LCP INSIGHT CLARITY ADVICE

Reduced Lifetime Allowance: Fixed Protection 2016 and Individual Protection 2016

AUGUST 2015

SUMMARY

The Lifetime Allowance (LTA) reduces from £1.25m to £1.0m on 6 April 2016.

Background

The Government has confirmed that the Lifetime Allowance (LTA) will reduce from its current £1.25m level to £1.0m from 6 April 2016; and that it will increase each year in line with CPI from 2018 onwards.

Two forms of transitional protection will be available for those who have already built up large pensions savings, in essence to avoid retrospective taxation.

IMPORTANT NOTE:
The Government has confirmed that these protections will have the same conditions as the 2014 protection regimes with one exception: the application process will be different. This note sets out how the 2016 protections are expected to look based on this confirmation. It may be some time before more information is available – the tax law initial drafting will be later in 2015 and finalised summer 2016 (with retrospective effect).

The drop in the LTA of £250,000 could mean that, if you have large pension savings, you could face additional tax of up to £62,500 (and be able to take less cash sum at retirement) if you do not register for one or both of the protections being made available.

How does the LTA apply?

When your pension savings are tested against the LTA (usually when you start to draw your pension) you will pay extra tax to the extent that you have exceeded the LTA. Very broadly, for an individual normally subject to 40% income tax in retirement, 55% tax is effectively charged instead, on the benefits in excess of the LTA.

Will I have to take any action, and when?

If your existing pension savings (including any that are already in payment) are large, and you expect to draw benefits of total HMRC value above £1.0m, you might benefit from one or both of the new protections.

If you have any of the existing LTA protections introduced in 2006, 2012 or 2014 see the section on this at the end.

Our understanding is that individuals will still need to apply to HMRC to get a 2016 protection, but HMRC have only so far confirmed that the deadline for this will not be as early as 5 April 2016. But, you should collect information about your benefits to consider your overall position and plans now, as 5 April 2016 will still be a key date for decisions and some key actions. If you think that you may be affected, you will need to consider taking financial advice.

What are the expected key features of the two protections?

Fixed Protection 2016	Individual Protection 2016
Gives you a "protected" LTA of £1.25m	Gives you a "personal" LTA between £1.0m and £1.25m
Can be lost if certain events happen	Cannot be lost
Almost everyone can apply (if they have not had a disqualifying event after 5 April 2016)	Not everyone will qualify
Normally you will have to stop further pension savings	You can continue to make further pension savings

Fixed Protection 2016 (FP16)

Individuals with FP16 will continue to have an LTA of £1.25m.

There are conditions which, if broken, mean you lose or will be disqualified from applying for FP16 and revert to the standard LTA of £1.0m (increasing with inflation from 2018):

If you want to rely on FP16 you may need to opt-out of your schemes before 6 April 2016. However, you should take advice before taking any action.

If you are a member of a defined contribution (DC) arrangement:

Any contribution (including AVCs) made after 5 April 2016 will cause FP16 to be lost (or will disqualify you from applying for FP16).

If you are a member of a defined benefit (DB) arrangement:

Any "excess" increase in your benefits after 5 April 2016 will cause FP16 to be lost (or will disqualify you from applying for FP16).

If you have already become a deferred member before 6 April 2016 the increases added to your pension before retiring will not normally count as "excess" increases, but you should check with your scheme.

Additional benefits built up after 5 April 2016 due to additional pensionable service and/or an increase in pensionable salary may well count as "excess" increases. Again you should check with your scheme.

You will generally lose FP16 (or be disqualified from applying) if:

you join any pension arrangement after 5 April 2016. This applies even if you join an arrangement solely to get life cover, if that arrangement has "registered pension scheme" tax status. If you are "auto-enrolled" into a scheme under the statutory requirements, you can unwind this within one month and not lose FP16.

If the standard LTA ever increases above £1.25m, then FP16 will fall away.

Case studies

DC case study: Peter

At 5 April 2016 Peter has a DC fund of £0.9m. He hopes that, from investment returns alone, it will grow in the six years until he plans to draw benefit by 4% pa, to £1.14m.

He plans to rely on FP16 to get a "protected" LTA of £1.25m. He cannot apply for IP16 (£0.9m is less than £1.0m).

If he is right, FP16 will mean his final fund of £1.14m suffers no LTA charge (because £1.14m is less than £1.25m). Without FP16, there would be an LTA charge on up to £0.14m of his fund (£1.14m-£1.0m), or slightly less to the extent that the standard LTA is higher than £1.0m as a result of CPI increases from 2018.

If his fund does better and he has £1.3m when he draws benefit, then he will pay an LTA charge. But this will be on £0.05m rather than on £0.3m without FP16.

Suppose instead Peter's DC fund at 5 April 2016 had been say £1.15m.

This is more than £1.0m so he applies for IP16 and receives a personalised LTA of £1.15m – perhaps as well as FP16.

He might, as before, choose to pay no new contributions and use FP16 to protect fund growth up to a total fund of £1.25m, with the IP16 acting as a safety net in case some action unintentionally loses FP16.

Or it may be that he chooses to pay contributions at some point, and though that would lose him his FP16/ disqualifying him from applying, IP16 would still protect £1.15m of his fund from an LTA charge.

Individual Protection 2016 (IP16)

You will be able to apply for IP16 if at 5 April 2016 you have total pensions savings from tax registered pension schemes worth more than an HMRC value of £1.0m. If you qualify and apply for IP16 you will be given a "personal" LTA equal to that HMRC value capped at £1.25m, from 6 April 2016.

Once calculated, your personal LTA will change only in special circumstances, for example if your benefits become subject to a pension debit following a divorce.

If the standard LTA ever increases above your personal LTA, your IP16 will fall away.

There are no other conditions to meet so you can carry on actively saving in a pension scheme and hold IP16.

To see whether you qualify, you will need valuations on the HMRC prescribed basis of your benefits in all your pension schemes at 5 April 2016 (with allowance for any that have already been taken and for transfers made to certain overseas schemes). The valuations are not always straightforward to work out and you should read HMRC's guidance (see overleaf for where to find out how the 2014 valuation had to be done).

If you qualify for IP16, it may be possible to hold both IP16 and FP16, with the IP16 ignored unless and until FP16 is lost.

Case studies

DB case study: Mary

Mary has earned a DB pension on 5 April 2016 of £58,000 pa (HMRC would value this, at 20x, at £1.16m) normally payable from age 60.

She could register for IP16 (at a personal LTA of £1.16m) and/or FP16 (for £1.25m).

She plans to draw pension at age 60. She estimates that if she stays in the scheme earning additional pensionable service and salary growth, her pension from age 60 will be £70,000 pa (HMRC value £1.4m); but that if she opts out immediately, her accrued pension will grow with leaver revaluation to £65,000 pa by then (HMRC value £1.3m).

Staying in the scheme she will probably not be able to retain FP16, but IP16 will mean she will pay an LTA charge based on £12,000 pa of her pension (HMRC value £1.4m less £1.16m, divided by 20) ie the growth since 5 April 2016. If she opts out, she will give up £5,000 pa of prospective gross pension, but will keep her FP16 and pay an LTA tax charge on £2,500 pa of her pension (ie HMRC value £1.3m less £1.25m, divided by 20).

Mary wants to cover all options. She is considering continuing to earn some extra pensionable service and pensionable salary growth, but then to draw her pension at age 57, knowing that her scheme would apply an "early payment reduction".

She estimates that her pension from age 57 would be £48,000 pa (HMRC value £0.96m).

This is below the standard LTA of £1.0m (even before any CPI increases from 2018). So neither protection would be necessary – but IP16 would provide some protection if her early retirement plans change or her projections are wrong.

Frequently asked questions

Would I benefit from these protections?

This will very much depend on your personal circumstances.

In assessing whether and how the two protections could work for you, you may wish to take into account the following.

- How and when do you plan to draw your benefits, and will they be big enough to attract an LTA charge? You should make allowance for how much LTA you will have already used up from benefits drawn before 6 April 2016.
- If you have benefits in several schemes, what are the options under each (including eg options to draw benefits before 6 April 2016 if you are old enough)?
- Will you qualify for IP16 and for what "personal LTA"?
- Do you think the Government will change the standard LTA again (up or down) by the time you start drawing benefits? Or make any other relevant tax change?

And in particular in relation to FP16:

- Will an employer offer any compensation (eg a "cash" supplement) if you have to give up future pension benefits to retain FP16?
- Will opting out of your scheme impact other benefits (eg life cover)?

I registered for a 2006, 2012 or 2014 LTA protection. Can I apply for any of the 2016 protections?

If you registered for Primary Protection or have already or will register for Individual Protection 2014, then IP16 and FP16 will not be of any benefit, as the former protections will provide the more valuable protection. If you registered for any of Enhanced Protection (EP) or Fixed Protection 2012 or 2014 (FP12 and FP14) these are likely to provide more protection than FP16.

However, you may want to check carefully whether it is/will still be in place for you by 5 April 2016 and if not, FP16 could be of interest. We wait to hear whether IP16 can be held in tandem with eg FP14 or FP12.

Remember that if your benefit value was over £1.25m at 5 April 2014, you still have until 5 April 2017 to apply for IP14 at https://online.hmrc.gov.uk/shortforms/form/IP2014?dept-name=&sub-dept-name=&location=36

http://www.hmrc.gov.uk/manuals/ptmanual/ptm094000.htm

What should I do next?

If you believe that you may be affected by the change in LTA you should consider taking financial advice, taking into account your personal circumstances. You should also monitor future announcements by the Government regarding the application process and consider your situation when the protections are finalised.
HMRC's 'pension schemes newsletter 70' contains further information, which can be found via here: https://www.gov.uk/government/publications/pension-schemes-newsletter-70-july-2015/pension-schemes-newsletter-70-july-2015

For more information on the Lifetime Allowance or any other matter of pensions taxation, you can find HMRC guidance at: https://www.gov.uk/tax-on-your-private-pension/overview and http://www.hmrc.gov.uk/manuals/ptmanual/index.htm

How do I apply for the protections, and by when?

Our understanding is that individuals will still need to apply to HMRC to get a 2016 protection. But HMRC is currently considering what deadlines, if any, to set for applying - they have only so far confirmed that it will not be as early as 5 April 2016. But you will still need to get the HMRC value of your benefits as they stand at 5 April 2016 for IP16. You should aim to get this information early enough to support any benefits you decide to draw after 5 April 2016.

This note is not, nor is it intended to be, a comprehensive guide to the topics discussed. The case studies are simplified examples to illustrate key points and do not consider all tax allowances and other details. The note should not be relied upon as advice, nor taken as an authoritative statement of the law. Lane Clark & Peacock LLP can take no responsibility nor accept any liability for your use of material in this document and no decisions should be taken as a result of this document. It is based on our understanding of material issued by HMRC and HM Treasury up to 31 August 2015.

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