CASE STUDY

LIFETIME ALLOWANCE AT AGE 75

APPROVED FOR ADVISER USE ONLY | JUNE 2020

An adviser with a client approaching age 75 wants to double check what will be tested against the lifetime allowance on his birthday.

The Challenges

Marissa's new client Brendan will turn 75 on 1 July 2020. Marissa has not had to worry too much about lifetime allowance tests at age 75 before: her other clients who have reached that age have generally only had annuities or have been nowhere near the lifetime allowance.

Brendan, however, has three pensions. One is still uncrystallised and currently worth £381,100. The second is in flexi-access drawdown: it was originally crystallised in May 2009 and is currently worth £651,250. The third is also in flexi-access drawdown and was originally crystallised before 6 April 2006 (A-Day). Brendan has tended to take income from this plan over the years and it is currently valued at £100,000.

At face value Brendan's pensions are over the lifetime allowance, but Marissa knows that it is not quite that straight forward when crystallised funds and pre A-Day pensions are involved. She wants to remind herself of the rules and work out whether she needs to take any action ahead of Brendan's birthday.

The Actions

Firstly, Marissa looks at the paperwork Brendan has provided from his previous adviser to see how much lifetime allowance he has available for the age 75 test. The records show that the second pension was worth £525,000 when it was crystallised in May 2009. The lifetime allowance was £1.75m at the time, so this used 30% of the lifetime allowance. There is also a note on the paperwork to say that the pre A-Day pension was valued at £350,000 at the time for lifetime allowance purposes, using a further 20% of the lifetime allowance. Therefore Marissa can see that Brendan has 50% of his lifetime allowance available.

Marissa completes some research and reminds herself that there are three separate benefit crystallisation events (BCEs) which can take place at age 75:

- BCE 5 tests funds in a defined benefit arrangement which have not yet been crystallised
- BCE 5A tests any growth in a drawdown pension
- BCE 5B tests uncrystallised funds in a money purchase pension.

Brendan does not have a defined benefit pension, so only BCE 5A and 5B will apply. Marissa considers each of the pensions in turn.

The uncrystallised pension is the simplest; assuming the fund value of £381,100 stays roughly the same, it will use approximately 35.5% of the lifetime allowance, which will be £1,073,100 on Brendan's birthday.

The second pension is now worth £651,250, but only the growth needs to be tested. Marissa was initially going to deduct £525,000 to find the growth, but then remembers that this figure from 2009 would include the pension commencement lump sum, which should not be included.

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The amount put into drawdown in 2009 was £393,750, so the pension value has grown by £257,500. This will use up 23.99% of the lifetime allowance.

Marissa then considers the pre A-Day pension. However, her research shows her that only the growth in pensions originally crystallised post A-Day are caught by BCE 5A. Therefore only two of Brendan's three pensions will be tested on his 75th birthday.

The Results

Marissa can see that even with only two of the pensions being tested Brendan is going to exceed the lifetime allowance. Fortunately, Marissa can see from the paperwork that Brendan has not make a pension contribution since 2015 and he is still eligible to apply for Fixed Protection 2016. This will give Brendan available lifetime allowance of 50% of £1.25m (£625,000) rather than 50% of £1,073,100 (£536,550).

Looking again at the two pensions to be tested, Marissa can see that the total value is £638,600: Brendan will still be slightly over the lifetime allowance. If left as it is, the excess £13,600 will be subject to a 25% lifetime allowance excess charge on Brendan's birthday. It would then also be subject to income tax when Brendan withdrew it from the pension.

Brendan is normally a higher rate tax payer, but as it happens he has been unwell for much of this year and has needed far less income from his pension than normal. Marissa can see that Brendan will be able to take a £13,600 income payment and only pay basic rate tax.

Withdrawing the money will mean that it can no longer benefit from the tax efficient investment growth a pension provides, and would form part of Brendan's estate for inheritance tax purposes if something were to happen to him. However, in this case Brendan is likely to use the relatively modest amount for normal expenditure, and as he is likely to return to being a higher rate tax payer going forward, it is highly likely that taking an income payment and paying income tax will be the cheaper option for him.

Contact Details

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