AF1 2023/2024:
Pension Rules part 2
Taking the benefits.

The milestones for this part are to understand:

- The principle rules regarding taking benefits.
- How benefits from a Final Salary pension can be taken.
- How benefits from a Money Purchase arrangement can be taken.
- To understand how LTA operated prior to 23/24
- To understand the impact of the 2023 budget on the LTA.

The key rules

- With a few exceptions a member can only take benefits from a pension once they are 55.
- There is no need to stop working to take the benefits.
- Benefits can be taken earlier than 55 if the member qualifies for an ill health pension.
- Apart from the Pension Commencement Lump Sum member benefits are taxable as non-savings income
- There is no minimum age for a pension to be paid to a spouse or dependent on the death of the member.

Taking Final salary benefits.

- All schemes will have a scheme pension age.
- Benefits can be taken earlier subject to the trustees' approval as long as the member is over 55. This will probably result in a lower initial pension.
- Apart from deciding on whether and how much PCLS to take. The member does not need to make any further decisions.
- The pension will be paid direct from the scheme and will increase each year in line with CPI although this may be capped at 5%
- The scheme will pay a pension to the member's spouse and/or dependent on the member's death.
- This is always taxable.

Taking Money Purchase benefits

The member has three options in taking benefits from his pension fund.

- Buy a lifetime annuity.
- Move the fund into a Flexible access Drawdown (FAD) fund

- Take Uncrystallised Fund Pension Lump Sum.

- These are not either/or decisions and individuals can use all three with the same fund.
- Apart from the UFPLS, a PCLS of 25% of the uncrystallised fund can be taken when buying an annuity or moving into drawdown.

Lifetime Annuity

- This is a purchase of a lifetime income with the pension fund after taking the PCLS.
- The member can take different options such as a guarantee period, spouse's pension and indexation. These will reduce the amount of income payable.
- Once purchased the annuity cannot be renegotiated.
- A spouse's/depenant's pension will be tax free if the member died under 75. It will be taxable if the member dies over 75.

Flexi Access Drawdown

- After taking the PCLS the member designates the fund as a FAD.
- They can then take whatever they want from the fund (which could be nil).
- If the member dies nominated person(s) can take the whole fund as cash or continue in drawdown or buy and annuity.
- This is currently tax free if the member died under 75 but taxable if the member died over 75.

UFPLS

- Here the member can take an ad hoc sum from the pension fund.
- 25% of each withdrawal is tax free and the remaining amount is taxable.

The Lifetime Allowance (LTA)

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% of taken as a cash sum or 25% if taken as income by drawdown. The income would of course pay income tax on this.

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 x 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.

- **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 crystalisation.
- 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 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 now:

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- How benefits from a Final Salary pension can be taken.
- How benefits from a Money Purchase arrangement can be taken.
- To understand how LTA operated prior to 23/24
- To understand the impact of the 2023 budget on the LTA.