AF1 2021/2022:
Pension Rules part 2

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.
- To understand the different types of transitional protection that are available

The principle of LTA

The principle of LTA is 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 21/22 £1,073,100. (If relevant to answering a question you'll be given a previous year's LTA.) Whenever a Benefit Crystallisation Event, (BCE) occurs, the administrator must calculate the percentage of the LTA that the crystallised amount 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.

> Ben has had a BCE and is £200,000 in excess of the LTA
>
> He could pay a charge of £110,000 leaving a cash sum of £90,000
> Alternatively he could pay a charge £50,000 and use the remaining £150,000 either to buy an annuity or designate it as a FAD

When an MP arrangement is crystallised, the figure you use is simply the monetary amount being crystallised.

> Carmel had a first BCE crystallising £750,000 in 15/16 when the LTA was £1.25m. This used up 60% of her LTA.
>
> 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.
>
> If there is a BCE in 21/22 she has £107,310 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%

The maximum PCLS is always restricted to 25% of the remaining LTA

> Tom has £100,000 of his LTA left. He wants to crystallise £150,000. The maximum PCLS will be £25,000 (25% of £100,000) rather than £37,500 (25% of £150,00).

To calculate the monetary amount that is being crystallised from a DB pension multiply the pension before any PCLS is taken by 20

> Fay is retiring and her pension will be £20,000 a year. In monetary terms this is £400,000 which is the amount of LTA she has used up. Assuming that this is her first BCE in 20/21 she would have used up 37.13% of her LTA

Assuming there has been no previous BCE a DB pension would have to be £53,865 before an LTA charge was triggered. If the pension is higher than this the effects can be mitigated by taking the maximum PCLS and multiplying the residual pension by 20 and then adding on the PCLS.

> Connor is retiring and has a DB pension of £60,000 and has never had a previous BCE.
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> £60,000 x 20 is £1,200,000 so the excess would be £126,900 and assuming it is taken as cash the charge would be £69,795
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> If the commutation factor were 14 the maximum PCLS would be £270,096 and the residual pension £40,646.
>
> £40,646 X 20 = £812,920 + £270,096 = £1,083,016
>
> This is £9,916 above the LTA so the charge would be £5,453

Reduced LTA

The standard LTA of £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. He has no further BCE until June 2021 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

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

It is probably sufficient to be aware that a BCE will occur:

- On the death of the member either by paying a Death in Service Benefit and when the nominated person(s) takes these as cash, designating uncrystallised benefits are taken as cash, designating it as a FAD or buying a dependants/nominee's annuity
- When the member takes benefits (PCLS, Lifetime Annuity, FAD or UPFLS)
- When a serious ill health lump sum is paid
- When the member reaches 75 with either an uncrystallised fund or a Flexible Access Drawdown

There are no BCE after the member reaches 75, hence the requirement to have a final check at 75. However in calculating the charge at 75 any excess is **always** charged at 25%.

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.

Transitional Protection

Transitional Protection allows individuals to have a fund higher than the Lifetime Allowance without suffering a charge. The original two, Primary and Enhanced Protection were launched at A Day and as changes were made to the LTA further ones were introduced

Whether to apply for one of these was a decision for the member rather than the scheme. However, it is possible to have what is called scheme specific protection which potentially covers all members of the scheme. This will be looked at later.

The different types of protection available to individual members can be summarised as follows:

Name	**Latest date to apply**
Primary Protection	April 5 2009
Enhanced Protection	April 5 2009
Fixed Protection (2012)	April 5 2012
Fixed Protection (2014)	April 5 2014
Individual Protection (2014)	April 5 2017
Fixed Protection (2016)	No final date
Individual Protection (2016)	No final date

Primary Protection

Prior to A-Day the concept of LTA did not exist and certain individuals, usually high earning executives, had pension funds or rights more than the initial LTA of £1.5m. If the value of their fund was higher than £1.5m on April 5 2006 they were able to apply for Primary Protection and had until April 5 2009 to do so.

Primary Protection gave the member a **Lifetime Allowance Enhancement Factor** or **LAEF**. This was calculated by deducting £1.5m from the fund value on April 5 2006 and dividing the result by £1.5m. The enhancement factor should always be calculated to two decimal places and always rounded up so 0.32 becomes 0.33

The LAEF will probably be given to you but this is how it was calculated

Carol had a fund of £2,250,000 on 5/4/06.

$$\frac{£2,250,000 - £1,500,000}{£1,500,000} = 0.5$$

Conrad's fund on 5/4/06 was £3m.

$$\frac{£3,000,000 - £1,500,000}{£1,500,000} = 1$$

The original plan was that members would multiply the standard LTA in the year of crystallisation by their enhancement factor and then add back the standard LTA to give them their own personal allowance.

Fiona's enhancement factor was 0.5 and had a BCE in 2009/10 when the LTA was £1,750,000 Her personal LTA would be £1,750,000 x 0.5 which is £875,000 plus £1,750,000 to give £2,625,000.

This system worked until 2012/13 when the LTA was reduced to £1.5m followed by a further reduction to £1.25m in 2014/15 and £1m in 2016/17. To avoid penalising those with Primary Protection the Government introduced the concept of an **underpin of £1.8m** which meant that in calculating an individual's LTA we apply the enhancement factor to £1.8m and then add back in £1.8m.

John has Primary protection with an enhancement factor of 2.2 and is having his first BCE on July 1 2020. His LTA is £1.8m x 2.2 which is £3,960,000 plus £1,800,000 to give £5,760,000.

This means the individual's LTA with Primary Protection will be a fixed amount until and if ever the standard lifetime allowance exceeds £1.8m. Therefore, when there is a BCE since April 6 2012 we don't need to worry about calculating the percentage that was used up, simply deduct the amount that is being crystallised from the individual's enhanced LTA.

A quick sidebar on enhancement factors. Some notes and training guides show them in different ways so 0.5 becomes 50% or 1.5. The way described here is how HMRC do it and you should expect to see any enhancement factor in an exam question to be presented in this way.

Primary Protection and Cash Protection

As the fund must have been more than £1.5m to qualify for Primary Protection it follows that the member would normally have had a PCLS entitlement of more than £375,000 which was 25% of £1.5m.

Any cash protection is increased by a factor of £1.8m over £1.5m which is a 20% increase so a £500,000 protected cash sum becomes £600,000. The value of the fund is irrelevant.

A member can never renounce Primary Protection and can only be reduced if a pension sharing order is attached.

When that happens, the administrator must recalculate the enhancement factor by deducting the pension credit from the fund value at A-Day.

Fred had a pension fund of £3m at A-Day and is LAEF was 1.0. Following a pension sharing order his wife was awarded £1m. This reduces the A-Day fund to £2m so the LAEF is recalculated as 0.34.

This will not affect any protected tax free cash but if the sharing order reduces the A-Day fund below £1.5m both Primary Protection and any protected cash will be lost.

Enhanced Protection

The other way individuals had to protect their pre-2006 benefits was Enhanced Protection. This was open to anyone but the main appeal was to those just under the then LTA of £1.5m. Having Enhanced Protection means the member will never be subject to a Lifetime Allowance charge but is not allowed to have any pension input. If there is an input, Enhanced Protection is lost and can never be reclaimed.

Cash could also be protected but it was the percentage of cash to the fund at A-Day that was registered, not a lump sum as is done with Primary Protection.

Peter applied for enhanced protection with cash protection. At A Day his fund was £1.6m and he had a cash entitlement of £640,000 so she gets cash protection of 40%.

It was possible to register for both Primary and Enhanced assuming you met the criteria for Primary. Enhanced takes priority and the member is not allowed any pension input. Having both can lead to an interesting situation when cash is taken.

Raviva has registered for both Primary and Enhanced Protection and has cash protection with both. At A Day her fund was £2m and she had protected cash of £800,000 under Primary and 40% under enhanced. In August 2018 the fund has a value of £2.6m so if she uses Enhanced her maximum PCLS is 40% of this which is £1,040,000. Using Primary the maximum PCLS is £800,000 revalued by 20% which is £960,000 so she would use Enhanced.

On the other hand if the fund had fallen to £1.8m she could still take £960,000 under Primary as it is not linked to the fund value but under enhanced only 40% could be taken which is £720,000

Fixed Protection

The other individual protections were brought in whenever the LTA was reduced. Generally one year's notice was given and individuals could register to keep their LTA at the higher level. These are referred to as Fixed Protections.

Fixed Protection 2012 (FP12) meant that the member's LTA was £1.8m.
Fixed Protection 2014 (FP 14 meant that the member's LTA was £1.5m.
Fixed Protection 2016 (FP16) that will give a member an LTA of £1.25m

In all cases the protection will be permanently lost if the member has any pension input.

In 2019/20 it is too late to apply for either FP12 or FP14. There is no cut-off date for applying for FP16 but there must have been no input on or after 6 April 2016. There is no minimum fund value for FP16. This could be useful if someone believes that with reasonable investment growth the fund might be greater than £1m when benefits are taken. The only other proviso is that the applicant must not have either Primary, Enhanced or any previous Fixed Protection

Under all versions of the Fixed Protection if there have been no previous BCE then you simply deduct the amount that is being crystallised from whatever is the fixed protection figure.

Tova has FP14. In November 2017 she crystallises £800,000.

She has £700,000 of LTA remaining

The administrator must still issue a certificate (in this case for 53.33%). This is because Tova may renounce FP14 or switch to one of the Individual Protections when the remaining percentage will be applied to a different figure.

Individual Protection

There are two versions, **Individual Protection 2014 (IP14)** and **Individual Protection 2016 (IP16)** The last date to apply for IP14 was April 5 2017. There is no cut-off date for IP16 and the individual can elect for this when they have a BCE.

The basis of protection for both is the same in that the member's lifetime allowance will be the total of all their pension rights at either 5 April 2014 or 5 April 2016 but capped at either £1.5m or £1.25m respectively. Unlike Fixed Protection the member can have further input. This can be useful as in this situation.

Tom had a SIPP with a fund value of £1.4m at 5 April 2014. If he applied for Fixed Protection (2014) he would be prohibited from making any further contributions.

If the fund falls in value that gives him a dilemma. He can hope the fund will recover but if he renounces FP14 to allow further input, his LTA will be the standard one for that year so in 20/21 that would be £1,073,100.

If he had taken IP 14 the protection would have been £1.4m rather than £1.5m but he can have further input should his fund fall in value.

It is possible to apply for both Fixed and Individual Protection but only for the same year, that is FP14 and IP14 but not FP14 and IP16. Where both are taken FP takes priority and no input is allowed unless it is renounced.

Those who already have an earlier version of Fixed protection can also renounce it and take up Individual Protection.

It is also possible for those with enhanced protection to apply for IP 14 & 16 by revoking EP. This means further input is possible and they will benefit from a higher lifetime allowance than the current one. Anyone who has already revoked EP can also apply for IP 2016

Scheme Specific Lump Sum Protection

This is taken out by the scheme administrator rather than the member. The most common type occurs when a member of a money purchase occupational scheme had a higher cash entitlement than 25% of the fund at A-Day. This was because prior to A-Day the method of calculating the PCLS from an occupational scheme was based on a formula rather than just a straight 25% of the fund value which often resulted in a higher PCLS.

The maximum amount of cash at A-Day was registered by the administrator and increased in line with the rise in Lifetime Allowance. As with Primary Protection this is now increased by 20% as it assumes the Lifetime Allowance is still £1.8m.

It is only the pre A-Day cash that is protected, the fund built up after that date is subject to the normal maximum of 25%. However, the fund at A Day is adjusted proportionally to take account of changes in the LTA.

For April 2020 the A-Day fund is increased by £1,077,300/£1.5m

Brian had a fund of £100,000 fund at A day with protected cash of £50,000. In 2020/21 the fund value was £130,000.

The pre day cash is increased by 20% to £60,000

The fund at A Day is revalued £100,000 x £1,073,100/£1,500,000 = £71,540

The growth is £130,000 less £71,540 which is £58,460 The usual 25% can be taken as cash which gives us £14,615 so the total of the two elements is £74,615.

If the client has Fixed Protection (2012) the A day fund is **increased** by the factor 1.8/1.5
If the client has Fixed Protection (2014) the A day fund remains the same. To be strictly accurate the factor applied is 1.5/1.5. Fixed 2016 would be revalued by 1.25/1.5

Cash protection will be lost if the member transfers the fund unless this is as a result of a bulk transfer. This can also be a “buddy” transfer where at least one other member transfers. The issue of transfer is significant because the member’s scheme may only allow benefits to be secured by a lifetime annuity which means that if they want to use FAD they will lose their higher protected cash. Again this shows the importance of checking what options are open under the member’s existing scheme.

That concludes this part so you should now:

- Understand when an LTA check must be made.
- Be able to value the benefits that are being crystallised.
- Understand how each Benefit Crystallisation Event affects the individual's LTA.
- Understand the different types of transitional protection that are available