J05 Pension Income Options 2020/2021
Lifetime Allowance

In this part, the principles of LTA will be covered and the next will focus on the different transitional protections.

The milestones for this part are:

- To understand when an LTA check must be made.
- To be able to value the benefits that are being crystallised.
- To understand how each Benefit Crystallisation Event affects the individual's LTA.

The principle of LTA

The principle of LTA is very simple. There is no limit on the benefits that can be paid from a registered pension scheme but if the individual breaches their lifetime allowance a charge will be made.

The Standard Lifetime Allowance for 20/21 is £1,073,100. (This together with the LTA for previous years will be in the question paper.) Whenever a Benefit Crystallisation Event, (BCE) occurs, the administrator must calculate the percentage of the LTA the that has used and inform the member of this.

This is repeated at each subsequent BCE. Once all an individual's LTA has been used, any further BCE becomes chargeable at either 55% if taken as cash and 25% if used to provide an income either by annuity or drawdown.

> Carmel had a first BCE crystallising £750,000 in 15/16 when the LTA was £1.25m. This used up 60% of her LTA.
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> She has a second BCE in 17/18 crystallising £300,000. The LTA was £1 million so a further 30% is used. In total she has used 90% and has 10% remaining.
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> If there is a BCE in 20/21 she has £107,300 of LTA left.

HMRC practice which should be followed in any exam question is that the percentage should be rounded down to two decimal places. For example, 16.857% should be rounded down to16.85%

Reduced LTA

The standard LTA for 20/21 is £1,073,100 can be reduced in two circumstances:

- the member had a protected pension age on April 6 2006
- the member is receiving a pension that started before April 6 2006.

If a member has a protected pension age their LTA is reduced by 2.5% for each complete year between taking benefits and 55. Note that it is complete years so if benefits are taken on the member's 45th birthday there are 9 complete years to 55 so the reduction is 22.5%.

It also has an impact on the maximum PCLS since this is always the lower of 25% of the amount being crystallised and 25% of the member's available lifetime allowance.

A pension that was in payment at A-Day also reduces the individual's LTA. This is valued at 25 times the pension in payment at the date of crystallisation. **This reduction is made at the first crystallisation event after A Day.**

> Henry had a pension that started in 2004 and is now paying him £20,000 a year. In June 2020 he crystallises a Personal Pension. His pre A-Day pension is deemed to have a value of £500,000 (£20,000 times 25) so his LTA is reduced to £573,100.
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> If the pre A-Day pension wiped out the LTA there would be no lifetime allowance charge at that point but any post A-Day crystallisation would always incur a charge.

Benefit Crystallisation Events and valuations

The different BCEs will now be described using the HMRC references. Don't worry about remembering whether it's BCE 1 or 4 as that won't be tested. Since there is no logical order to HMRC's numbering they will be easier to understand if they are grouped around the different key events.

Member dies before 75

The first of these is a Lump Sum Death Benefit which is **BCE 7**. It occurs when:

- there is a death in service benefit paid
- or where a member dies with an uncrystallised fund and the nominated person decides to take the cash option within two years of death.

The charge will always be 55%.

> Annie dies and her nominee takes a return of fund of £900,000 so this would not incur a LTA charge. If the value of the fund was £1.5 million so £445,000 is chargeable at 55%

If a nominated person decides to designate the fund as a dependent's/nominee's FAD this is **BCE 5C**

If they decide to purchase dependant's/nominee's lifetime annuity this is **BCE 5D**.

The charge is always 25%.

It is the amount of the uncrystallised fund at the member's death that is tested rather than the amount the nominated person receives.

> Kate died with an uncrystallised fund of £2 million. She nominated her two daughters and the fund to be split equally between them. A lifetime allowance charge will be made.

Paying the charge

In all other BCE's the administrator and the beneficiaries are jointly an severally liable. The payment of any AAC on death is different.

- The scheme will inform the deceased's Personal Representatives (PRs) of the amount of LTA that has been used.
- The PRs notify HMRC of any excess over the standard LTA
- HMRC issue a bill to the beneficiaries who are liable to pay this
- The beneficiaries then decide how to take the death benefits

Payment of benefits to the member before 75

BCE 6 occurs on the payment of a **relevant lump sum** before the age of 75. These include

- the payment of a PCLS from an uncrystallised fund
- a serious ill health payment.
- taking an UFPLS.
- the payment of a lump sum when the LTA has been exceeded.

As these are lump sum payments the charge is 55%.

Care needs to be taken with a UFPLS since whilst 25% will be tax free, it is not a PCLS. The whole withdrawal will use up a percentage of the LTA. Note too that if the member is under 75 you cannot have a UFPLS from funds in excess of the available lifetime allowance.

> David has £200,000 of remaining lifetime allowance and has £300,000 of uncrystallised funds. He could only take £200,000 as a UFPLS with the remaining £100,000 being chargeable.

Payment of a PCLS will never give rise to an LTA charge but the amount that can be paid will be restricted to 25% of the individual's remaining Lifetime Allowance.

> Pat has £400,000 of LTA left and an uncrystallised fund of £500,000. She can only take £100,000 as a PCLS

The payment of a PCLS is always going to be linked with buying a lifetime annuity or moving into FAD which is also a BCE.

BCE 4. occurs when an annuity is purchased from a money purchase arrangement. Typically, with a fund of £400,000 the member would take £100,000 as a PCLS and use the remaining £300,000 to buy a lifetime annuity. These are two separate BCEs although £400,000 has been crystallised using up 40% of the current lifetime allowance.

BCE 1 occurs when designating funds into a FAD is and again is likely to be linked with taking a PCLS.

Designating a FAD and buying an annuity are two separate BCE so if someone has a FAD and then later buys an annuity could they be charged twice? In principle, they could but it can be mitigated.

> Zac takes a PCLS of £125,000 and designates £375,000 to a FAD. Some years later he decides to buy an annuity with the remaining FAD fund which is then £400,000. All that is tested is the £50,000 increase in the value of the FAD.

BCE 2 occurs when a scheme pension is paid which will always be the case with a final salary pension. The amount crystallised is 20 times the pension before commutation so with a standard LTA of £1,073,100 a pension that is more than £53,665 will result in a charge.

For schemes in the state sector that pay a pension plus a separate PCLS the calculation is 20 times the pension plus the PCLS. This method can also be used to reduce or eliminate the charge for a pension more than £52,750.

> Sandra has a scheme pension of £60,000 which has a BCE value of £1,200,000 and therefore £126,900 will become chargeable.
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> To reduce this she takes the maximum PCLS which if the commutation factor is 14 which would be £270,967.
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> This would reduce her pension by £19,354 to £40,646. She recalculates the amount to be tested as follows, £40,646 x 20 is £812,920 plus the PCLS of £270,967 to give a total of £1,083,877 so only £10,777 is chargeable.

BCE 3 is fairly rare and linked to a scheme pension. A charge occurs if this increases by the greater of RPI or 5% and is unusual in that applies even if the member is over 75. This is to prevent someone taking a lower pension to avoid a lifetime allowance charge then having large increases to their pension. Breaching the maximum will not be a BCE if the scheme has more than 20 members and the increase is given to everyone.

Member reaches 75

The next group of BCEs occur when the member reaches 75. There is no compulsion to crystallise benefits at 75 and once the relevant BCE test has been made there are no further tests when benefits are taken after 75 with the exception of BCE3.

BCE 5 occurs when the member reaches 75 with an entitlement to a scheme pension and hasn't yet taken this.

BCE 5A is where the member has a capped drawdown or FAD but as BCE 1 will already have taken place only the increase, if any, in the fund is tested.

BCE 5B is where the member has an uncrystallised money purchase fund.

The charge for all these will be 25% because at this stage no decision has been taken on whether benefits will eventually be taken as cash or income.

PCLS after 75

There are no uncrystallised funds after 75 since a BCE check will have been made. (BCE5 or 5B) To avoid confusion these will be referred to as **unused funds**. Whilst taking benefits from an unused fund will not be a BCE the amount that can be taken as a PCLS may be limited by the remaining LTA.

No one older than 75 can have 100% of the LTA because of there would have been a BCE at 75. As the maximum PCLS cannot be more than 25% of an individual's remaining LTA this would seem to discriminate against taking a PCLS after 75.

> Ann was 75 on October 1 2020. On September 1 2020 she crystallised all her fund of £800,000 and took a PCLS of £200,000. That was her first BCE. She had no pension funds at 75.
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> Brian was also 75 on October 1 2020, had no previous BCEs and his fund was £800,000. An LTA check was carried out and this used up 74.55% of his LTA. In January 2020, he decides to crystallise all his fund (assume it is still £800,000) but as he only has £273,100 of LTA left it appears that the maximum PCLS would be £68,275. (25% of £273,100).

To avoid this uncrystallised funds tested at 75 are ignored when calculating the individual's remaining LTA so Brian still has £1,073,100 LTA and can take 25% of his unused fund giving a PCLS of £200,000.

If benefits had been taken before 75 these will reduce the available LTA.

> Carol crystallised some of her fund when she was 70 using up 25% of her LTA. The BCE carried out on her 75th birthday used up a further 50%.
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> She now plans to take the remaining unused fund of £500,000. For calculating the maximum PCLS the amount used at 75 is ignored so she has 75% of the LTA remaining. For 20/21 this would be £804,825

The formula to calculate the maximum PCLS is the **lower** of

A. 25% of the individual's remaining unused fund coming into payment from the balance of unused funds at 75 (within the LTA)

B. 25% of the individual's remaining LTA at the time of taking the PCLS.

In Carol's case, option A would be £125,000 (25% of £500,000)
Option B would be £201,206 (25% of £804,825) so £125,000 is the maximum PCLS

Here are some more examples:

> Ben is 83 and had 100% uncrystallised benefits at 75 with a value of £1m. He is now fully crystallising his fund which has grown to £1.2m. Option A would give £300,000 (25% of £1.2m), option B £268,275 (25% of the LTA) so the maximum PCLS is £268,275

> Raj had crystallised 60% of her LTA by the time she reached 75. She had £250,000 in uncrystallised funds at 75.
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> When she used up of the remaining fund, it had a value of £300,000. Option A would be 25% of £300,000 (£75,000). Option B would be 25% of the remaining LTA. The remaining LTA is £429,240 (£1,055,000 x 40%) so 25% of this is £107,310 so the maximum PCLS is £75,000.

If benefits are taken after 75, whilst they are not BCEs they are treated as such to calculate the amount of remaining LTA.

> Aaron did not crystallise any benefits before reaching 75 so for PCLS purposes he has 100% of LTA remaining. At that time his fund had a value of £720,000. When he was 78 he crystallised £400,000 putting £300,000 of his unused fund into a FAD and took £100,000 PCLS. Three years later in 20/21 he takes the remaining unused fund which is £420,000. Under Option A the maximum PCLS is 25% of £420,000 which is £105,000
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> His remaining LTA is £1,073,100 less £420,000 which is £653,100. 25% of this is £163,275 so the maximum PCLS is £105,000.

If a UFPLS is taken from unused funds, the tax free element is restricted to the lower of:

- 25% of the UFPLS
- OR 25% of the individual's remaining LTA

> Emma is 80 and her remaining LTA is £200,000. She has £250,000 unused funds. She can take this as a UFPLS but only 25% of the remaining LTA, that is £50,000 will be free of tax

Serious Ill health lump sum after 75

The conditions for paying this are the same as a pre-75 payment. It can only be paid from unused funds and there must be sufficient remaining LTA to cover the payment.

As with the PCLS calculation the reduction in LTA resulting from BCE 5 & 5B are ignored.

Remaining BCE

BCE 8 occurs when benefits are transferred to a Recognised Overseas Pension Scheme. This will be looked at in more detail in the section on transfers but the one thing to note is that the charge will always be 25%.
BCE 9 occurs when there have been certain error payments and probably need not concern us.

Events that are not BCE

These are:

- Payment of a spouse/dependant's pension from a final salary scheme.
- Payment of a dependant/nominee pension from a joint life annuity.
- Designating a dependant/nominee FAD to a successor FAD
- A dependant, nominee or successor withdrawing income or lump sums from a FAD
- Taking benefits under small pots rules and this does not require the member to have any LTA.
- Triviality of up to £30,000 is not a BCE but the member does need to have some LTA.

A smaller employer may sometimes use what is termed a **Relevant Life Policy** to provide death benefits. It is taken out by the employer insuring the life (and possibly Critical Illness) of an employee. The benefit is usually written as a multiple of the employee's salary.

It is outside the pensions regime so the premiums do not count towards the employee's annual allowance and if a claim is made it does not count towards the Lifetime Allowance. Neither are the premiums taxed as a Benefit in Kind.

It can only be taken out when there is an employer/employee relationship so it is not available to the self-employed.

BCE administration

In terms of administration every time there is BCE the administrator must check how much of the member's LTA has been used up and tell the member how much this is.

If an occupational scheme is paying the pension this information must be sent to the member at least once a year.

If the crystallised funds have been used to buy an annuity the insurance company will take over this responsibility

If only a lump sum has been paid the information must be given to the member within three months of the BCE occurring.

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The annual statements can cease once the member is over 75 for the whole of the tax year. They can also cease if the fund has been transferred to a new scheme as this will take over the responsibility. Finally, when all the LTA has been used up there is no need to send out any further statements.

Should there be a lifetime allowance charge (other than for death benefits) the administrator and the member are jointly liable to pay this. In general, the administrator must report the charge and pay it. Within three months the member must be told how much of their savings are subject to the charge together with how the tax has been calculated and whether the administrator has paid or intends to pay the tax.

The LTA charge is treated as a recovery of tax relief previously given. This means that individuals cannot use any allowances, losses or reliefs to mitigate this.

That concludes this part so you should now understand

- To understand when an LTA check must be made.
- To understand how each Benefit Crystallisation Event affects the individual's LTA.