Replacing the Lifetime Allowance (LTA)

In the 2023 Spring Budget, it was announced that the Lifetime Allowance (LTA) would be abolished.

Originally implemented in 2006, among other major changes that sought to simplify retirement funds and their associated taxes, the LTA placed a cap on the amount of money you could build up in your pension over a lifetime, helping savers avoid an additional tax charge.

Having been in force for under two decades, it begs the question – what changed? And more importantly, how does the LTA's abolishment affect your workplace savings allowances?

What was the LTA?

Lifetime Allowance (LTA):

The maximum amount of money you can accumulate as pension savings throughout your lifetime while still benefiting from tax relief.

For the past 18 years, the LTA has dictated the maximum level of tax-efficient pension savings that almost all individuals in the UK could accrue over their working lives.

Originally set at £1.5m in 2006, the LTA rose to £1.8 million by April 2010. By 2016, this had been reduced to £1 million before slowly beginning to rise again, reaching £1,073,100 in 2020 and remaining at this level until it was abolished (historic figures shown in Appendix 1).

No additional tax charge would apply for those who stayed within the limit. However, if you were fortunate enough to have a pension fund that exceeded the LTA limit, unfortunately, you would also have to pay the charge.

The tax charge became payable either once you drew benefits from your pension plan or at age 75 if no funds had been taken or pension holders were using drawdown to give them regular income while still keeping some of their pension pot invested.

Even though the LTA was set at a certain fund value, this did not mean those lucky enough to be on defined benefit (or final salary) schemes were exempt. Instead, the fund's overall value was calculated for LTA purposes, making almost everyone subject to the pension savings limit.

Since the commencement of LTA, "protections" (see Appendix 2) have been in place to limit the tax liability of certain investors. For example, Primary and Enhanced Protections were introduced to protect those who had either already exceeded the limit or were likely to exceed it when the LTA was brought into force. This protection prevented them from being retroactively penalised for building legitimate pension savings over their careers without knowing there would be a cap on this at a later date. When the LTA amount was reduced, Fixed or Individual Protections served a similar function by ringfencing funds that exceeded the new lower limit.

Tax-free cash could also be protected from 2006, either separately or along with the protection of the fund as a whole, and this was known as scheme-specific tax-free lump sum (SSTFLS). Before April 2006, in some circumstances, tax-free cash could be calculated on a different basis to the straightforward 25% of the fund value. For example, the tax-free cash available was often quite a bit more than 25% of the fund, and this entitlement could be preserved on a personalised basis. However, the protection only applied to the portion of the fund accrued before April 2006.

In most cases, having protection meant that your funds could avoid some or all of the LTA tax charges. However, in return, you could not make any further contributions or accrue any more benefits.

Lifetime Allowance vs Annual Allowance

Alongside the introduction of LTA came the Annual Allowance (AA), which is still in force today. The AA dictates the maximum contributions that can be made in any year which would receive tax relief.

If an individual makes or receives contributions (for example, from an employer) throughout the year that rises above the AA, there would be no tax relief on these "excess" contributions. Where the contributions came from an employer, there would even be a tax charge rather than a rebate.

The AA started at a generous £215,000, rising to a maximum of £255,000 in 2010. As the LTA reduced, so did the AA, dropping to £50,000 from 2011 and as low as £40,000 between 2014 and 2022. From April 2023, it has been £60,000.

Even with the removal of the LTA, the AA remains with us, with one major change. Those with LTA protections who could not make further pension savings can now contribute without losing their protection, with one exception. Anyone can still apply for Fixed Protection if applied for after 15 March 2023; protection can still be lost if contributions are made.

The LTA's Replacement

As of April 2024, the LTA has been replaced by three components:

- Pension Lump Sum Allowance (LSA)
- Pension Lump Sum and Death Benefit Allowance (LSDBA)
- Overseas Transfer Allowance

Pension Lump Sum Allowance (LSA)

The new approach focuses in on the tax-free lump sum you normally receive from your pension pot. If the fund is below the old LTA, a full 25% can be taken tax-free. Funds that are over the LTA will have a cap applied. Since the tax-free amount can be up to 25%, the LSA from April 2024 is £268,275, equating to 25% of the most recent LTA allowance (£1,073,100).

Pension Lump Sum and Death Benefit Allowance (LSDBA)

As the name suggests, the LSDBA applies to benefits paid as a lump sum from a pension fund on death. Death benefits paid as an income are, therefore, not affected by this limit.

The LSDBA is the maximum tax-free lump sum which can be taken from a pension during an individual's lifetime and paid to beneficiaries upon death. Lump sums over the LSDBA will be taxed at the recipient's marginal rate.

The LSDBA matches the most recent LTA at £1,073,100 unless the deceased individual had any protection/s in place on their LTA (see Appendix 2). In this case, the deceased's personal LSDBA would match the protected fund's value (or the value of the fund as of 5 April 2024 in the case of Enhanced Protection).

Overseas Transfers

Pension benefits can be transferred to schemes outside of the UK in some circumstances. This equates to the same allowance level as the LSDBA, meaning the transfer of less than £1,073,100 to an overseas scheme is free of tax. Any amount over this limit may incur tax charges in the UK before the funds transfer.

The Future – Opportunities and Risks

As always, the future is unknown, and various political parties have indicated that they may reinstate the previous allowances in some shape or form. The only real certainty is that things will unlikely remain the same forever.

While these changes present many opportunities, they also present risks to those in retirement. Therefore, advice is essential to ensure these are effectively managed, and opportunities for tax mitigation are maximised.

Cash-Flow Risk

Though it may be tempting to draw large sums from your pension fund now, since there are no excess tax charges, income tax still applies. There is also the risk that excessive withdrawals will result in you outliving your pension fund by several years and becoming reliant on your State Pension for the latter part of retirement.

Therefore, careful planning on expenditure patterns, standard of living, and sustainable income levels must be carried out annually.

Investment Risk

It is also vital that you establish the rates of investment returns you require from your pension fund, as the sequence of these returns will play a major role in the sustainability of withdrawals. Therefore, the risk profile of all investors should be assessed before an asset allocation and diversified portfolio strategy is designed.

Increased Tax-Free Cash Entitlement

Some people may find that these new rules provide them with a slightly higher tax-free cash entitlement than they had previously.

Due to a simplification of the formula for calculating tax-free cash entitlement under scheme-specific tax-free lump sum (SSTFLS) protection, those with any of the fixed or individual protections will get more of a lump sum after April 2024, with the greatest increases going to those with 2012 fixed protection (see Appendix 2).

If an individual has withdrawn some but not all of their tax-free cash before 5 April 2024, the maximum lump sum will be based on a percentage of the remaining LTA amount. With the LSA being based on a fixed monetary amount, the remaining lump sum can, therefore, end up being higher than the usual 25%. To benefit from this, a calculation is required, and you will need to be able to provide evidence of the tax-free cash you have already received to obtain this higher amount.

Transitional Tax-Free Amount Certificate (TTFAC)

Individuals also have the option to apply for a “transitional tax-free amount certificate” (TTFAC) to receive additional allowances. However, whether you can apply for a TTFAC depends on whether and when your pension funds are crystallised.

Your pension becomes crystallised as soon as you begin taking cash from it, and it is vital that your funds are not crystallised before the TTFAC is approved and received. However, if you have already received funds from your pension before 6 April 2024, you can still apply for a certificate as long as it is approved and received before you crystallise more funds after 6 April 2024.

Are you making the most of your allowances?

With extensive knowledge of all types of pensions, we can help you make sense of your allowances, entitlements, and protections to ensure your retirement fund is as tax efficient as possible.

Head to our website to learn more about our **pensions and retirement planning services**, and make an appointment with one of our expert financial planners to get started.

Appendix 1 – Lifetime Allowance (LTA) and Annual Allowance (AA) Historic Figures

LTA AND AA TIMELINES:

Tax year	Standard lifetime allowance	Annual Allowance	High Earner Max Taper	MPAA
2023/2024	£10,731,001	£60,000	£10,000	£10,000
2022/2023	£1,073,100	£60,000	£4,000	£4,000
2021/2022	£1,073,100	£40,000	£4,000	£4,000
2020/2021	£1,073,100	£40,000	£4,000	£4,000
2019/2020	£1,055,000	£40,000	£10,000	£4,000
2018/2019	£1,030,000	£40,000	£10,000	£4,000
2017/2018	£1,000,000	£40,000	£10,000	£4,000
2016/2017	£1,000,000	£40,000	£10,000	£10,000
2015/2016(*)	£1,250,000	£40,000		£10,000
2014/2015	£1,250,000	£40,000		
2013/2014	£1,500,000	£50,000		
2012/2013	£1,500,000	£50,000		
2011/2012	£1,800,000	£50,000		
2010/2011	£1,800,000	£255,000		
2009/2010	£1,750,000	£245,000		
2008/2009	£1,650,000	£235,000		
2007/2008	£1,600,000	£225,000		
2006/2007	£1,500,000	£215,000		

* Special rules applied from 6 April to 8 July and from 9 July 2015

Appendix 2: Pension Protections (April 2006-April 2024)

PENSION PROTECTIONS (April 2006 – April 2024)

Protection	Effective from	Applicable LTA	Lump Sum Protection	No contributions after:	Closing date for applications
Primary Protection	*06-Apr-06*	*Personalised (1)*	*Lower of 25% of fund or £375,000 (2)*	*not applicable*	*05-Apr-09*
Enhanced Protection	*06-Apr-06*	*Not applicable*	*Lower of 25% of fund or £375,000 (2)*	*05-Apr-06*	*05-Apr-09*
Fixed Protection 2012	06-Apr-12	£1.8 million	£450,000	05-Apr-12	05-Apr-12
Fixed Protection 2014	06-Apr-14	£1.5 million	£375,000	05-Apr-14	05-Apr-14
Individual Protection 2014 (3)	06-Apr-14	LOWER OF: £1.5 million or fund value as of 5 April 2014	LOWER OF: £375,000 or 25% of the fund as of 5 April 2014	not applicable	05-Apr-14
Fixed Protection 2016	06-Apr-16	£1.25 million	£312,500	05-Apr-16	05-Apr-25
Individual Protection 2016 (4)	06-Apr-16	LOWER OF: £1.25 million or fund value as of 5 April 2016	LOWER OF: £312,500 or 25% of the fund as of 5 April 2016	not applicable	05-Apr-25 (5)

Note 1: Personal LTA of fund value as of 6 April 2006. Fund must £1.5m or higher.

Note 2: Personal lump sum protection for higher amounts must be separately applied for.

Note 3: Fund must be valued at £1.25m or higher as of 6 April 2016.

Note 4: Fund must be valued at £1m or higher as of 6 April 2016.

Note 5: If applied for after 5 April 2023, no further contributions allowed.

Compliance

The content of this factsheet is correct at the time of publication and should be regarded as information only and should not be regarded as advice or recommendation.