# LIFETIME ALLOWANCE

The standard lifetime allowance was introduced from 6 April 2006 ("A Day") and is an HMRC limit on the total value of an individual's pension arrangements which qualify for favourable tax treatment. Additional tax charges apply to any value above the lifetime allowance.

Further changes were made to the standard lifetime allowance rules with effect from 6 April 2012 and 2014. The lifetime allowance from 6 April 2017 is £1 million

The standard lifetime allowance amounts since its introduction in 2006 are shown in the table below :

| Tax Year | Standard Lifetime Allowance |
|---|---|
| 2006/07 | £1.50m |
| 2007/08 | £1.60m |
| 2008/09 | £1.65m |
| 2009/10 | £1.75m |
| 2010/11 & 2011/12 | £1.80m |
| 2012/13 & 2013/14 | £1.50m |
| 2014/15 and 2015/16 | £1.25m |
| 2016/17 and 2017/18 | £1.00m |

## Testing against the allowance

The value of your pension arrangements is tested against the lifetime allowance:

- Each time that you start to draw benefits. If you draw benefits in stages, then a separate test is carried out each time; or
- On your death, for any pension arrangements you are not taking benefits from yet; or
- If you transfer to an overseas pension arrangement; or
- If you take your pension by income drawdown, then a further test is made when you subsequently buy an annuity or reach age 75, whichever is earlier.

## Testing when you draw benefits

This will be the most common check against the lifetime allowance. The value of the benefits you are starting to draw is compared with the amount of lifetime allowance you have remaining at the time. In carrying out this calculation, any pension already in payment on A Day is multiplied by 25 to arrive at a capital value.

For example, suppose you have a fund of £800,000 and another pension scheme which is already paying a pension of £12,000 p.a. You decide to draw benefits from £450,000 of your fund on 1 March 2016.

The value of the pension you are already drawing is 25 times £12,000 = £300,000. Adding this to the fund of £450,000 you are now drawing on produces a total of £750,000.

The lifetime allowance on 1 March 2016 is £1,250,000. You have therefore used up 60% of your lifetime allowance (750,000/1,250,000). You still have 40% of the lifetime allowance available for the future.

On 1 January 2018 you decide to draw from the balance of your fund, which has grown from £350,000 to £450,000. The lifetime allowance is now reduced to £1m, so you have 40% of this still available, i.e. £400,000. £50,000 of your fund is over the limit and will be subject to tax charges.

## What are the charges?

The additional tax charges on funds in excess of the lifetime allowance are:

- 55% on any payment made as a lump sum
- 25% on payments taken as an income (in addition to income tax)

## Protection against the charges

There are a number of different types of protection currently or historically available to pension fund holders to protect themselves against the tax charge.

- **April 2006**
    - **Primary Protection**
      If the value of your pension benefits at 5 April 2006 was more than the 2006/2007 lifetime allowance of £1.5million, you had the opportunity to apply for Primary Protection. A person covered by Primary Protection has a Primary Protection Factor which is the additional percentage of Lifetime Allowance to which you are entitled based upon how much your benefits at 5 April 2006 exceeded the value of the 2006/2007 standard lifetime allowance. The lifetime allowance decreased to £1.5 million on 6th April 2012, however members with primary protection have a protected amount based on a standard lifetime allowance of £1.8m. You are no longer able to apply for this protection.

    - **Enhanced Protection**
      If your pension fund exceeded the Lifetime Allowance at April 2006 or you felt it would exceed the lifetime allowance in the future, you could apply for this protection. This protection allows you to take benefits from your pension fund without them being subject to a lifetime allowance tax charge. Certain actions such as accruing benefits after 6 April 2006 can result in the loss of enhanced protection. You are no longer able to apply for this protection.

- **April 2012**
    - **Fixed Protection 2012**
      Following the reduction in the lifetime allowance to £1.5m in April 2012, it was possible to apply to fix your lifetime allowance at the level of £1.8m. As with Enhanced Protection, certain actions can result in the loss of protection such accruing further pension benefits. You are no longer able to apply for this protection.

- **April 2014**
    - **Fixed Protection 2014**
      Ahead of the reduction in the lifetime allowance to £1.25m in April 2014, it was possible to apply to fix your lifetime allowance at the level of £1.5m. As with Enhanced Protection, certain actions can result in the loss of protection such accruing further pension benefits. You are no longer able to apply for this protection.

    - **Individual Protection 2014**
      This protection allows you to fix your lifetime allowance at the value of your pension benefits as at 5 April 2014 up to a maximum of £1.5m however your fund size at that date must be at least £1.25m. You are able to continue to make pension contributions however you are not able to apply for this protection if you already hold Primary Protection. This protection can be applied for until 5 April 2017.

- **April 2016**
    - **Fixed Protection 2016**
      Following the reduction in the lifetime allowance to £1.0m in April 2016 it is possible to apply to fix your lifetime allowance at the level of £1.25m. As with Enhanced Protection, certain actions can result in the loss of protection such accruing further pension benefits. If you hold another form of protection (other than Individual protection 2014), you are unable to apply for this protection.

    - **Individual Protection 2016**
      This protection allows you to fix your lifetime allowance at the value of your pension benefits as at 5 April 2016 up to a maximum of £1.25m however your fund size at that date must be at least £1.0m. You are able to continue to make pension contributions however you are not able to apply for this protection if you already hold Primary Protection.

You will have a certificate from HMRC for any of the above forms of protection that you hold. You should be aware that protection can be lost in the event of certain actions such as:

- Commencing a new pension arrangement other than to accept a transfer of existing benefits
- An increase in your benefits in excess of cost of living increases
- Paying contributions to a pension arrangement
- Undertaking certain pension transfers

You were also able to protect tax free cash entitlements at A Day of more than £375,000 of the fund as part of this process and this would be reflected on your Protection Certificate. If the scheme, of which you were a member at A Day, had an entitlement to tax free cash greater than 25%, it is possible to protect this as "Scheme Specific Protection" however this can be lost upon transfer to an alternative scheme.

If you have applied for one of the forms of protection, then your fund will be protected up to that level. If you do not have protection and your fund performs well, there is a risk that it could exceed the lifetime allowance at some point. One way of reducing this risk is to draw your benefits earlier, rather than delaying and letting the funds grow until they are excessive.

As mentioned above, if you take income drawdown there is a further test against the lifetime allowance when you subsequently buy an annuity or reach age 75, based on the fund value at that time. If you do not have protection, the risk of exceeding the lifetime allowance can be reduced by drawing regular income from the fund, rather than taking little or no pension and allowing the fund to become excessive.

## The position on death

On death, any pension funds you are not drawing from are tested against the lifetime allowance.

For example, suppose a person has already drawn on pension arrangements which used up 80% of their lifetime allowance. If they die on 1 March 2017 they have 20% of the lifetime allowance of £1.00m unused, i.e. £200,000.

If they still have a fund of £400,000 at that time on which they have not started drawing benefits, that fund is tested against the allowance and £200,000 is within the allowance and £200,000 is excess.

The way in which this works is that the amount within the allowance, i.e. £200,000, can be paid out as a tax free lump sum. The balance can be paid out as a lump sum or dependant's pension and will be subject to a lifetime allowance charge. Under these circumstances it is the responsibility of the deceased's personal representatives to report the lifetime allowance charge to HMRC and arrange for the charge to be paid.

If you have applied for protection on your funds as set out above, the standard lifetime allowance does not apply on death and the full fund up to the protected amount could be paid out as a lump sum.

**Curtis Banks Ltd**

**April 2017**