

DO YOU KNOW YOUR Pension Lifetime Allowance(LTA)?

PART ONE

WHAT IS IT? HOW DO YOU MEASURE YOUR FUNDS AGAINST IT? AND WHAT IS THE OPTIMUM TIME TO DO SO?

We are receiving more and more queries about the pension Lifetime Allowance (LTA), perhaps inevitably as the pension pots of individuals grow, while the LTA does not. To help answer some general questions, Richard Wadsworth, our Director, Glasgow, has put together the following four-part 'Q&A' to coach you through this subject.

For queries about your specific situation, please contact your Carbon Financial planner, or get in touch with us for an initial chat.

What is the LTA?

It's the amount against which the total value of your pension is measured. It is important to think about the LTA not necessarily as a limit as such, but a value, the excess over which will usually suffer an additional tax charge at some point in time. Our view is that the LTA is something individuals should be aware of, but not necessarily obsess about it.

What is the value of the LTA?

The current value of the LTA is £1,073,100.

The LTA has been as high as £1.8m in the past, but has reduced in steps in 2012, 2014 and 2016. Since then, it had been increasing with inflation, but the Spring 2021 Budget froze the LTA until 2025/26. It is assumed that inflationary increases will resume thereafter.

The value of investments and the income derived from them can fall as well as rise. You may not get back what you invest. This communication is for general information only and is not intended to be individual advice. It represents our understanding of law and HM Revenue & Customs practice. You are recommended to seek competent professional advice before taking any action. Tax and Estate Planning Services are not regulated by the Financial Conduct Authority.

What about pension protection?

You may have made an election to preserve a higher LTA around 2006 when the LTA rules were introduced, or at any of the reduction 2012, 2014 or 2016 dates. Prior to reducing the LTA, the Government recognised that individuals may have been funding towards a higher overall pension value, so it offered some relief from the reduced LTA, subject to various conditions, such as, and in many cases, not making any further pension contributions.

The 2016 protections are still available and may be worth considering, if either no further contributions (or accrual for final-salary schemes) were made to your pensions after 5th April 2016, or your funds were worth more than £1m on 5th April 2016.

There is also protection for situations where individuals have an entitlement to more than 25% tax-free cash.

How do I value my funds for measurement against the LTA?

For pension 'pots' ('defined-contribution' (DC) arrangements), it's easy: it is simply the value of the pension pot at the time. So, for example, if you were a member of a work pension which is invested in a fund, the value of which goes up and down over time, it is that value which would be used for measurement against the LTA.

Final-salary or 'defined-benefit' (DB) pensions are valued differently. These arrangements don't have a fund as such, but the promise of an income (and lump sum, usually if part of the income is given up) at a future date. To value a DB pension for LTA measurement purposes, the income the pension investor is entitled to is multiplied by 20, and any lump sum that is taken is added to that figure. So, if you have a DB pension entitlement of £15,000 per annum plus a lump sum of £80,000, the value for LTA purposes would be £380,000 (£15,000 times 20, plus £80,000).

If you have received final-salary pension income before April 2006, the situation is more complicated and better explained by one of our planners based on your individual circumstances.

Is the transfer value of a Defined Benefit pension relevant to the calculation?

No. Please note that the transfer value of a DB pension scheme is irrelevant for measurement against the LTA.

When do my funds get measured against the LTA?

Once your funds grow to exceed the LTA, an alarm does not go off deep inside an HMRC department, nor should it necessarily trigger you to do anything.

Your funds are measured against the LTA on the earlier of: when you begin taking an income or a lump sum (and the total value of the arrangements from which you actually take benefits exceeds the LTA – and you might only take benefits from some of your arrangements initially), your death, and age 75. There are no further LTA charges after age 75.

SIMPLE TAKEAWAY

For most individuals with pension pots, you will only need to consider the LTA when you withdraw tax-free cash or reach age 75.

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There's quite a lot to think about here, but we hope that our guide has given you a basic overview of how the LTA works. In Part Two of the series we turn our attention to what happens to pension funds in excess of the LTA. And what happens upon your death?