North East Scotland Pension Fund

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GUIDE TO

Lifetime Allowance

There are two controls on the amount of pension savings you can make without having to pay extra tax. These controls are known as the Annual Allowance and Lifetime Allowance.

This factsheet looks at Lifetime Allowance. For information on the lifetime allowance please refer to the Annual Allowance factsheet.

What is the lifetime allowance?

The lifetime allowance is simply the total amount of pension you can have without triggering a tax charge. If the value of your pension benefits when you draw them (not including any state retirement pension, pension credit or any partner's or dependant's pension you may be entitled to) is more than the lifetime allowance, or more than any protections you may have, you will have to pay tax on the excess benefits.

The lifetime allowance covers any pension benefits you may have in all tax-registered pension arrangements - not just the Local Government Pension Scheme (LGPS).

The lifetime allowance was introduced in 2006 and was reduced in 2012, 2014 and again in 2016. Each time the lifetime allowance reduced, if you had already planned your pension savings on the basis of the higher lifetime allowance, you have been able to protect your pension savings by applying to the HMRC for lifetime allowance protection. These protections are covered in more detail later in this factsheet.

The lifetime allowance steadily reduced from 2012/13 to 2016/17. From 2018/19 onwards the lifetime allowance increase each year in line with inflation. The lifetime allowance will remain at **£1,073,100 million for 2022/23.**

Tax Year	Lifetime Allowance
2012/13	£1.5 million
2013/14	£1.5 million
2014/15	£1.25 million
2015/16	£1.25 million
2016/17	£1.00 million
2017/18	£1.00 million
2018/19	£1.03 million
2019/20	£1.055 million
2020/21	£1,073,100 million
2021/22	£1,073,100 million
2022/23	**£1,073,100 million**

How is the lifetime allowance calculated?

For pensions drawn on or after 6 April 2006, the capital value of those pension benefits is calculated as:

Your annual pension X 20 + any lump sum you draw from the pension scheme

Each time you take payment of a pension benefit the capital value of the benefits you are taking is expressed as percentage of the lifetime allowance limit applicable on that date and is deducted from your available lifetime allowance. So even if your pensions are small and individually will not be more than the lifetime allowance you should keep a record of any pensions you receive.

If you have a pension that came into payment before 6 April 2006, this will also be treated as having used up part of your lifetime allowance. For these pensions, the capital value is calculated by multiplying the current annual rate, including any pensions increase, by 25. Any lump sum already paid is ignored in the valuation.

When you take your LGPS benefits, if the capital value of those benefits is more than your available lifetime allowance you will have to pay tax on the excess. If your excess benefits are paid as a pension the tax charge will be 25% of the capital value of the excess; the ongoing pension payments be will also be subject to income tax. If the excess benefits are taken as a lump sum they will be taxed once only at 55%.

You can choose to pay the tax charge immediately by a reduction to your lump sum, pay the tax directly to HMRC yourself, or you can ask the scheme to pay the charge for you in return for a permanent reduction to your pension – this is called a lifetime allowance debit.

Examples

Sarah retires on 31 May 2022

LGPS annual pension	£25,000
LGPS lump sum	£45,000
AVC taken as lump sum	£116,375
Capital Value of benefits	**£661,375**

((£25,000 x 20) + £45,000 + £116,375)

Sarah has not drawn any pension benefits previously; the capital value of her benefits is less than the LTA limit for 2022/23 of £1.073million. She has used 61.6% of the available LTA.

Patrick retires on 31 May 2022

LGPS annual pension	£50,000
LGPS lump sum	£120,000
Capital Value of benefits	**£1,120,000**
((£50,000 x 20) + £120,000)	
Tax charge payable on benefits in excess of £1.073m	**£15,510 Tax charge**

(£47,000/20 x12 x 55%)

This example assumes Patrick has not applied for any lifetime allowance protection and that he has opted to be paid the benefits in excess of the LTA as lump sum. He has used 100% of the available LTA.

What is the charge for exceeding the lifetime allowance?

If your LGPS benefits are more than your lifetime allowance limit you will have to pay tax on the excess. If your excess benefits are paid as a pension, the charge will be 25%, with income tax deducted on the ongoing pension payments. If the excess benefits are taken as a lump sum they will be taxed once only at 55%.

You can choose to pay the tax charge immediately by a reduction to your lump sum or you can ask the scheme to pay the charge for you in return for a permanent reduction to your pension – this is called a lifetime allowance debit.

What is changing?

When you take your LGPS benefits, if the capital value of those benefits is more than your available lifetime allowance you will have to pay tax on the excess. If your excess benefits are paid as a pension the tax charge will be 25% of the capital value of the excess; the ongoing pension payments be will also be subject to income tax. If the excess benefits are taken as a lump sum they will be taxed once only at 55%.

You can choose to pay the tax charge immediately by a reduction to your lump sum, pay the tax directly to HMRC yourself, or you can ask the scheme to pay the charge for you in return for a permanent reduction to your pension – this is called a lifetime allowance debit.

Individual Protection 2016 (IP2016)

You can apply for Individual Protection 2016 from 6 April 2016 if you have pension savings valued at over £1 million (including taking into account past benefits already in payment) on 5 April 2016. However, if you have primary protection you can’t apply for IP2016.

IP2016 gives a protected lifetime allowance equal to the value of your pension rights on 5 April 2016 - up to an overall maximum of £1.25 million. You will not lose IP2016 by making further savings in to your pension scheme but any pension savings in excess of your protected lifetime allowance will be subject to a charge.

Fixed Protection 2016 (FP2016)

You can apply for Fixed Protection 2016 from 6 April 2016 if you expect your pension savings to be more than £1 million (including taking into account past benefits already in payment) when you come to take them on or after 6 April 2016. FP2016 can be used to help reduce the lifetime allowance charge.

However, because FP2016 is lost if your benefits increase by more than the cost of living increase in any one tax year, if you apply for and wish to keep FP2016 you must have opted out of the LGPS with effect from 6 April 2016 (because the cost of living increase in 2016/17 was zero and thus any increase in your benefits on and after 6 April 2016 will result in the loss of FP2016).

You can't have FP2016 if you already have primary, enhanced, fixed protection 2012 or fixed protection 2014.

With FP2016 your lifetime allowance is fixed at £1.25 million rather than the standard lifetime allowance. The maximum tax free lump sum you can take on retirement is the lesser of:

- 25% of the capital value of your LGPS benefits, or
- 25% of the lifetime allowance which, for those with fixed protection 2016, is £312,500 (i.e. 25% of your lifetime allowance of £1.25million), or
- 25% of your remaining lifetime allowance if you have previously take payment of (crystallised) pension benefits (as you will have already used up some of your lifetime allowance).

FP2016 will also be lost if you start a new pension arrangement, other than to accept a transfer of existing pension rights, or if you pay contributions into a money purchase pension arrangement, other than to a life assurance policy providing death benefits that started before 6 April 2006. You will also be subject to restrictions on where and how you can transfer benefits.

If you lose fixed protection 2016 you must electronically notify HMRC within 90 days of the day on which you could have first reasonably expected to have known that an event had occurred causing you to lose this protection. Failure to do so could result in a fine and daily penalty until you supply them with the required notification.

How do I apply for Fixed and Individual Protection 2016?

HMRC have introduced an online self-service for pension scheme members to apply for IP2016 or FP2016. There is no application deadline for IP2016 or FP2016 (although to apply for IP2016 you will need to inform HMRC of the value of your pension savings on 5 April 2016 and your pension administrator is only obliged to provide you with this information up to 5 April 2020), however, you must apply before you take your retirement benefits as you will need to provide the HMRC reference number to your pension fund administrator if you want to rely on the protection. Once you have successfully applied for protection the online service will provide you with a reference number which you will need to keep.

Are my savings already protected?

Each time the lifetime allowance reduced, if you had already planned your pension savings on the basis of the higher lifetime allowance you could protect your pension savings by applying to HMRC. If you have applied for a previous protection i.e. enhanced protection, primary protection, fixed protection 2012, individual protection 2014 or fixed protection 2014 you should have received a certificate to confirm your protection.

However you may still be subject to the lifetime allowance charge if you lose this protection.

You can find more information about these protections and when they may be lost at Tax on your private pension contributions.

I think I might be affected – what should I do?

Before considering any action to reduce your tax liabilities you should always seek independent financial advice from an FCA registered adviser . For help in choosing an independent financial adviser visit the MoneyHelper website.

There are certain considerations that you may wish to take into account:

- Converting annual pension for lump sum at retirement can reduce the capital value of your pension benefits
- If you wish to slow down your pension build up the 50/50 section of the LGPS allows you to pay half your normal contributions and build up half your normal pension whilst still retaining full life and ill health cover
- If you opt out of the LGPS with the right to a deferred benefit you will not be able to aggregate your benefits should you re-join the LGPS at a later date.

More information

If you have any questions about your LGPS membership or benefits, please contact:

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DISCLAIMER

The information in this guide is based on the Local Government Pension Scheme (Scotland) Regulations 2018 and other relevant legislation. It applies to people who were contributing members of the Local Government Pension Scheme on 1 April 2015 or who have since joined the Scheme. This guide was up-to-date at the time of publication in 2022. It is for general use and cannot cover every personal circumstance, nor does it cover specific protected rights that apply to a very limited number of employees. In the event of any dispute over your pension benefits, the appropriate legislation will prevail as this guide does not confer any contractual or statutory rights and is provided for information purposes only.