

## LIFETIME ALLOWANCE

The lifetime allowance was introduced from 6 April 2006 ("A Day") and is an HMRC limit on the total value of an individual's pension arrangements which qualify for favourable tax treatment. Additional tax charges apply to any value above the lifetime allowance.

Further changes were made to the lifetime allowance rules with effect from 6 April 2012. The lifetime allowance is currently set at £1,500,000.

### Testing against the allowance

The value of your pension arrangements is tested against the lifetime allowance:

- each time that you start to draw benefits. If you draw benefits in stages, then a separate test is carried out each time; or
- on your death, for any pension arrangements you are not taking benefits from yet; or
- if you transfer to an overseas pension arrangement; or
- if you take your pension by income drawdown, then a further test is made when you subsequently buy an annuity or reach age 75, whichever is earlier.

### Testing when you draw benefits

This will be the most common check against the lifetime allowance. The value of the benefits you are starting to draw is compared with the lifetime allowance at the time. In carrying out this calculation, any pension already in payment on A Day is multiplied by 25 to arrive at a capital value.

For example, suppose you have a fund of £1m and another pension scheme which is already paying a pension of £12,000 p.a. You decide to draw benefits from £600,000 of your fund on 1 June 2012.

The value of the pension you are already drawing is 25 times £12,000 = £300,000. Adding this to the fund of £600,000 you are now drawing on produces a total of £900,000.

The lifetime allowance on 1 June 2012 is £1,500,000. You have therefore used up 60% of your lifetime allowance ( $900,000/1,500,000$ ). You still have 40% of the lifetime allowance available for the future.

On 1 January 2015 you decide to draw from the balance of your fund, which has grown from £400,000 to £650,000. The lifetime allowance is still £1.5m, so you have 40% of this still available, i.e. £600,000. £50,000 of your fund is over the limit and will be subject to higher charges.

### What are the charges?

The additional tax charge on funds in excess of the lifetime allowance is 55% on any payment made as a lump sum and 25% on pension payments.

### Protection against the charges

If, on A Day, you felt that your future pension value would exceed the lifetime allowance, you had the opportunity to apply for protection of your entire pension assets against the higher tax charges. You will have a certificate from HMRC for primary protection or enhanced protection.

You were also able to protect tax free cash entitlements at A Day of more than 25% of the fund as part of this process.

In addition, because the lifetime allowance reduced from £1.8m to £1.5m on 6 April 2012, anyone without primary or enhanced protection was able to apply for a new level of protection, called fixed

protection, which protected your fund against the old limit of £1.8m. Enhanced protection could also be given up and replaced by fixed protection.

If you have applied for protection, then the lifetime allowance should not apply to you. If you do not have protection and your fund performs well, there is a risk that it could exceed the lifetime allowance at some point. One way of reducing this risk is to draw your benefits earlier, rather than delaying and letting the funds grow until they are excessive.

As mentioned above, if you take income drawdown there is a further test against the lifetime allowance when you subsequently buy an annuity or reach age 75, based on the fund value at that time. If you do not have protection, the risk of exceeding the lifetime allowance can be reduced by drawing regular income from the fund, rather than taking little or no pension and allowing the fund to become excessive.

### **The position on death**

On death, any pension funds you are not drawing from are tested against the lifetime allowance.

For example, suppose a person has already drawn on pension arrangements which used up 80% of their lifetime allowance. If they die on 1 March 2013 they have 20% of the lifetime allowance of £1.5m unused, i.e. £300,000.

If they still have a fund of £400,000 at that time on which they have not started drawing benefits, that fund is tested against the allowance and £300,000 is within the allowance and £100,000 is excess.

The way in which this works is that the amount within the allowance, i.e. £300,000, can be paid out as a tax free lump sum. The balance can be paid out as a dependant's pension and will not be subject to the higher tax charges.

If you have applied for protection on your funds as set out above, the lifetime allowance does not apply on death and the full fund could be paid out as a lump sum.

**Curtis Banks PLC**

**April 2012**