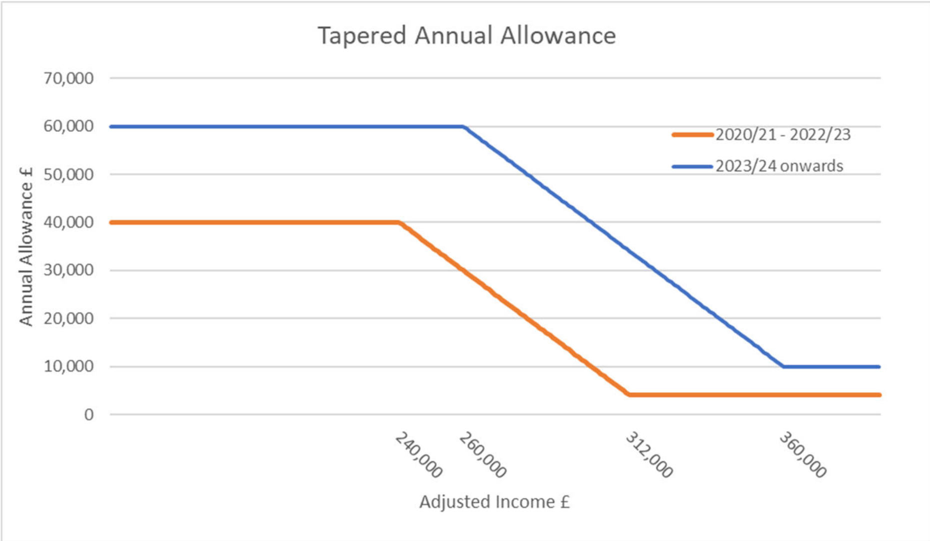
Those with adjusted income between £260,000 and £360,000 are expected to be subject to a tapered Annual Allowance; and those with adjusted income of £360,000 or more will be subject to the new minimum tapered annual allowance of £10,000.

How the tapered Annual Allowance worked from 2020/21 to 2022/23 tax years

The standard Annual Allowance was £40,000 for the tax years 2020/21 to 2022/23. Individuals with ‘adjusted income’ (see below) above £240,000 are subject to an Annual Allowance of less than £40,000. For these individuals, the Annual Allowance reduced steadily in proportion to income above £240,000, ultimately reaching £4,000, for those deemed to have an income of over £312,000.

You are able to carry-forward any unused Annual Allowance from the previous three tax years. Please visit here for information on how the Annual Allowance was determined in earlier years.

The chart below illustrates the (tapered) Annual Allowance from 2023/24 tax year compared to the 2022/23 tax year at an equivalent 'adjusted income'.



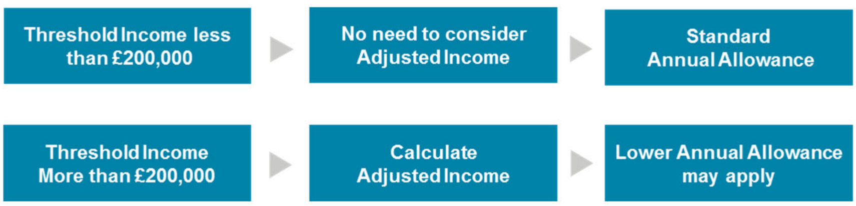
The definition of 'adjusted income'

Broadly, adjusted income is defined as your taxable income from **all** sources (not just employment income) during the tax year plus the value of your pension savings over the year (less any employee contributions with 'relief at source'). For a defined contribution arrangement, these pension savings are equal to the total contributions credited to your arrangement(s) over the year. For a defined benefit arrangement (also known as a 'final salary' arrangement), the pension savings are equal to the pension input amount (the amount HMRC test against the Annual Allowance) for the year - broadly 16 times the new pension accrued over the year, net of an allowance for inflation.

The definition of 'threshold income'

For some individuals, the reduced Annual Allowance will not apply, even if their adjusted income is above £260,000. If your 'threshold income' is less than £200,000 then your Annual Allowance, from 6 April 2023, is £60,000 regardless of your adjusted income. 'Threshold income' is broadly equal to your taxable income, excluding the value of pension savings and deducting any member contributions with 'relief at source', such as to a personal pension, but adding back any employment income given up in the tax year for pension provision as a result of any salary sacrifice entered into on or after 9 July 2015.

The above is a summary. For full details on how to accurately determine your 'threshold income' and 'adjusted income' please see HMRC guidance here.



Money Purchase Annual Allowance

Please also note that the standard Annual Allowance may be reduced if you have “flexibly accessed” any money purchase funds from any of your pension arrangements on or after 6 April 2015.

Once members were given the ability to access their pension savings flexibly (from 6 April 2015), a money purchase annual allowance (MPAA) was introduced for those members who accessed their savings and wished to continue making further contributions to a money purchase pension, limiting the tax-relief available on these contributions. The MPAA increased to £10,000 with effect from 6 April 2023. It had been £4,000 since 6 April 2017.

What happens if you exceed the Annual Allowance?

If you exceed the Annual Allowance plus any unused allowances from the three previous tax years you will have to pay an additional tax charge. The tax charge is calculated by adding the amount by which you have exceeded the Annual Allowance (allowing for unused allowances from the three previous years) to your other taxable income - tax will then apply depending on what tax band the excess amount falls into.

You will need to complete your self-assessment tax return to accurately determine whether you are subject to an Annual Allowance tax charge**.** HMRC's guidance on how to do this can be found here**.**

Member example (money purchase)

Anne's basic salary is currently £260,000 and she has no other source of income. Anne pays 5% of her basic salary into her DC occupational pension scheme (which reduces her taxable earnings as it operates ‘net pay’ rather than ‘relief at source’) and her employer pays 15%.

Annual Allowance from 2023/24

Anne's pension savings over the tax year were £52,000, of which she paid £13,000 and her employer paid £39,000. Her taxable income was therefore £247,000 and above the £200,000 threshold, meaning the reduced Annual Allowance applies to her.

Her adjusted income for assessing the Annual Allowance is taken to be her taxable earnings (£247,000) plus the value of her pension savings over the year (£52,000) - i.e. £299,000.

As her adjusted income exceeds £260,000 by £39,000, her Annual Allowance will be reduced by 50% of this - i.e. £60,000 - 50% x £39,000 = £40,500. So, Anne had pension savings of £52,000 but an Annual Allowance of only £40,500.

This means that she will have exceeded her reduced Annual Allowance by £11,500 and will be subject to an Annual Allowance charge of £5,175 (based on a marginal tax rate of 45% and assuming that she has no carry-forward available).

Scheme Pays

In certain circumstances, a pension scheme is obliged to pay the Annual Allowance tax charge on behalf of an individual, this is known as Mandatory Scheme Pays. If an individual does not have a right to Mandatory Scheme Pays, many pension schemes offer what is known as Voluntary Scheme Pays. A pension scheme may set its own criteria for when Voluntary Scheme Pays can be used.

If a pension scheme pays an individual’s tax charge on their behalf, the individual's benefits in that scheme would be reduced to reflect the scheme pays payment.

Finding out more

The tax changes – you can find more details of the current rules on the HM Revenue & Customs website at https://www.gov.uk/tax-on-your-private-pension/pension-tax-relief

and the recent changes here:

From 6 April 2023 - https://www.gov.uk/government/publications/abolition-of-lifetime-allowance-and-increases-to-pension-tax-limits/pension-tax-limits

From 6 April 2024 - https://www.gov.uk/government/publications/abolition-of-the-lifetime-allowance-from-6-april-2024/abolition-of-the-lifetime-allowance-lta

Your pension benefits – any questions regarding your pension benefits should be directed to your usual pension contact.

Getting advice – If you do not currently have an IFA, there is information on how to find one on the MoneyHelper website. There is also a directory of IFAs who are regulated by the Financial Conduct Authority. Go to www.moneyhelper.org.uk and search for 'Find a retirement adviser'.

You can also check the details of any IFA you are thinking of using on the Financial Conduct Authority website at https://register.fca.org.uk/. Alternatively, phone their contact centre on 0800 111 6768 and ask them to check for you.

Remember that you may have to pay a charge for any advice that you receive.

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