

## AF7 Pension Transfer 2023/24

### Part 5 Impact of lifetime allowance and maximum PCLS

This part will look at the recent changes in the Lifetime Allowance and the rules regarding the maximum PCLS that can be taken. Both the LTA and maximum PCLS need to be considered when advising a transfer is appropriate and whether to consolidate money purchase arrangements.

Whilst the changes simplify the existing arrangements some clients will have existing transitional protection which could increase the LTA and the PCLS available to them.

The milestones are to understand the:

- The changes brought about by the 2023 Budget.
- The different Transitional protections and how these interact with the new rules.
- How Individual Protection 2016 can increase the PCLS

#### Pre and Post 2023 Budget

The lifetime allowance was introduced in 2006 and limited the amount that can be taken or crystallised without incurring the Lifetime Allowance Charge. This was 55% if taken as a cash sum or 25% if taken as income by drawdown. A client choosing to take income would of course pay income tax on this.

Prior to April 6 2023 one factor that had to be considered in considering a transfer was whether this would breach the LTA which in 2022/2023 was £1,073,000. Whilst the transfer is not a **Benefit Crystallisation Event (BCE)**, we need to calculate the amount the value of the DB pension compared to the transferred fund. DB pensions are assessed at 20 times the pension before commutation so an initial pension of £45,000 would be valued at £900,000. The TV might though be much more than this which could breach the LTA. For a DB pension to breach the LTA it would have to be more than £53,365 before commutation.

One potential benefit of transferring from a DB scheme into a SIPP is that it can give a higher PCLS than would be available from staying with the scheme. This is because 25% of the SIPP can be taken whereas in a DB scheme it is calculated by a different formula so the higher the TV the more PCLS can be taken.

In the 2023 Budget the Chancellor announced that the LTA would be abolished from 24/25 but for the current year whilst the LTA will remain at £1,073,100 the LTA charge will be 0%. Instead, it will be taxed as income on the individual's own rates regardless of whether the excess is taken as income or a lump sum. However, the **maximum PCLS will be restricted to 25% of £1,073,100 or £268,275** and that is not likely to be adjusted for inflation.

That would seem to simplify things, but it is complicated if the member has some form of transitional protection. Each time the government changed the LTA it allowed those affected by this change to elect for protection and this could result in a higher PCLS being available.

## Primary and Enhanced Protection

- These were introduced on April 6 2006 and the member had three years, that is until April 5 2009 to claim this.
  - **Primary Protection** protected those who had funds or rights greater than the original LTA of £1.5m on April 5 2006.
  - They were given an **Enhancement Factor** which this is applied to £1.8m.
  - If the EF was 0.5 their Lifetime Allowance would be  $£1.8m \times 0.5 + £1.8m = £2.7m$
  - You could also have applied for cash protection which would be stated as a monetary amount, e.g., £500,000. This is increased by 20% so the maximum PCLS would be £600,000.
  - If the individual has no cash protection the maximum PCLS will be 25% of £1.5m, £375,000.
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- **Enhanced Protection** enabled anyone regardless of the value of their pension savings on 5 April 2006 to avoid being subject to the LTA charge.
  - However, having elected for this no further contributions could be made otherwise protection would be lost.
  - This prohibition on further input will no longer apply in 23/24.
  - They could also have applied for cash protection which would be based on the percentage of their fund at A Day. For example if the fund was £1m and the cash entitlement was £400,000 then the percentage would be 40%
  - That still remains but the maximum PCLS is restricted to the lesser of the percentage of the fund value at 5 April 2024 and the total fund value at crystallisation.
  - For example if the fund value at April 5 2023 was £1.4 million, but when the benefits were crystallised in 2027 they had risen to £1.6m, the maximum PCLS would be 40% of £1.4m.
  - If no cash protection had been selected then the maximum PCLS would be 25% of £1.5m, £375,000.

## Fixed Protection

The government reduced the standard LTA three times since 2012:

- 2012 reduced to £1.5m
- 2014 reduced to £1.25m.
- 2016 reduced to £1m

On each occasion it offered Fixed Protection to those whose funds were higher than the new lower LTA

These were

- FP 2012 LTA £1.8m
- FP 2014 LTA £1.5m
- FP 2016 LTA £1.25m
- Having elected for any of these meant no further input into a pension was allowed otherwise the protection would be lost.
- As with enhanced protection this prohibition is abolished from 23/24.
- There was no specific cash protection but the maximum PCLS was the lesser of 25% of the fund at crystallisation or the amount of Fixed Protection

Jack has registered for FP 2012 and has a pension fund of £2m. If he wants to move the whole pension into drawdown the maximum PCLS would be £450,000, 25% of £1.8m

If the fund had fallen to £1.6m the maximum PCLS would be £400,000, 25% of £1.6m)

The closing date to apply for FP12 and 14 has passed but there was no end date to apply for FP 16. To do this:

- There must have been no pension input after April 5 2016
- You have no other protection other than IP2014.
- If you applied after 14 March 2023 and were successful you will still be prohibited from further pension input.

### **Individual Protection**

- Unlike Fixed Protection these allowed individuals to have further input without losing this protection
- There are two versions: IP 14 and IP 16
- The holder would get their own LTA based on the pension fund or rights on 5 April 2014 or April 2016
- To apply for IP 14 the pension rights had to be at least £1.25m and was capped at £1.5m.
- For IP 16 the pension rights had to be at least £1m and capped at £1.25m
- In both cases the maximum PCLS is the lesser of 25% of the member's IP and 25% of the fund at crystallisation.

It is still possible to apply for IP 16 and this can be advantageous in giving the individual a higher PCLS.

Ahmed has a SIPP with a value of £1.6m and has no protection. The value of his fund on 5 April 2016 was £1.2m.

He successfully applied for IP 16 and has a protected LTA of £1.2m

Twelve months later the fund has increased to £1.7m and he decides to put the whole fund into drawdown. The maximum PCLS would be £300,000 (25% of £1.2m) and £500,000 would be taxed as income.

If he hadn't applied for IP 16 then the maximum PCLS would have been £268,275 and £626,900 would be taxed as income.

That concludes this part so you should understand:

- The changes brought about by the 2023 Budget.
- The different Transitional protections and how these interact with the new rules.
- How Individual Protection 2016 can increase the PCLS