Bloomsbury Wealth®

The Bloomsbury Wealth GUIDE TO PENSIONS

Understanding how the annual and lump sum allowances apply to your pension benefits.

INTRODUCTION

On 6th April 2006 the UK pension regime underwent a radical and refreshing overhaul. Known as 'pension simplification', eight regimes merged into one. However, in the environment of austerity which followed the global financial crisis in 2008, further changes were introduced which serve to limit the value of tax reliefs (and thus their cost to the Exchequer) afforded to registered pension schemes.

This document explains the various changes made to the main aspects of UK pension rules following subsequent changes that came into force on the 6th April 2024.

As ever with complex rules, each individual's personal preferences, needs and circumstances will be different and what makes sense for one person may not be appropriate for another. You should, therefore, use this publication only as the starting point for a discussion with your professional adviser to formulate a plan of action in the light of your overall wealth plan.

Warm regards,

The Bloomsbury Wealth Team

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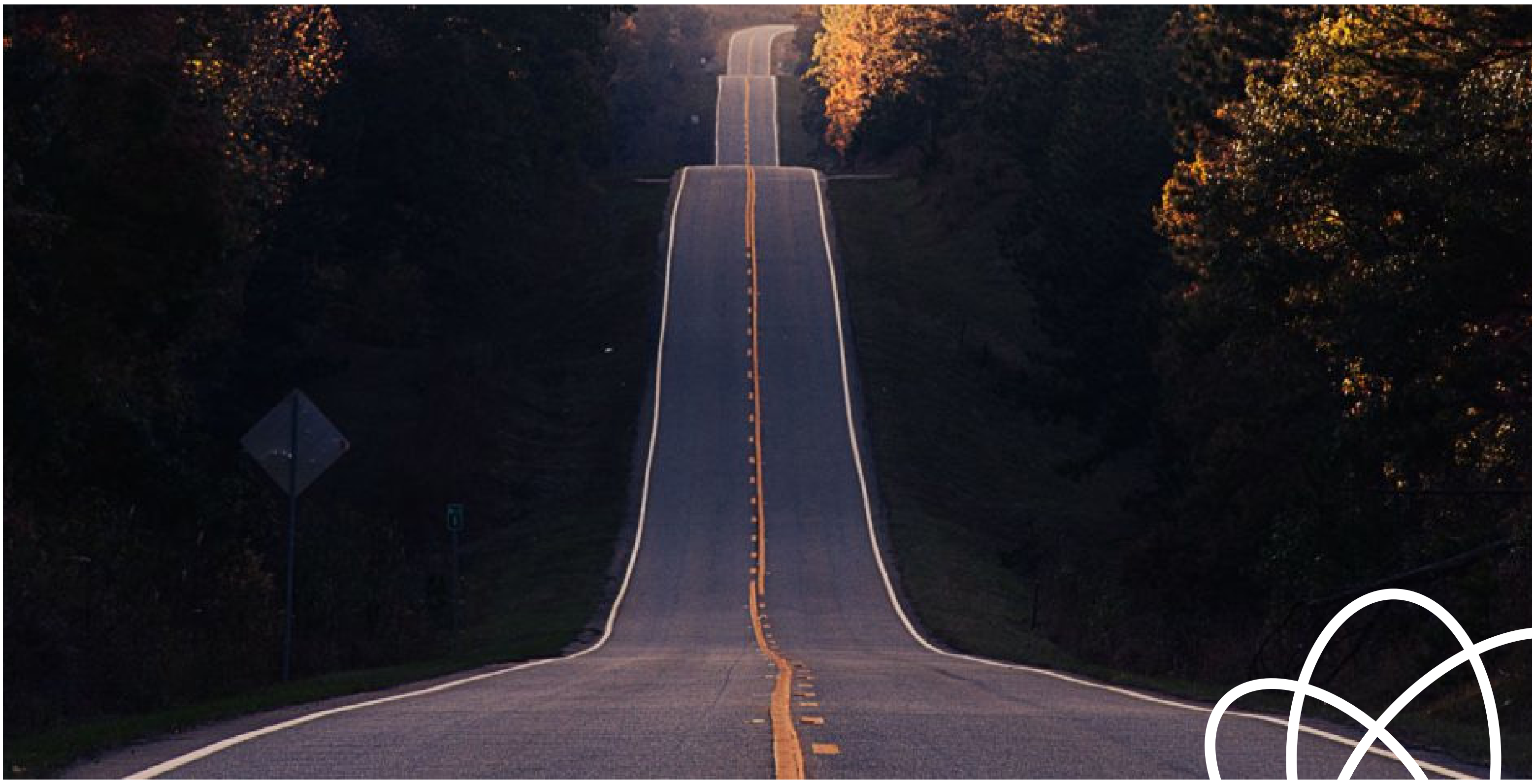
THE ANNUAL ALLOWANCE

The pension annual allowance was first introduced in April 2006 and has changed several times since. It refers to a limit to the total amount, for tax relief purposes, of contributions that can be paid to defined contribution pension schemes and the total amount of benefits that can be built up in defined benefit pension schemes each year.

In addition to the annual allowance there are two further limits on 'tax-relievable' contributions:

- One is on the amount of tax-relievable contributions which an individual can personally make towards pensions. These are limited to the higher of £3,600 gross each year or 100% of relevant UK earnings.
- Employer contributions are also relievable for the employer as an expense against profits, assuming that the contributions qualify as being "incurred wholly and exclusively for the purposes of the employer's trade or profession" as defined by His Majesty's Revenue and Customs (HMRC). This effectively means that the amount of the contributions has to be reasonable given the individual's role within the organisation and their level of overall remuneration. However, there is no explicit requirement that they do not exceed the level of the member's relevant earnings.

There is no limit on amount of pension contribution or accrual that can be made but there is a limit on the amount of tax relief that can be claimed. The annual allowance does not affect the amount of tax relief that can be received; it is a limit above which a tax charge is made to reclaim the excess tax relief.



Standard annual allowance

The annual allowance since April 2011 is as follows:

Tax Years	Annual Allowance
2011/12-13/14	£50,000
2014/15-22/23	£40,000
2023/24	£60,000

Currently increases in pension benefits must not exceed the annual allowance of £60,000 or a tax charge will apply on any excess, which has the effect of clawing back any income tax relief given on that amount.

For defined benefit schemes, the increase is calculated using a formula based on the amount by which the individual's accrued benefits have increased by more than inflation during the relevant tax year.

For defined contribution schemes, it is based on the value of contributions paid by or for the member's benefit, including contributions made by an employer.

If the annual allowance is breached, it is the member who is responsible for the annual allowance charge on any tax-relievable contributions made by an employer/third party (as well as on their own contributions).

Money purchase annual allowance

In addition to the standard annual allowance, there is also further consideration for those who have accessed their pension flexibly (see Pension benefit options for more information on pension benefit options after April 2015).

Where this has been done under the new flexible pension rules, the money purchase annual allowance (MPAA) rules will also apply. The MPAA was introduced in the Taxation of Pensions Act 2014 and is designed to discourage abuse of the new flexible pension rules by introducing a lower annual allowance (originally £10,000, reduced to £4,000 for 2017/18 to 2022/23 but now £10,000 again) where flexibility has been accessed. For the avoidance of doubt, the MPAA does not replace the current annual allowance rules but must be calculated alongside the normal annual allowance from the date that it is triggered.

The following events will trigger the MPAA:

- Drawing funds from a scheme using flexi-access drawdown;
- Taking an uncrystallised funds pension lump sum (UFPLS);
- Converting a pre-6th April 2015 'capped drawdown' arrangement to flexi-access drawdown and then drawing funds;
- Taking more that the permitted maximum from a 'capped drawdown' arrangement;
- Receiving a standalone lump sum when entitled to primary protection with lump sum protection that exceeds £375,000;
- Receiving a payment from a lifetime annuity which has the option to decrease the income received other than in permitted circumstances or
- Receiving a scheme pension directly from a defined contribution scheme where the scheme is paying scheme pensions to fewer than 11 members (including dependants).

The MPAA does not apply where a dependant, nominee or successor takes flexible benefits from a dependant's, nominee's or successor's flexi-access drawdown or annuity. See the 'Pension death benefits' section for more information on these pension benefits.

The MPAA can be triggered part-way through a tax year, resulting in contributions being tested against an alternative annual allowance (the standard annual allowance less the MPAA) for those before the trigger event and against the MPAAfor those paid after the trigger event.

As the MPAA only applies to money purchase (defined contribution) schemes and not to benefit accrual in defined benefit schemes, it is possible to trigger the MPAA and still have a standard annual allowance for defined benefit schemes. However, if contributions to defined contribution schemes after the trigger event exceed the MPAA then the alternative annual allowance of £50,000 applies to any defined benefit accrual.

CASE STUDY

Mark has a SIPP to which his employer is contributing £3,000pm. He decides to take uncrystallised lump sum from the pension on 1st December, which is a trigger event for the MPAA. The contributions paid before the trigger event (totalling £24,000) are assessed against an alternative annual allowance of £50,000 (£60,000 less the MPAA of £10,000). Those contributions after 1st December (£12,000) are assessed against the £10,000 MPAA, resulting in a tax charge on the £2,000 excess even though the total paid in the year is under the £60,000 annual allowance.

Tapered annual allowance

Since 5th April 2016 an additional type of annual allowance has applied to 'high-income' individuals, which reduces the standard annual allowance by tapering the amount allowable as income rises. For the tax years 2016/17 to 2019/20 inclusive, 'high income' individuals were defined by HMRC as:

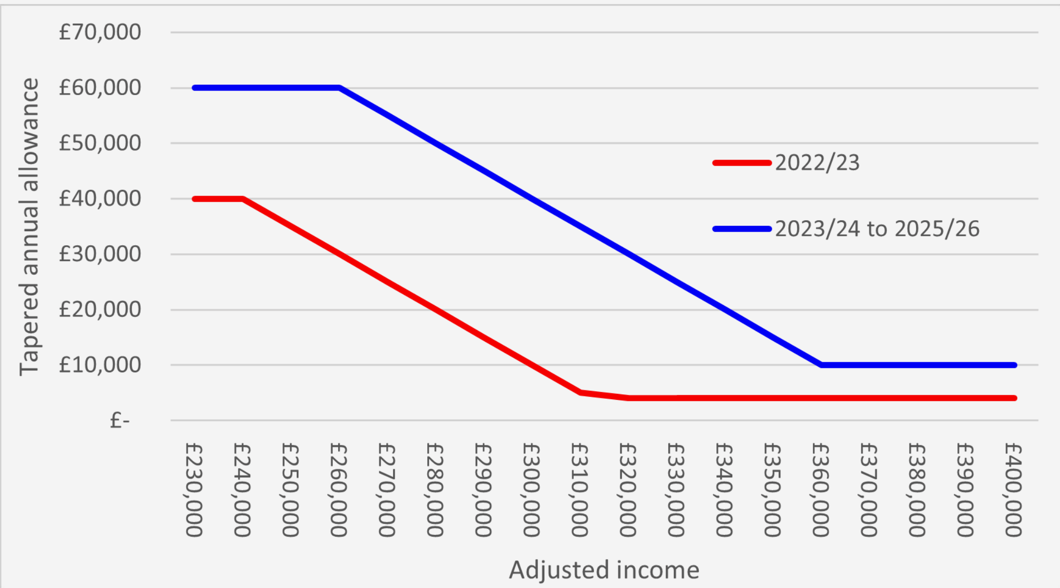
- those who have 'adjusted income' of over £150,000 for a tax year and
- those who have 'threshold income' of over £110,000.

From tax year 2020/21 to 2022/23, these limits were increased to £240,000 for 'adjusted income' and £200,000 for 'threshold income'. From the 2023/24 tax year these changed again to:

- those who have 'adjusted income' of over £260,000 for a tax year and
- those who have 'threshold income' of over £200,000.

The applicable figures for each individual tax year are used when determining whether tapering applies for that year.

For individuals whose income is above both figures in those tax years, every £2 of adjusted income above the figure for the relevant tax year will reduce their standard annual allowance by £1 up to a maximum reduction of £36,000 for 2022/23 and £50,000 for 2023/24 onwards. Therefore an individual with adjusted income of £360,000 or above will have an annual allowance from 2023/24 onwards of £10,000 but only £4,000 for 2022/23. See below:



CASE STUDY

Bill has a salary of £250,000, dividends of £5,000 and interest of £5,000. He receives an employer pension contribution of £40,000 and makes a personal contribution of £20,000.

His adjusted income is:
£260,000 (total income) + £60,000 (all pension contributions) - £20,000 (gross personal contributions) = £300,000

His threshold income is:
£260,000 (total income) - £20,000 (gross personal contributions) = £240,000

It is important to understand what are 'adjusted' and 'threshold' income.

Adjusted income is defined as:

- Total gross income from all sources chargeable to income tax;

plus

- All pension contributions (including employer payments) including any taken from salary sacrifice arrangements;

less

- Any gross pension contributions paid personally;
- Any other allowable deductions, i.e. professional subscriptions or charitable donations;
- Any lump sum death benefits where the recipient is liable to tax.

Threshold income is defined as:

- Total gross income from all sources chargeable to income tax;

plus

- Any salary sacrifice or flexible earnings (but not employer pension contributions);

less

- Any gross pension contributions paid personally where tax relief is received;
- Any other allowable deductions, i.e. professional subscriptions or charitable donations;
- Any lump sum death benefits where the recipient is liable to tax

For those who can do so, it may be possible to reduce 'threshold income' and avoid the tapered annual allowance by splitting pension contributions between employee and employer rather than making only an employer contribution.

The table below shows the maximum employer contributions that can be paid, based on total income chargeable to income tax that does not trigger a tax charge. This assumes no personal contribution or carried forward annual allowance.

	2022/23		2023/24 onwards	
Income chargeable to income tax	Maximum employer contribution after tapering	Adjusted income	Maximum employer contribution after tapering	Adjusted income
£200,000	£40,000	£240,000	£60,000	£260,000
£210,000	£36,667	£246,667	£56,667	£266,667
£220,000	£33,000	£253,000	£53,333	£273,333
£230,000	£30,000	£260,000	£50,000	£280,000
£240,000	£26,667	£266,667	£46,667	£286,667
£250,000	£23,333	£273,333	£43,333	£293,333
£260,000	£20,000	£280,000	£40,000	£300,000
£270,000	£16,667	£286,667	£36,667	£306,667
£280,000	£13,333	£293,333	£33,333	£313,333
£290,000	£10,000	£300,000	£30,000	£320,000
£300,000	£6,667	£306,667	£26,667	£326,667
£310,000	£4,000	£314,000	£23,333	£333,333
£320,000	£4,000	£324,000	£20,000	£340,000
£330,000	£4,000	£334,000	£16,667	£346,667
£340,000	£4,000	£344,000	£13,333	£353,333
£350,000	£4,000	£354,000	£10,000	£360,000

Source: A J Bell, 06/04/2023

Carried forward annual allowance

Carry forward relief may be available where the annual allowance has already been used in the current tax year and where, in any of the three previous tax years, starting with the oldest year first, benefit accrual was less than the annual allowances in those tax years. You can use carry forward if you were a member of any registered pension scheme in the tax years from which you wish to carry forward the unused annual allowance.

Carry forward can therefore be used to avoid the annual allowance tax charge for benefits accrued by or for you that will exceed the current year's annual allowance.

You will need to check if you have any unused allowance by looking back at your pension contributions and accrual history in relation to both your current and previous pension schemes by reference to the preceding three tax years. If any annual allowance in these tax years was not used, it can be carried forward and used against any pension inputs which exceed the current year's annual allowance.

You cannot carry forward any unused MPAA and when the MPAA applies you cannot contribute more than £10,000 per tax year to defined contribution pension schemes. Carry forward can therefore not be used to reduce any excess tax charges that result due to the MPAA. However, it can be used for any defined benefit accrual which is either tested against the alternative annual allowance (if the defined contribution payments exceed the MPAA) or the standard annual allowance.

The tapered annual allowance does not restrict the use of carry forward, so if the tapered annual allowance now applies and inputs in the previous three tax years were less than the annual allowances in those years, a larger input than £10,000 could be made without a tax charge. If you were a member of a registered pension scheme but made no contributions in the previous three tax years (2022/23 to 2024/25), you could therefore potentially make a contribution of £130,000 (including the tapered £10,000 for 2025/26) in 2025/26.

Unused tapered annual allowance can also be carried forward to future tax years but is based on your earnings in the tax year which is being carried forward, not the tax year in which the contribution is being made, even if you are no longer defined as having a 'high income'.

Paying the annual allowance tax charge

It is your responsibility to tell HMRC if you are liable for an annual allowance tax charge. This can be via your self-assessment tax return by including the relevant information on the additional pages. If you do not complete a tax return you will need to complete a registration form to request one.

If the annual allowance charge for the tax year is more than £2,000 and contributions to one pension scheme exceeded the annual allowance, you can request that the scheme administrator pays the annual allowance charge on your behalf.

This is known as 'scheme pays' and the administrator will deduct funds to pay the charge by reducing the fund value in a defined contribution scheme or reducing the accrued benefits in a defined benefits scheme.

If you have overpaid to a pension scheme and exceeded the annual allowance or paid an excess contribution in excess of your relevant earnings, HMRC will only allow a refund of a contribution if it was made in error by you or your employer. It is not possible to claim a refund of contributions purely on the basis of exceeding the annual allowance.

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It is your responsibility to tell HMRC if you are liable to an annual allowance tax charge. This can be via your self-assessment tax return by including the relevant information on the additional pages. If you do not complete a tax return you will need to complete a registration form to request one.

THE LUMP SUM ALLOWANCES

When the UK pension regime was changed on 6th April 2006, a new control mechanism, the 'lifetime allowance' (LTA), was introduced. There were several circumstances in which the total value of your accumulated pension benefits had to be tested to see if it exceeded the LTA. These included taking benefits, transferring benefits to another scheme, attaining age 75 and death. However, in April 2024 the LTA was abolished and replaced with two lump sum allowances that relate to the maximum amounts that can be paid as tax-free lump sums.

The tax charge for breaching the LTA was removed on 6th April 2023 and the LTA itself was abolished on 6th April 2024. This means that people previously unable to make pension contributions, either due to the value of their benefits exceeding the LTA or because they would have lost various LTA protections, can now make contributions or accrue benefits without the possibility of an LTA tax charge. From 6th April 2024 only lump sums taken from pensions are tested; income benefits can be taken with no test. Lump sums paid tax-free are tested and subject to limits to cap the total value of tax-free lump sums that can be paid. These tests are known as relevant benefit crystallisation events (RBCEs).

This means there should be no additional tax charges on drawing benefits from pension schemes whose value exceeds the final standard LTA of £1,073,100. However, the LTA still plays a part when taking pension benefits as it can influence the amount of the new lump sum allowances.

If you exceed your lump sum allowances, some excess payments are now taxed at your own marginal rate of income tax rather than at the previous LTA tax charge rates. The following are the two main lump sum allowances:

- Lump sum allowance (LSA) – Initially £268,275 (25% of the final standard LTA of £1,073,100);
- Lump sum death benefit allowance (LSDBA) – Initially £1,073,100 (equal to the final standard LTA).

Taking a lump sum from your pension in your lifetime or on death are now benefit crystallisation events. The LSDBA only applies if the member dies before age 75.

The following types of lump sums are taxed at marginal rates of income tax if an individual has no remaining LSA or LSDBA:

- Funds exceeding the LSA paid as lump sums;
- Serious ill-health lump sums that exceed the available LSDBA (payments made where an individual has less than one year to live);
- Defined benefit pension lump sum death benefits;
- Pension protection lump sum death benefits;
- Uncrystallised funds lump sum death benefits;
- Annuity protection lump sum death benefits;
- Flexi-access drawdown and drawdown pension lump sum death benefits.

For funds exceeding the remaining LSA and LSDBA, the excess can still be taken either as a lump sum (subject to income tax) or left in the scheme for income drawdown, annuity purchase or scheme pension, depending on the scheme.

Pension providers and scheme administrators are still likely to require LTA information even though the LTA does not apply as this information may be relevant for the allowances, other schemes the individual may have or benefits previously taken.

More information on taking benefits from pensions is included later in this guide and a reminder of the previous LTA details is included in the appendix to this guide.

Overseas transfer allowance (OTA)

If UK pension benefits were transferred to a qualifying recognised overseas pension scheme (QROPS), their value was tested against the LTA at that time, regardless of whether or not benefits had previously been taken or the age of the member. As benefits are not being taken these are not now tested against either the LSA or LSDBA.

From the 6th April 2024 the test against the LTA has been replaced by a separate overseas transfer allowance (OTA) that is equal to at least the former standard LTA of £1,073,100. An individual's OTA is equal to their LSDBA so can be higher if they previously held a form of LTA protection.

If pension benefits were taken before 6th April 2024 the OTA will be reduced by an amount equal to the percentage of the LTA used. Pension benefits transferred that are over the OTA are subject to an overseas transfer charge (OTC) of 25%.

Currently, for benefits taken before 5th April 2024 the OTA is reduced by the LTA previously used but all funds are tested against the available OTA so drawdown funds can be double-counted.

The 2017 budget introduced an OTC under which the entire transferred fund is subject to a rate of 25% and which applies to certain transfers to QROPS on or after 9th March 2017. In addition, even though an OTC may not have been due on the original transfer, any future change within five full tax years after the date of transfer, such as a change of residence, will result in the charge becoming due.

Specialist advice is therefore needed before considering a transfer of pension benefits overseas.

HOW ARE PENSION BENEFITS TESTED DURING LIFETIME?

From 6th April 2024, pension benefits are now tested when a member of the pension takes a lump sum. If a lump sum is taken during the member's lifetime the tax-free amount is tested against the lump sum allowance (LSA).

As detailed earlier, the LSA has been fixed at £268,275 (based on 25% of the former standard lifetime allowance). Benefits are tested against the LSA if a member takes either of the following types of tax-free lump sum:

- Pension commencement lump sum (PCLS) or
- The tax-free part of an uncrystallised funds pension lump sum (UFPLS).

Trivial commutation, small pots and winding up lump sums are not tested against the LSA but there must be some available LSA for both trivial commutation and winding up lump sums.

More information on the types of lump sum can be found in the 'Pension benefits options' section of this guide.

Pension commencement lump sum (PCLS)

From 6th April 2024 the maximum pension commencement lump sum (PCLS) is restricted to the lower of the available LSA and 25% of the pension fund value (or deemed benefits value if a defined benefit scheme).

The LSA is based on 25% of the standard LTA or protected LTA if higher. The available tax-free lump sum is therefore now capped at the higher of £268,275 (25% of the final standard LTA amount of £1,073,100) or 25% of a protected LTA amount if a form of LTA protection is held.

Therefore, even though the LTA has been abolished, its legacy still applies to the maximum pension commencement lump sum (PCLS) and lump sum death benefits that people can take tax-free from their total pension benefits. There is currently no indication that this amount will be index-linked and therefore it seems that it will reduce in real terms over time.

Uncrystallised funds pension lump sum (UFPLS)

A UFPLS can be paid from a defined contribution pension (if allowed by the scheme) and is a lump sum paid to the member (more information is in the 'Pension benefit options' section). Up to 25% of a UFPLS can be paid tax-free but only up to the amount of the available LSA. Only this tax-free part is tested.

Serious ill-health lump sums

If a pension scheme member has fewer than 12 months to live, then they may be able to take a serious ill health lump sum from any schemes that have not already been used to provide benefits. If under 75 then the amount of any serious ill health lump sum that can be paid tax-free is capped at the member's available LSDBA. Any excess would be subject to income tax.

Other lump sum payments

A pension scheme can pay a lump sum to a member who has no LSA available if the scheme has no other way of making the lump sum payment. These will be known as pension commencement excess lump sums (PCELS) and are likely to only apply to defined benefit schemes due to the other options for payments that are available to defined contribution schemes.

A PCELS will be subject to income tax as it is not part of either the LSA or LSDBA.

HOW ARE PENSION BENEFITS TESTED ON DEATH?

If a pension scheme member dies before age 75, only lump sums paid to beneficiaries are tested, not the value of all pension benefits such as pensions paid to beneficiaries.

The maximum tax-free lump sum amount that can be paid on the death of a pension scheme member before age 75 is equal to the LSDBA.

The LSDBA is equal to the standard LTA (or protected LTA if higher), less any previous tax-free lump sums paid via PCLS, serious ill health lump sums or tax-free elements of UFPLS (more information on these is in the 'Pension benefits options' and 'Pension death benefit options' sections of this guide).

Several types of death benefit lump sums are tested and these are:

- Defined benefit lump sum death benefits;
- Defined contribution or money purchase uncrystallised funds lump sum death benefits;
- Pension protection lump sum death benefits;
- Flexi-access drawdown lump sum death benefits;
- Annuity protection lump sum death benefits;
- Capped drawdown pension lump sum death benefits.

For example, if a person had previously taken their maximum PCLS and their remaining pension is in flexi-access drawdown, if their beneficiaries choose to take a lump sum on the member's death this will be tax-free up to the member's LSDBA but reduced by the PCLS previously taken.

If a lump sum in excess of a person's LSDBA is paid it is subject to income tax at the marginal rate of the beneficiary.

It is worth remembering that the two-year rule still applies to lump sum death benefits and funds designated for beneficiaries' income, i.e. the lump sum needs to be paid out within two years of the scheme receiving details of the date of death in order for the payment to be tax-free.

Death benefits paid after age 75 remain subject to tax. Further details are in the 'Pension death benefits' section of this guide.

PREVIOUS LTA PROTECTIONS

For those with LTA protections, their existing higher limits can be retained as long as the protection was applied for before 15th March 2023. Pension contributions can be made without the loss of those types of protection.

Protection against the LTA tax charge was initially introduced on 6th April 2006 for those individuals whose pension benefits exceeded, or were expected to exceed, the LTA, which was then £1.5 million.

There were two types of protection available - Primary Protection and Enhanced Protection - and anyone wishing to use them had to make an election to do so before 6th April 2009.

When the LTA was reduced from £1.8 million to £1.5 million on 6th April 2012, a third type of protection, Fixed Protection, was introduced; the election for this had to be made before 6th April 2012.

When the LTA was reduced from £1.5 million to £1.25 million on 6th April 2014, a fourth type of protection, Fixed Protection 2014, was introduced; the election for this had to be made before 6th April 2014.

A fifth type of protection, Individual Protection 2014, was introduced from 6th April 2014 and offered a protected personal LTA equal to the value of the total pension benefits as at 5th April 2014, provided that these were more than £1.25m. The maximum protected value was £1.5m. Those with Individual Protection could continue to make pension contributions or otherwise accrue benefits; the deadline to apply for this protection was 5th April 2017.

As a consequence of the LTA being reduced from £1.25 million to £1 million on 6th April 2016, a seventh type of protection, Fixed Protection 2016, was added along with an eighth type, Individual Protection 2016. The deadline for applying for either FP16 or IP16 was 5th April 2025.

For those with the various types of Fixed and Individual Protection, their higher PCLS amount is now their LSA and their protected LTA amount is their LSDBA.

Currently Primary Protection results in a LSA of £375,000 and a LSDBA of £1.8m, increased by the member's primary protection factor. Even with a higher protected lump sum, members may need to wait to access their PCLSs until this has been corrected in legislation.

For those with Enhanced Protection with lump sum protection, the LSA is capped at the amount of PCLS available on 5th April 2023 with the LSDBA is equal to the value of their uncrystallised funds on 5th April 2024. If no lump sum protection is specified then their LSA is £375,000.

Transferring after 6th April 2024 with Enhanced Protection may need to be considered carefully until the legislation is updated, because if a transfer is made the value of the member's protected LSDBA could be zero if the receiving scheme did not exist on 5th April 2024. Similarly, those with protected lump sum based on values on 5th April 2023 could also find themselves with a zero value if a transfer is made after 6th April 2024. Hopefully both of these issues will be resolved in future legislation.

More details of all the types of protection are detailed in Appendix two.

TRANSITIONAL ARRANGEMENTS

Standard transitional calculation

For those who have taken benefits before 6th April 2024, their LSA and LSDBA will be reduced by an amount based on the amount of LTA previously used.

At the first RBCE after 6th April 2024, their LSA is reduced by an amount based on the percentage of LTA previously used from all pension benefits. Consequently, if they have used 50% of their LTA (whether standard or protected), then their LSA will be reduced by 25% of the 50% LTA used.

The steps are as follows:

1) 25% x (% LTA used) x Standard or protected LTA amount = equivalent amount used.
2) LSA = Standard or protected amount - equivalent amount used.

For example, due to Fixed Protection 2014 a person had a LTA of £1.5m but took benefits before 6th April 2024 equating to 50% of the LTA. Their LSA is £187,500 due to a higher allowance from their protected LTA, reduced by the amount of LTA previously taken.

The LSDBA is reduced by an amount equal to the percentage of LTA previously used. This is 100% of LTA used if either a serious ill health lump sum has been paid or a lump sum death benefit paid if either before age 75. 25% of the LTA applies in all other instances.

In most instances, the LSDBA will be reduced by the same amount as the LSA is reduced.

On death after 6th April 2024, any lump sum payable from pension benefits crystallised before 5th April 2024 (if benefits are in flexi-access drawdown, for example) will not be tested against a person's LSDBA.

For benefits in payment before 6th April 2006 (before the LTA existed) the LSA and LSDBA are reduced by 25% of the deemed fund value of the pensions in payment. Similar to the previous LTA regime, this is calculated as 25 times the pension in payment or 25 x 80% of any capped drawdown maximum.

Transitional tax-free amount certificates (TTFAC)

Transitional tax-free amount certificates can be applied for if the amount of lump sums taken prior to 6th April 2024 was lower than the equivalent amount calculated using the above method. This replaces the amount calculated using the standard calculation and deducts the actual amount of tax-free lump sums previously taken.

Applying for this certificate can be beneficial for people who have taken a PCLS of less than 25% of the deemed value of the pension benefits; for example:

- they took benefits from a defined benefit pension scheme and decided to take them as all pension or with a lump sum that was less than 25% of the equivalent fund value or
- they took a PCLS when the LTA was less than £1,073,100, which it was for a limited time from April 2016 to April 2018.

The actual PCLS that is available after 6th April 2024 with a TTFAC is still restricted to the lower of

- 25% of the pension fund (or one third of the funds used to provide pension income);
- the member's remaining LSA and
- their remaining LSDBA.

For those who commenced a pension before 6th April 2006 and this was their only scheme, they cannot apply for a TTFAC and their LSA and LSDBA will be reduced as per the standard transitional calculation.

If they also took benefits between 6th April 2006 and 5th April 2024 they can apply for a TTFAC. In a similar way to the standard calculation for benefits in payment before 6th April 2006, the LSA and LSDBA are reduced by 25% of the deemed fund value of the pensions in payment. Similar to the previous LTA regime, this is calculated as 25 times the pension in payment or 25 x 80% of any capped drawdown maximum.

TTFAC should be applied for by the pension scheme administrator of any pension scheme of which the person applying is a member. This is likely to be the pension scheme for which the first RBCE occurs, as applications have to be made before the first RBCE after 6th April 2024. The application process will need to include evidence of the previous benefits taken and LTA used but it is up to the pension scheme administrator to determine what evidence is needed so pension schemes and providers may ask for different forms of evidence.

The legislation states that once a TTFAC has been provided it cannot be ignored, even if it puts the member in a worse situation than the standard calculation. Consequently professional financial advice is essential before applying for one.

Scheme-specific tax-free lump sums

Some pension scheme members had an entitlement, under the pre-6th April 2006 rules, to a tax-free lump sum which was higher than the 25% of the LTA maximum which was subsequently introduced. These individuals were given automatic protection of this entitlement, whether or not they applied for Primary or Enhanced Protection by 5th April 2009. This protection continues after the March 2023 pension changes.

However, at the time of writing the calculation in the legislation produces a higher lump sum that under the previous rules. This could result in an overpayment when compared to the LSA and LSDBA.

Stand-alone lump sums (where 100% of the fund is paid at a tax-free lump sum) are capped at their value on 5th April 2023.

Final thoughts

We will not pretend that the 'simplified' pension regime was, or is, simple but the removal of the LTA does make things simpler. Nevertheless, there are still clearly many traps for the unwary and parts of the legislation that need work.

There are also other options that need to be considered as part of a holistic financial plan which include:

- saving for financial independence using other tax wrappers;
- taking benefits earlier than planned and
- considering the order in which benefits are taken if you have more than one scheme.

Each unique situation needs careful review based on a proper analysis of the individual's objectives, preferences, tax position, pension benefits and employment/self-employment circumstances. As ever, professional financial advice is essential if you are to minimise tax charges.

PENSION BENEFIT OPTIONS

Introduction

The Taxation of Pensions Act 2014 brought about changes to the way in which pension benefits can be accessed from defined contribution (DC), also known as money purchase, pension schemes. These changes allowed individuals to take as much or as little as they liked from their DC pension arrangements on reaching the minimum pension age (MPA). The MPA is currently age 55 but in 2028 it will increase to age 57 and thereafter rise in line with the state pension age (SPA) so that it is always 10 years before SPA.

It is important to note that DC pension schemes do not have to provide all of the new options. Furthermore, there are also changes to the death benefits payable from DC pension schemes and these are described in the 'Pension death benefits' section.

The tax-free pension commencement lump sum (PCLS) is still available from pension schemes upon reaching the MPA and in most cases is the lower of:

- 25% of the deemed value of pension benefits and
- the lump sum allowance (LSA).

This section is intended to provide an overview of each option for taking benefits from UK-registered DC pension schemes.

Lifetime annuities

An individual with a DC pension fund has the option of purchasing a lifetime annuity upon reaching the MPA. A lifetime annuity is usually provided by an insurance company in exchange for a lump sum from the pension fund and provides a regular income for the life of the member (the annuitant). This income is subject to income tax via the pay as you earn (PAYE) system. In the event of the annuitant's demise the pension will continue only if at outset it includes a minimum guaranteed payment period and/or a spouse's or nominee's pension.

The amount of income provided is dependent on several factors, including:

- the member's age (and that of any other specific individual who will receive income benefits after the member's death) when the annuity is purchased;
- whether it is based on standard, ill health or lifestyle terms;
- whether it is conventional or investment-linked;
- whether it is paid as a level, escalating or flexible income;
- whether or not it includes a spouse's or nominee's pension;
- whether or not it includes a guaranteed payment period;
- the frequency of payment;
- whether it is paid for life or for a shorter period (up to five years) and
- whether it is paid in advance or arrears.

Those who are considered by the insurer to have lower than average life expectancy (whether due to age, existing health conditions and/or lifestyle issues such as smoking) tend to be offered better annuity rates in recognition of the expectation that the annuity will probably be paid for a shorter period than average. It is always worth enquiring whether improved terms might be available as a result of medical underwriting.

Lifetime annuities can provide a useful starting point when considering pension benefits as they provide insurance against longevity and, if index-linked, also provide an element of future inflation protection.

Conventional annuities are either level or escalate at a fixed rate or in line with a published measure of inflation such as the retail prices index. Escalating annuities provide some protection against future increases in expenditure but start at a lower rate than level ones so their attractiveness depends on the extent to which such expected expenditure increases can be met from other resources – the time taken for the value of income received from an escalating annuity can exceed average life expectancy.

Investment-linked annuities can be divided into two types, unit-linked and with profits, based on the type of the underlying investment but all work in a similar way.

The member's pension fund is invested in one or more collective funds and a level of initial income is selected as a percentage of the total value. This percentage is converted to a number of units depending on the prevailing unit price. The initial income level can be adjusted by opting to assume a future return in the underlying fund – the lower the assumed future return, the higher the potential for future increases in actual income and vice versa.

The available underlying funds depend on those offered by the annuity provider and obviously the pattern of returns that they achieve depends on the performance of the selected ones. As well as unit-linked funds whose price is directly linked to the performance of the underlying assets, some providers offer access to their with profits fund. Such funds 'smooth' returns to investors by retaining some of the returns in positive years to provide the ability to subsidise them in negative ones, albeit at the cost of transparency.

Example

Monty decides to use his £100,000 pension fund to purchase an investment-linked annuity and to invest in the Acme Managed Fund, whose units are priced at £2. He elects to assume a future growth rate of 3% and a starting income of 5% paid annually, so £5,000. This translates to 2,500 units per year so this is the number that will be encashed each year to provide his income. As long as the fund price increases by at least 3% each year, he will receive the starting income plus whatever additional return is earned. However, if the fund price does not increase by this amount in a year, his income will fall.

The advantages of an investment-linked annuity are that it provides the opportunity for unlimited increases in the payments without the risk of consuming the entire fund during the member's lifetime as can happen with flexi-access drawdown. However the income can fall if the underlying funds fall in value, so such a vehicle is less suitable as a sole income source and ongoing monitoring and advice is likely to be necessary.

The annuity income can increase or decrease in payment. If the annuity is capable of being reduced (other than what is included in His Majesty's Revenue & Customs - HMRC - guidance) it is known as a flexible annuity and triggers the money purchase annual allowance (MPAA). Additional information is available in the relevant section of this guide.

A joint life annuity can be purchased by an annuitant with any chosen named beneficiary. The income then continues after the annuitant's death at a rate of between 50% and 100% of the level at the date of the member's death. The higher the percentage that continues (and the younger the survivor), the lower the starting rate of the original annuity. Guarantee periods can also be any length rather than (as was previously the case) restricted to a maximum of 10 years.

Annuity payments are made at a fixed frequency between monthly and annually, the most suitable depending on when the cashflow is needed. Payments may also be made in advance or arrears and while there is little difference between the rates of an annuity paid monthly in advance and one paid monthly in arrears, the variation between advance and arrears is more pronounced for annual payments, since the insurer has use of the cash for a year longer in the latter instance.

Furthermore, if no guarantee or survivor's benefits are purchased, an annuitant who dies within the first year of an annuity paid annually in arrears will actually receive no payments at all.

The tax treatment of death benefits from an annuity is the same as that for the pension scheme from which they are purchased, i.e. continuing income and lump sums payable on the annuitant's death before age 75 are paid free of tax (up to the LSBDA) and are taxable at the recipient's marginal rate of tax if the annuitant died after age 75. For more information please refer to the 'Pension death benefits' section.

Lifetime annuities can provide a useful starting point when considering pension benefits as they provide insurance against longevity and, if index- or investment-linked, also provide an element of future inflation protection. When considering other options it is worthwhile to start by seeing what can be provided by an index-linked lifetime annuity, particularly if this can be purchased using part of a pension fund to secure a minimum level of income required to meet an individual's basic expenditure.

A UFPLS does not allow the scheme member to access their tax-free PCLS but 25% of the value of the payment made as a UFPLS is usually tax-free with the remaining 75% taxable as pension income. If the individual is over age 75 when the lump sum is paid then the same rules apply.

Scheme pensions

Scheme pensions are usually payable from defined benefit (DB) pension schemes, although they can also be offered by certain types of DC pension schemes as long as the option of purchasing a lifetime annuity is also offered. For a scheme pension to be paid from a DC pension scheme the scheme administrator must secure the pension, i.e. either pay it directly from the scheme by investing in an asset with a secure income or do so via an insurance company (such as by buying an annuity).

The scheme pension must:

- be paid for the life of the scheme member;
- be paid at least annually;
- be incapable of being reduced year on year, except in limited circumstances and
- only be paid to a dependant of the member following their death.

Any dependants' pensions paid are subject to income tax via PAYE even if the member dies before age 75. However a scheme pension can include a lump sum death benefit either via an annuity protection lump sum death benefit or a pension protection lump sum death benefit. A lump sum death benefit up to the capital cost of the scheme pension, less gross income paid up to date of death, can be paid to the beneficiary and is taxed in the same way as other pension death benefits and subject to the LSDBA.

As described in this guide, care must be taken when using scheme pension as the MPAA can be triggered.

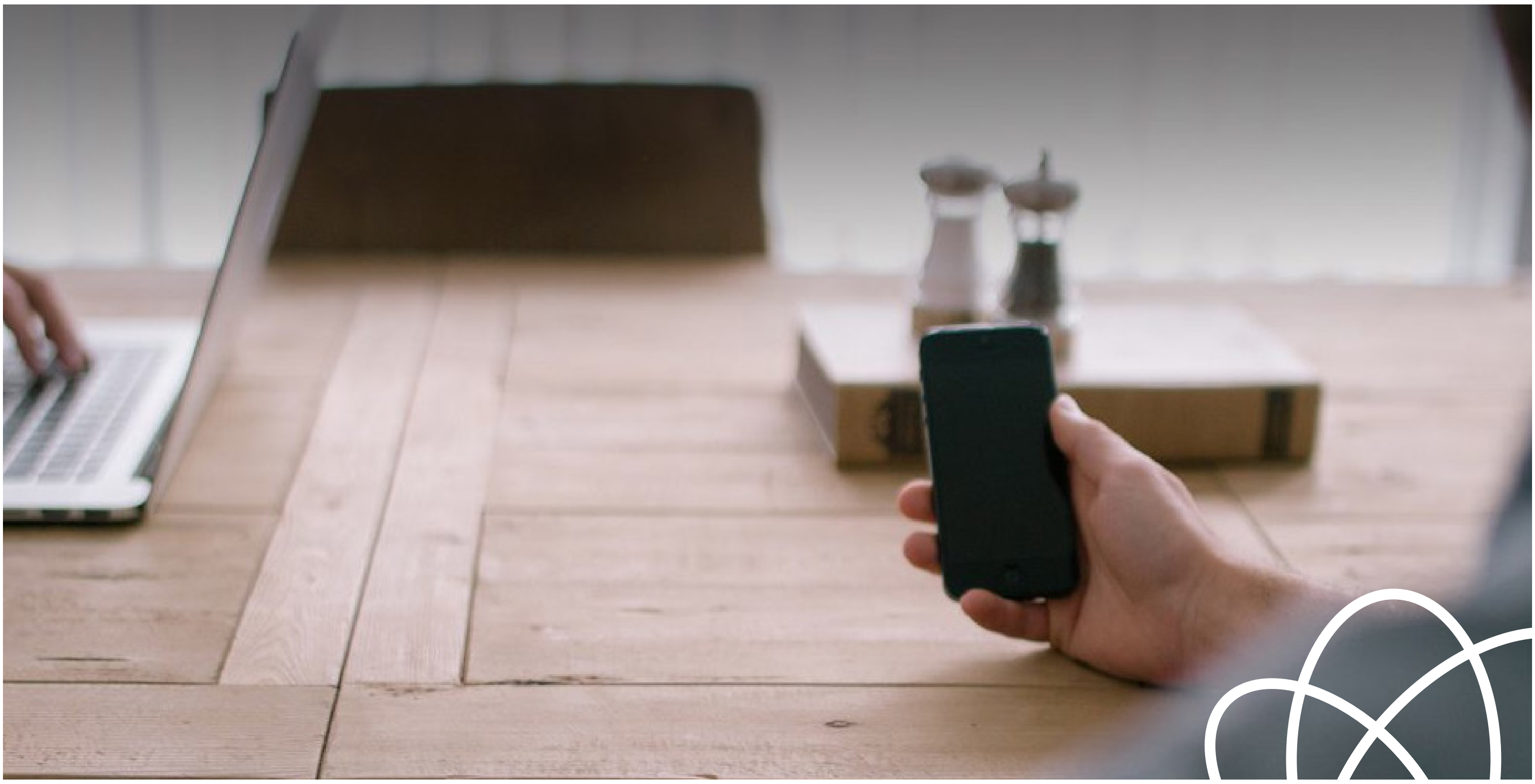
Uncrystallised funds pension lump sum (UFPLS)

An UFPLS is either a single lump sum or a series of lump sums taken from an individual's uncrystallised DC pension fund, uncrystallised meaning that either no benefits have previously been taken or that the funds have not been designated into flexi-access drawdown (see the next section).

The individual can therefore take a lump sum from their pension fund without having to use flexi-access drawdown, scheme pension or an annuity and this is treated as a UFPLS if:

- the payment is made from an uncrystallised pension fund;
- the individual pension member has reached at least the current MPA or has met the ill health conditions for earlier access to their pension benefits;
- the lump sum element is tested against the individual's LSA and
- the lump sum counts towards the individual's LSDBA.

A UFPLS does not allow the scheme member to access their tax-free PCLS but 25% of the value of the pension fund paid as a UFPLS is usually tax-free (subject to their LSA) with the remaining 75% taxable as pension income. If the individual is over age 75 when the lump sum is paid then the same rules now apply.



There are certain circumstances when a UFPLS cannot be paid to an individual pension member, as follows:

- They have Enhanced or Primary Protection with lump sum rights; further information is available in the relevant section of this guide;
- They have an enhancement factor and the available portion of their lump sum is less than 25% of the proposed UFPLS or
- They have a scheme-specific protected PCLS of more than 25% of their benefits.

Please note that if an individual accesses benefits using UFPLS then the money purchase annual allowance (MPAA) is triggered immediately before the UFPLS has been paid. A UFPLS payment is also tested against an individual's LSA and counts towards their LSDBA, the amount tested being equal to the tax-free element of the lump sum paid. Since 6th April 2024, if the amount exceeds the member's remaining LSA then the amount over the LSA will be taxable at their highest marginal rate of income tax.

Flexi-access drawdown

For newly crystallised funds, flexi-access drawdown replaces all types of drawdown which applied before 6th April 2015 (including flexible drawdown).

It allows an individual to withdraw an amount which they choose from their DC pension funds whenever they wish as long as they have reached MPA, met the ill health early retirement conditions or reached their protected retirement age. There are no restrictions on the amount of withdrawals that can be taken so, unlike previous versions of pension drawdown, there is no need for income withdrawal limits to be reviewed. Usually an individual will take their PCLS first (up to their personal PCLS entitlement or LSA, whichever is lower) with the balance of the pension funds then being designated into flexi-access drawdown; any further withdrawals are then subject to income tax as pension income.

This method of taking pension benefits allows the entire fund to be withdrawn in one tranche after the PCLS has been paid, although in practice this is constrained by the income tax liability that arises on the withdrawal. Depending on the fund value, a large withdrawal in a single tax year is likely to result in higher or additional rate income tax applying to the withdrawal, which might be avoided or reduced by spreading withdrawals over several tax years.

A large withdrawal in a single tax year is likely to result in higher or additional rate income tax applying to the withdrawal which might be avoided or reduced by spreading withdrawals over several tax years.

It is also important to consider flexi-access drawdown in the context of the individual's overall financial planning and risk profile. It is easy to take withdrawals at a rate that might not be sustainable over the long term, resulting in the need for other non-pension assets to be liquidated to fund lifestyle expenditure and objectives.

An income can be provided by a short-term annuity purchased from an insurance company. This must be paid at least annually and not last for more than five years and provides a regular income to the member. It can be an effective way of ensuring that a certain level of income is provided while leaving the remainder of the pension fund to be invested for a longer time horizon before it is needed for income withdrawals and providing additional flexibility against future changes in circumstances.

If an individual designates a pension into flexi-access drawdown the MPAA is not triggered immediately. The PCLS can be paid and the funds moved into flexi-access drawdown. The MPAA only applies from when income is first drawn from the remaining pension fund. Pension funds designated to flexi-access drawdown for individuals under the age 75 are RBCEs and the amount of PCLS available is 25% of the pension fund value or LSA, whichever is lower. The PCLS also counts towards the LSDBA.

Capped drawdown

'Capped drawdown' refers to all pension funds using drawdown starting before 6th April 2015, which were subject to the minimum and maximum annual withdrawal limits set by the Government Actuary's Department (GAD). Individuals who commenced capped drawdown prior to 5th April 2015 can continue with this and can designate new funds into this type of drawdown as long as the existing pension drawdown contract allows new funds to be allocated into the same arrangement as the existing funds.

Capped drawdown contracts retain their upper withdrawal limit, of 150% of the 'basic amount' (set by GAD and based on prevailing long term gilt yields), for withdrawals that can be taken in any scheme year. The lower limit remains zero. If income is withdrawn at a higher rate than the upper limit, the pension is automatically converted to flexi-access drawdown. An individual can also inform their scheme administrator that they wish to convert a capped drawdown arrangement to flexi-access drawdown.

The main advantage of retaining a capped drawdown pension is that withdrawals can continue to be made within its limits or phased retirement using capped drawdown can continue, both without triggering the MPAA as long as the individual has not flexibly accessed any other pension funds. This allows the individuals to continue to make pension contributions using the standard annual allowance and any carried forward unused allowance. For further information, refer to the relevant section in this guide.

If pension contributions are made, it is important to consider HMRC's 'recycling' rules, which are designed to ensure that tax relief is not obtained by taking a lump sum from a pension and then using this to make pension contributions.

Flexible drawdown

'Flexible drawdown' refers to all pension funds using drawdown which commenced before 6th April 2015 and which were not subject to the minimum and maximum annual withdrawal limits set by the GAD due to the individual receiving a minimal level of guaranteed income[1]. Previously, once an individual used flexible drawdown they lost their annual allowance and therefore could not make any further pension contributions and receive tax relief.

Any individual who was using flexible drawdown before 6th April 2015 is deemed to have flexibly accessed their pensions and from this date their further contributions are limited to the MPAA. All additional funds designated into drawdown will be subject to flexi-access drawdown rules.

Drawdown death benefits

An individual using drawdown for their DC pension benefits is subject to the same death benefit and tax rules that apply to someone who dies without accessing their pension funds. Further details of DC pension fund death benefits are available in the 'Pension death benefits' section of this guide.

[1] An income of at least £12,000pa from either or a combination of a lifetime annuity, defined benefit pension and state pension.

If the original individual receiving the pension died before age 75 the lump sum is paid tax-free up to their LSDBA, although after age 75 the lump sum is subject to income tax.

Trivial commutation

Where a pension fund is small enough, it is possible to commute it for a lump sum. Trivial commutation lump sums apply to defined benefit (DB) pensions if:

- the value of all benefits is less than £30,000;
- the lump sum paid removes all the individual's entitlement to the defined benefits;
- the individual has reached the MPA (currently age 55), has a protected earlier pension age or meets the conditions for an ill-health early retirement and
- the individual has some available LSA.

Only 75% of the lump sum payable is subject to income tax, with the remaining 25% being paid tax-free, which is the same as a UFPLS for a DC pension. The lump sum payment does not use up any of the LSA or LSDBA.

If the commutation arises from benefits that are already in payment then all of the payment is subject to income tax.

Trivial commutation of up to £30,000 can also be applied to certain pension death benefits when an individual receiving pension payments dies. This can apply to a dependant's pension being paid from a scheme pension and/or in respect of a guarantee period from a lifetime annuity or scheme pension. The lump sum payment must extinguish all of the recipient's entitlement to the death benefits in the scheme. The payment is subject to income tax at the recipient's marginal rate of tax for the tax year in which the lump sum is paid.

Only 75% of the lump sum payable is subject to income tax with 25% being paid tax-free, which is the same as a UFPLS for a DC pension.

Small pots lump sum payments

Small pot pension lump sums can be paid from both DB or DC pension schemes and apply to pension benefits in a scheme that are worth £10,000 or less when the payment is made. An individual can receive up to three small pot payments from non-occupational pension schemes, i.e. personal pensions, although there is no limit to the number of payments that can be taken by the same individual from occupational schemes as long as they are unconnected.

Small pot lump sum payments can only be made if:

- the individual has reached the MPA, has a protected earlier pension age or meets the conditions for an ill-health early retirement;
- the payment is £10,000 or less and
- for non-occupational pension schemes, the payment must extinguish all member benefit entitlement under the arrangement or
- for occupational or public service pension schemes, the payment must extinguish the member's entitlement to benefits under the paying scheme.

Small pot payments are taxed in the same way as UFPLS and trivial commutation lump sums, so 25% of the payment is tax-free and the balance subject to income tax. However, unlike UFPLS they do not trigger the MPAA so contributions and DB benefit accrual may continue subject to the standard or tapered annual allowance. If a small pot lump sum is taken from benefits that are already in payment then all of the payment is subject to income tax.

These do not count towards a member's LSA or LSDBA; nor does the member need any remaining allowances.

PENSION DEATH BENEFITS

Nominations to beneficiaries

Pension death benefit rules

The Taxation of Pensions Act 2014 brought about changes in the way in which death benefits from defined contribution (money purchase) pension schemes can be passed on to chosen beneficiaries.

Since 6th April 2024, pension death benefits have been tested against the LSDBA when a beneficiary chooses to take a lump sum. Death benefits taken as beneficiary pension income are not tested.

In most cases, where the member dies before age 75 the funds (whether taken as income or a lump sum) can be received tax-free (up to the remaining LSDBA), while on the member's death after 75 the beneficiary will be taxed at their own marginal income tax rate on benefits (whether paid as an income or a lump sum).

If death occurs before age 75 a LSDBA test is carried out if the beneficiaries choose a lump sum. If any excess is paid as a lump sum the beneficiaries will pay income tax on those funds. If the whole lump sum is paid more than two years after death it is all subject to income tax. If they are to be passed on tax-free, any funds designated for the beneficiary's income must also be so designated within two years of the scheme's knowledge of the member's date of death.

In the event of the subsequent death of the dependant or nominee, the tax position of benefits received by their nominated successor then depends on the age at date of death not of the original member but of the previous recipient of benefits. It is thus possible for the tax treatment of payments from the same pension fund to change between each successive recipient, according to the age at which the previous recipient died.

If the beneficiary dies having opted for beneficiary's income (or beneficiary's drawdown) and the successor chooses to take a lump sum, this will be tested against the beneficiary's LSDBA if they died before age 75. However, this can be avoided by the successor choosing to retain the funds in the pension scheme via drawdown.

Crucially, the scope for who can receive the benefits as an income was significantly widened in 2014. Previously, only a dependant (a spouse/partner or children regarded as financially dependent on the member) could receive a pension income. Under the current rules anyone, related or not, can be nominated to receive potentially either a lump sum or an income. This offered the potential to pass pension funds down through the generations without them ever falling into anyone's estate for inheritance tax (IHT) purposes. However, it was announced in the 30th October 2024 Budget that pension death benefits will be subject to IHT from April 2027.

Nominations and expressions of wishes

Pension providers' death benefit nomination forms now commonly include both a nomination and an expression of wishes section.

The nomination section ensures that the widest possible range of people ('eligible benefits recipients' - EBRs) are eligible to receive death benefits as an income, rather than a lump sum, in accordance with the scheme trust deed and rules. For example, the AJ Bell Personal Pension Scheme rules define EBRs in relation to a person (referred to in the male gender but obviously equally applicable to the female) as being:

Table 1: Treatment of death benefits on death before and after age 75

		Age at death of member		Age at death of subsequent recipient of benefits	
		Before 75	After 75	Before 75	After 75
No annuity purchased	Lump sum	Tax-free up to the remaining LSDBA	Beneficiary's marginal tax rate	Tax-free up to the original beneficiary's LSDBA	Beneficiary's marginal tax rate
	Income	Tax-free	Beneficiary's marginal tax rate	Tax-free	Beneficiary's marginal tax rate
Annuity purchased	Capital guarantee	Tax-free up to the remaining LSDBA	Beneficiary's marginal tax rate		
	Income	Tax-free	Beneficiary's marginal tax rate		
		Age 75		Age 75	

Data source: Bloomsbury Wealth

"his Spouse, his grandparents, such grandparents' descendants (including step and adopted descendants), such descendants' Spouses, Successors, persons interested in his estate, any other Member and any charity and person or unincorporated associations that is the subject of a written expression of wishes that he has made to the Scheme Trustee or Scheme Administrator to the effect that he would like them to consider making payment of death benefits to or for their benefit following his death or the trustees of any trust established for the purposes of receiving benefits under the Scheme."

The expression of wishes section then needs to be completed by the member with the details of the person(s) to whom they would like the trustees to consider allocating benefits on the member's death. This request is not binding but in practice the trustees are likely to give considerable weight to the member's wishes in terms of how they elect to distribute benefits.

What if no nominations are made?

Where a nomination is not made, the scheme administrator can only set up income drawdown for someone who is a dependant (unless there are no dependants, in which case the scheme administrator can set up drawdown for any individual). Scheme administrators retain any existing discretionary powers in respect of lump sum payments as this currently avoids unwelcome inheritance tax implications. Payments to individuals will be taxed in the same way as those to nominated recipients.

The scheme administrator would receive the member's will and liaise with other family members to help them to make a decision as to the beneficiaries to whom the benefits would be most appropriately distributed.

What if an expression of wish form is already in place?

On the member's death the existing expression of wishes can still be taken into consideration but in the event that it were considered appropriate by the trustees to redirect the benefits to other individuals, such benefits could only be distributed as a lump sum, not as an income.

What about defined benefit (final salary) pension schemes?

These schemes are not affected by the liberalisation of the rules applicable to defined contribution schemes but it is still important to ensure that the scheme holds a completed expression of wishes form and that it reflects the member's current wishes so that death benefits can be distributed correctly. To vary the member's expression of wishes, a new form should be obtained from the scheme administrators, completed and returned to them.

Existing pension bypass trusts

A pension death benefits spousal bypass trust is a type of discretionary trust which is established during the member's lifetime to receive any death benefits payable under pension schemes in the event of death before the member draws them. Provided that the trust is established correctly, it can have many advantages and prior to the recent changes was a very tax-effective way of providing for pension death benefits to be paid to a wide range of beneficiaries with a large amount of flexibility.

It also provided protection from 'hostile creditors' (e.g. on divorce or bankruptcy) and inheritance tax (IHT) savings at the time, as the death benefits did not fall into the spouse's estate until distributed to them.

In essence, they were an excellent way to provide an element of control 'beyond the grave'.

The trust would normally be established with an initial nominal gift of £10. It would then be nominated as the beneficiary to receive pension death benefits using the normal nomination process with the pension scheme administrator, so it requests that the death benefits are paid to the trustees of the trust. Whilst not binding on the administrator, we have never encountered a situation where a provider would not accept a nomination to such a trust.

The trust deed would contain a range of potential beneficiaries which would normally include the surviving spouse or partner, children, remoter issue and even charities. The member would normally prepare and sign a letter of wishes to guide the trustees (again it cannot be legally binding) as to how they would like the benefits to be paid. The trustees can, for example, make loans to a beneficiary rather than advancing capital, which ensures that the capital distributed remains outside the beneficiary's estate. Since all beneficiaries of the trust are only potential beneficiaries, no one has a legal right to either the capital or the income and therefore no claim against either can be made in the event of the death, divorce or bankruptcy of a beneficiary and the capital in the trust will not form part of the beneficiaries' estates for IHT purposes.

We suggest that the suitability of any existing bypass trust be reviewed to determine whether it is still necessary under the new rules. There are circumstances in which a bypass trust remains suitable.

However, the changes which came into force on 6th April 2015 mean that much of this can be achieved by retaining the pension funds in drawdown, which also provides a tax benefit in that the funds continue to benefit from the tax-advantaged pension environment for growth and income as opposed to the less favourable trust taxation regime. In addition, remaining in drawdown avoids any periodic and exit IHT charges and the costs and complexity of the trust itself.

Therefore, where the death of the member occurs after age 75, there may now be a weaker case for using a bypass trust due to the more punitive tax regime to which funds would be subject within the trust compared to being left in drawdown.

It is worth bearing in mind that where both husband and wife are alive today, the statistical average chance of one of them not living beyond age 75 is only 7%.

We therefore suggest that the suitability of any existing bypass trust be reviewed to determine whether it is still necessary under the new rules. There are circumstances in which a bypass trust remains suitable, such as:

- when the member wishes to retain an element of influence over the future distribution of benefits;
- when the member dies before age 75, as the tax treatment is neutral compared to leaving funds within the scheme (subject to the LSDBA);
- when there are complex family circumstances, such as children from more than one relationship;
- when there are young or vulnerable beneficiaries;
- when the potential beneficiaries are not good at handling money and/or
- when it is desired to leave an amount up to the value of the IHT nil rate band to a bypass trust and the balance to individuals.

This list is not exhaustive and the cost of future periodic tax charges should also be considered when assessing whether such a trust should be retained, as well as the ongoing costs and less favourable tax treatment or any further legal advice that may be required.

PENSIONS AND INHERITANCE TAX (IHT)

Currently pensions are not included in a person's estate to IHT but any unused funds remaining in DC pension plans at death and other pension death benefits will be taxed as part of the individual's estate from 6th April 2027.

This will include funds paid out as a lump sum and those paid as beneficiary's drawdown or an annuity. Lump sum payments into pension bypass trusts will also be included.

Scheme pensions and funds paid as charity lump sum death benefits will be exempt.

The Government has stated that IHT will be payable on the value of the gross funds in the pension immediately before death, but before being distributed or designated to the beneficiary.

The scheme will pay any IHT charge and then the pre- and post-age 75 income tax rules on the residual funds will still apply, as detailed earlier in this guide.

The new rules will apply to all overseas pensions schemes as well as UK pension schemes.

The IHT spousal exemption will still apply in the normal way and so any funds that pass to a spouse or civil partner will remain free of IHT on first death.

More information and the implementation details will be known before April 2027 and advice should be obtained to review individual circumstances.

APPENDIX - LTA:
A REMINDER

In a money purchase pension scheme, any excess over the LTA was previously taxed at the rate of 25% - the 'lifetime allowance charge' - and income tax levied on any income benefits. Alternatively, in most cases the excess could be withdrawn from the pension fund as a lump sum, in which case it would be subject to a flat 55% tax charge and no further income tax charge.

If an individual had taken benefits under flexi-access drawdown (i.e. income is taken directly from the fund rather than via a guaranteed annuity purchased with the fund) then a second test against the LTA would normally be made at age 75. If the value of the individual's pension fund at that time exceeded the amount that was originally put into flexi-access drawdown then the excess would be tested against the LTA.

In the case of defined benefit pension schemes, the accrued pension benefit was multiplied by 20 to determine its value for testing against the LTA. A pension of £100,000pa would therefore be valued at £2 million for this purpose. Any LTA tax charge could be paid by the scheme via a deduction from the individual's benefits.

Some money purchase pension funds, such as trust-based occupational schemes and some family self-invested personal pension schemes (family SIPPS), allow the scheme trustees to pay a fixed pension directly from the fund. Known as 'scheme pension', the amount of the pension benefit is determined by reference to actuarial factors. The scheme pension was then multiplied by 20 to determine its value for testing against the LTA.

If an individual had not taken all their pension benefits in the form of a pension annuity, or if they had designated all their pension into flexi-access drawdown before age 75, then at age 75 the whole of the individual's remaining pension benefits would have been tested against the LTA and any excess would be subject to a one-off 25% tax charge (although there would be no subsequent test against the LTA).

If a member died before age 75 with uncrystallised benefits (i.e. where no benefits had been taken or allocated to drawdown) then the value was tested against the unused LTA and any excess taxed at either 25% (if taken as income – in addition to any income tax that applies) or 55% (if taken as a lump sum).

If a member died after age 75, regardless of whether or not they had taken any benefits, there was no further LTA charge, regardless of fund growth, as they would have been tested and taxed on any excess as appropriate at age 75.

APPENDIX TWO: PENSION PROTECTIONS

Primary protection
(had to be elected for by 5th April 2009)

Primary protection was available only if an individual's pension benefits exceeded £1.5 million on 5th April 2006, in which case the individual's LTA is:

$$\frac{\text{Benefits value as at 5th April 2006} \times \text{Greater of current LTA and £1.8 million}}{\text{£1.5 million}}$$

Individuals who had primary protection could continue to accrue further pension benefits if they wish and can continue to do so. They are subject to the normal maximum tax-free lump sum (of 25% of their pension benefits, up to a maximum of 25% of the standard £1.5 million LTA) unless they were entitled to a lump sum of more than £375,000 on 5th April 2006, in which case their maximum tax-free lump sum is:

$$\frac{\text{Lump sum to which they were entitled on 5th April 2006} \times \text{Greater of standard LTA and £1.8 million}}{\text{£1.5 million}}$$

Enhanced protection
(had to be elected for by 5th April 2009)

Enhanced protection was available to anybody, regardless of the value of their pension benefits on 5th April 2006 and meant that the individual would be exempt from the LTA charge whatever the eventual value of their pensions at the time that their benefits were put into payment.

Individuals with enhanced protection are subject to the normal maximum tax-free lump sum (of 25% of their pension benefits up to a maximum of 25% of the standard £1.5 million LTA) unless they were entitled to a lump sum of more than £375,000 on 5th April 2006, in which case they will have been notified of a lump sum percentage figure when they received confirmation of their enhanced protection from HMRC.

This percentage will have been calculated as:

$$\frac{100 \times \text{Lump sum to which they were entitled on 5th April 2006}}{\text{Benefits value as at 5th April 2006}}$$

HMRC has now stated that the maximum amount of tax-free cash for individuals with Enhanced Protection will be the lower of the protected percentage of their fund when they take benefits and the entitlement on the 5th April 2023. For those without a protected percentage their tax-free cash is the lower of 25% of the current pension funds or 25% of £1.5m.

This ensures that any future contributions do not increase a person's maximum PCLS under Enhanced Protection.

Fixed Protection

(had to be elected for by 5th April 2012)

The LTA gradually increased to £1.8 million for the 2010/11 and 2011/12 tax years but was then reduced to £1.5 million from 6th April 2012. A new form of protection, Fixed Protection, which allowed individuals to retain the £1.8 million LTA, was introduced for those individuals whose pension benefits exceeded, or were expected to exceed,

£1.5 million. It also provides a protected PCLS of £450,000.

Fixed Protection is subject to no further benefits (beyond limited inflationary increases) being accrued for the individual after 5th April 2012. If any further benefits are accrued for the individual after that date then HMRC must be notified and fixed protection will be lost. However, after 6th April 2023, existing Fixed Protection holders could re-start contributions to their pensions, whilst keeping their tax-free cash (PCLS) protection.

Fixed Protection 2014

(had to be elected for by 5th April 2014)

The LTA was further reduced from £1.5 million to £1.25 million on 6th April 2014 and yet another form of protection, Fixed Protection 2014, which allowed individuals to retain the £1.5 million LTA, was introduced for those individuals whose pension benefits exceed, or were expected to exceed, £1.25 million. This had to be elected for by 5th April 2014 and also protected tax-free cash (PCLS) up to £375,000.

Fixed protection 2014 was not available to individuals who already had Primary, Enhanced or Fixed protection and it was subject to no further pension benefits (beyond limited inflationary increases) being accrued for the individual after 5th April 2014. If any further pension benefits were accrued after that date then HMRC must be notified and Fixed Protection 2014 would be lost. However, after 6th April 2023, existing Fixed Protection 2014 holders could re-start benefit accrual whilst retaining their tax-free cash protection.

It was possible for an individual with Enhanced Protection to elect to HMRC to forego it, following which they could (prior to the relevant deadlines) apply for Fixed Protection or Fixed Protection 2014 if they did not also have Primary Protection (which could not be foregone).

Individual protection 2014

(had to be elected for by 5th April 2017)

Individual Protection 2014 (IP14) was available to all individuals who had pension benefits of more than £1.25 million on 5th April 2014.

It was possible for an individual with Enhanced Protection, Fixed Protection or Fixed Protection 2014 also to have applied for Individual Protection 2014 as a fall-back position in case they subsequently lost their other protection. These individuals are not affected by the March 2023 pension tax rules. They can continue contributing and can continue to protect their PCLS at a higher amount, rather than being restricted to £268,275.

Fixed Protection 2016

(had to be elected for by 5th April 2025)

Fixed Protection 2016 (FP16) allowed individuals to retain the £1.25 million LTA and up to £312,500 tax-free cash. Fixed Protection was not available to individuals who already had Primary Protection, Enhanced Protection, Fixed Protection or Fixed Protection 2014 and it was subject to no further pension benefits (beyond limited inflationary increases) being accrued for the individual after 5th April 2016. If any pension benefits were accrued after that date then HMRC had to be notified and Fixed Protection 2016 would be lost. However, since 6th April 2023, existing Fixed Protection 2016 holders have been able to re-start benefit accrual in their pensions whilst retaining their tax-free cash protection.

It is possible for an individual with Enhanced Protection to elect to HMRC to forego it, following which they may apply for Fixed Protection 2016 if they do not also have Primary Protection (which cannot be foregone). There has never been a deadline for applying for Fixed Protection 2016 but applications after 15th March 2023 then lose the PCLS protection if additional pension benefits are accrued.

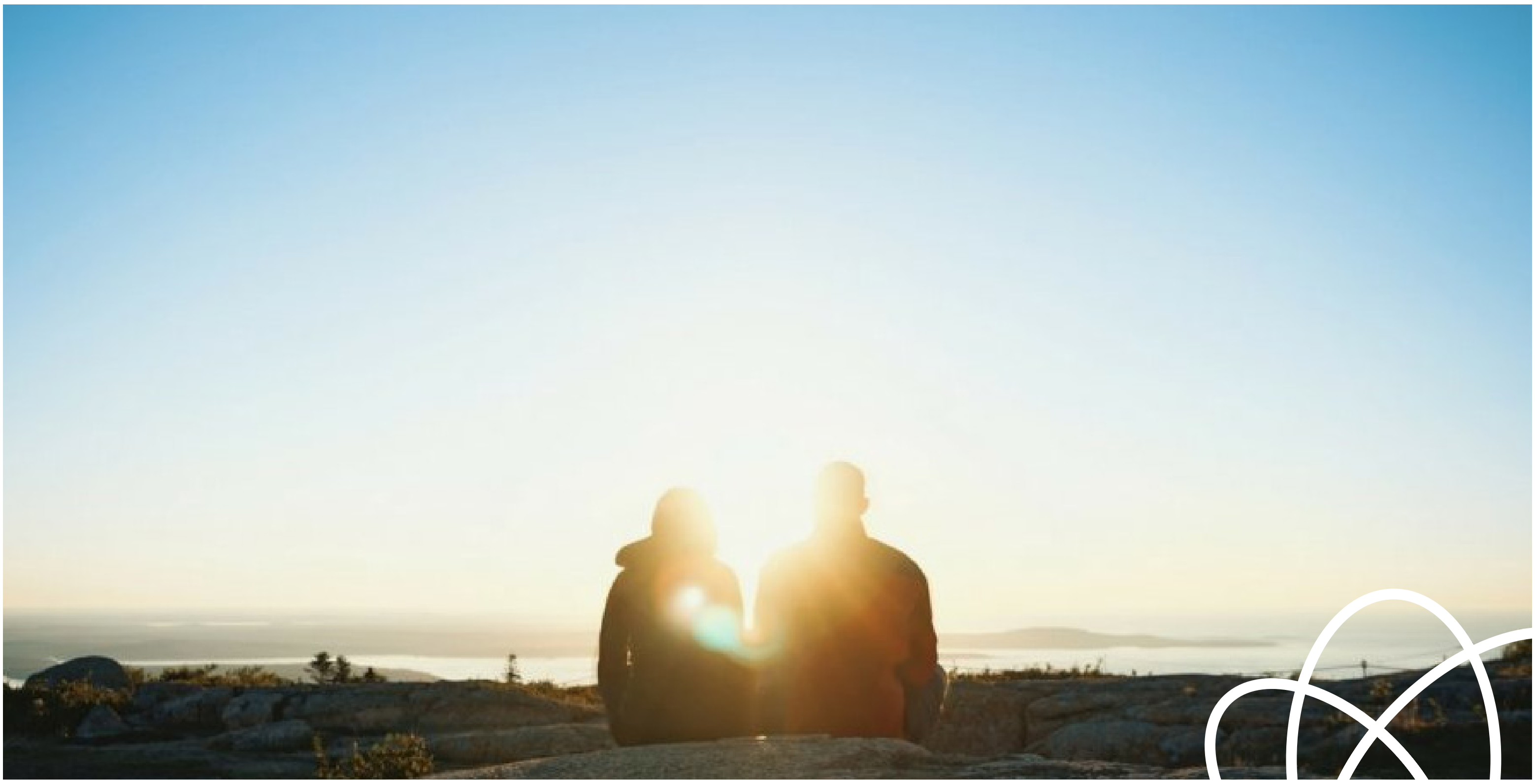
Individual Protection 2016

(had to be elected for by 5th April 2025)

Individual Protection 2016 (IP16) afforded protection from the LTA charge for pension benefits which were valued at between £1 million and £1.25 million as at 5th April 2016. Individuals with total benefits greater than £1.25 million and who were not already registered for Enhanced or Primary Protection could apply for it but IP16 was capped at £1.25 million. The IP16 amount became the standard LTA (SLA) amount for the individual.

Individuals with IP16 could continue to accrue future pension benefits without losing entitlement to IP16. This was the critical difference when compared to Fixed Protection 2016, which could be maintained only if:

- for a defined contribution scheme, no further contributions were received on their behalf by the scheme on or after 6th April 2016 up to 6th April 2023.
- for a defined benefits scheme, individuals did not accrue further benefits above a ‘relevant percentage’ from 6th April 2016 to 6th April 2023. This will normally be either the annual rate of increase specified in the scheme rules as at 11th December 2012 or the increase in the Consumer Price Index (CPI) over the preceding year (if no rate were specified).



The personalised limit under IP16 was fixed and would not increase over time. However, it could reduce if there were a pension debit (a reduction in the member's benefits due to a pension sharing order) on divorce. IP16 could not be given up by the individual but would automatically cease should the standard LTA increase to a higher level than the personalised allowance afforded by IP16.

Under IP16 the maximum tax-free lump sum available was 25% of the member's pension benefits up to a cap of 25% of their personalised LTA. So if, for example, an individual's personalised LTA as at 5th April 2016 were £1.2 million, their maximum tax-free lump sum would be £300,000. These individuals were not affected by the March 2023 pension tax rules. They can continue contributing and can continue to protect their PCLS at a higher amount, rather than being restricted to £268,275.

Fixed Protection 2016 takes priority over Individual Protection 2016 so an individual claiming both would have a PCLS of:

- £312,500 if no benefit accrual occurred between 5th April 2016 and 5th April 2023 or
- 25% of their total benefit value (between £1 million and the £1.25 million cap) as at 5th April 2016 if benefit accrual did take place between that date and 5th April 2023.

GLOSSARY OF TERMS

Adjusted income

Your adjusted income is made up of your gross annual income plus the total value of your pension contributions, including any employer contributions.

Annual allowance

The annual allowance, also called the 'annual pension contribution limit', is a cap on how much benefit you can accrue in your private or workplace pensions tax-free each year. For defined contribution (DC) arrangements, this is the amount contributed, while for defined benefit (DB) schemes, it is the value of any increase in benefits in that year. Although your benefits can increase by more than this, any excess is subject to tax.

Annuity

An annuity is purchased with a lump sum and then pays a guaranteed income (which may be level or escalate), either for a fixed period or for the rest of your life although it may include a provision to continue after death to your dependants.

Alternative annual allowance

If you are subject to the money purchase annual allowance (MPAA), the limit on contributions made by you, or on your behalf, to money purchase plans is reduced. For other types of tax-relieved pension saving, such as defined benefit pensions, you would have an alternative annual allowance (the standard annual allowance less the MPAA). However, if you are also subject to the tapered annual allowance the alternative annual allowance will also be subject to a gradual tapering.

Auto-enrolment

When you start a term of employment, in most circumstances your employer is required to enrol you into a workplace pension scheme in accordance with UK law; this is known as auto-enrolment. You can elect to opt out of the scheme although you may not be offered the option to join again until the following year.

Capped drawdown

Capped income drawdown allows you to leave your pension savings invested and take income as and when you need it during retirement. The amount that you can withdraw is limited to between nil and 150% of the 'basic amount' set by the Government's Actuary's Department (GAD).

Carry forward rule

The pension carry forward rule allows you to make pension contributions above the annual allowance of £60,000 and still receive tax relief, by carrying forward any unused allowance from the previous three years, provided that you were a member of a pension scheme during each of those years.

Crystallised pension

When you take benefits from your personal pension via drawdown or an annuity, it becomes a crystallised pension.

Defined benefit pension scheme

DB pensions, also called final salary pensions, are a type of workplace pension that pays you a retirement income based on your salary and how long you have been a member of the scheme.

Defined contribution pension scheme

DC pensions, also called money purchase pensions, are now the most common type of workplace and personal pension. Your contributions and those of your employer are invested in one or more funds and the value of the fund is used to provide your future retirement benefits. Your retirement income will therefore depend on how much has been saved into your scheme and how your investment has performed over time.

Dependant

A dependant is someone who may be eligible to receive pension benefits after a scheme member passes away. Under UK pension rules, this typically includes:

- Spouse or civil partner – The person legally married to or in a civil partnership with the member at the time of death.
- Children – Usually under age 23, or older if they are financially dependent due to a physical or mental condition.
- Other dependants – Someone who was financially dependent on the member, shared mutual financial dependence or was reliant on the member due to a disability.

The pension scheme provider will assess each case based on the rules of the scheme and HMRC guidelines.

Earmarked pension

An earmarked pension is the proportion of an individual's pension owed to their divorced former partner when they start withdrawing.

Emergency tax code

Emergency tax codes can be applied temporarily if HMRC does not have up-to-date details of your income.

Flexi-access drawdown

Flexi-access drawdown, also called income drawdown or capped drawdown, allows you to leave your pension savings invested and take income as and when you need it during retirement.

Guaranteed minimum pension (GMP)

The guaranteed minimum pension (GMP) was a portion of a workplace pension scheme provided to employees who were contracted out of the State Earnings-Related Pension Scheme (SERPS) via their employer's pension scheme between 6th April 1978 and 5th April 1997. The GMP was designed to match the SERPS pension that these employees would have received had they not been contracted out.

Guaranteed annuity rate (GAR)

An annuity rate determines how much retirement income you can purchase with your pension savings. Some pension schemes were set up to offer a guaranteed annuity rate (GAR), which can offer a favourable rate on an annuity purchase if rates have subsequently fallen, although the terms of the offered annuity need to be checked as they may not meet the member's needs.

Lifetime allowance

The pension lifetime allowance (LTA) was the total value that you could save across all of your pension pots without having to pay an extra tax charge. It was abolished with effect from 6th April 2024 and has been replaced by the lump sum allowance and lump sum death benefit allowance.

Lifetime allowance protection

Lifetime allowance protection is a series of safeguards which HMRC put in place to protect pension savers from previous reductions in the lifetime allowance over several years.

Money purchase annual allowance (MPAA)

The money purchase annual allowance (MPAA) is a limit on how much money you can save into defined contribution pension schemes tax-free, after you have started drawing an income from your scheme.

Nominated beneficiary

A person, trust, charity, or society that you nominate to receive your pension savings when you die.

Pension sharing order (PSO)

As part of the financial settlement in a divorce, a court may order your former partner to split their pension benefits with you in a process called 'pension sharing'. If this happens you are entitled to take a share of their pension straight away and can either join their pension scheme or move your share into a scheme of your own.

Personal pension scheme

A personal pension scheme is a long-term investment product designed for saving for retirement that you set up yourself. This is different to a workplace pension, which is set up by your employer.

Protected retirement age (PRA)

At present, pension legislation states that you need to be aged 55 or over to access your workplace or personal pension. It is expected this will rise to 57 from 2028 as the normal minimum pension age (NMPA) increases to 67.

A protected retirement age (PRA) can apply to certain careers where early retirement is common such as professional sports, modelling and military service.

Protected rights pension

Employees who were not contracted out of SERPS via a contracted out employer pension scheme (so could have been a member of a contracted in employer scheme or of no employer scheme at all) could, from 1988, elect to contract out of SERPS individually. Those who did so could claim a rebate of part of their national insurance contributions (the amount depended on their earnings) to be paid to their own personal pension scheme. The resulting fund was known as protected rights.

Salary sacrifice

Your employer may offer salary sacrifice as part of your workplace pension scheme. Salary sacrifice allows you to give up a portion of your salary or bonus and for your employer to pay it into your pension scheme alongside their own employer contribution. This is commonly done as it reduces both employee's and employer's national insurance contributions, which are not due on employer pension contributions.

Self-invested personal pension (SIPP)

A self-invested personal pension (SIPP) is a type of defined contribution personal pension that lets you choose (subject to HMRC rules) how your savings are invested, rather than being limited to the choice of funds offered by the scheme provider.

State Earnings-Related Pension Scheme (SERPS)

SERPS, also called the Additional State Pension, was in place from 1978 to 2002, offering a top-up to the basic state pension.

State pension

The state pension is a regular payment made by the government once you reach state pension age, provided that you have accumulated sufficient years' credits by either working or by meeting other criteria.

State pension age

You can claim the state pension once you reach state pension age, which is currently age 66, rising to 67 by 2028.

Successor

A successor is someone who inherits pension benefits after the death of a dependant, nominee or another successor. They are not chosen by the original pension holder, but instead either:

- nominated by a previous beneficiary or
- chosen by the pension provider if no nomination exists.

Tapered annual allowance

If you have an adjusted income of over £260,000, your annual allowance may be reduced. This is called the tapered annual allowance. For every £2 of adjusted income over £200,000, the annual allowance decreases by £1. The tapered annual allowance can be no lower than £10,000.

Pension commencement lump sum (PCLS)

When you take your pension at retirement, you can withdraw some or all of your benefits as a cash lump sum, usually up to 25% of the value of the benefits, which is tax-free.

Tax relief

Most UK taxpayers get tax relief on their pension contributions. HMRC will usually gross up a basic rate taxpayer's contributions at the basic rate. For example, if you were to contribute £100, the tax relief will essentially boost that saving up to £125. Higher rate and additional rate taxpayers can claim further tax relief through their self-assessment tax return.

Uncrystallised pension

Your personal pension remains uncrystallised until you start taking a retirement income or lump sum from it using either drawdown or an annuity.

Uncrystallised funds pension lump sum (UFPLS)

You can choose to take an uncrystallised funds pension lump sum (UFPLS) and receive 25% of each payment you take from your pension tax-free; income tax will be charged on the remaining 75%.

Workplace pension

A workplace pension is a long-term investment product set up by your employer and designed to help you to save for retirement.

ABOUT BLOOMSBURY

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USE OF MORNINGSTAR DIRECT© DATA

For further information please get in touch with your usual Bloomsbury contact, telephone 020 4502 4560 and ask for a member of the wealth team or alternatively email truewealth@bloomsburywealth.co.uk

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