nucleus

The lifetime allowance

There are tax advantages to the amount of money someone can take out of their pension pots – 25% of it will be tax free, the remainder will be taxed at their marginal rate of tax.

There is no limit on the total amount of benefits a member can take from their registered pension scheme. However, an individual has a single lifetime allowance, and if the accumulated value of the benefits they take is greater than this allowance, then the excess is subject to the lifetime allowance charge.

Individuals, most commonly, use up their lifetime allowance when they start to take their pension benefits, but there are other occasions that trigger a test of pension savings against the lifetime allowance – these are called 'benefit crystallisation events' (BCEs).

This factsheet will explain what the different BCEs are, how lifetime allowance is used up, and how the lifetime allowance charge is calculated and paid.

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If you only read one thing…

- An individual has a single lifetime allowance, and if the accumulated value of pension benefits they take is greater than this allowance, then the excess is subject to the lifetime allowance charge.
- At a benefit crystallisation event (BCE), the scheme administrator must check how much lifetime allowance the pension benefits crystallised use up, and compare this against the member's available lifetime allowance.
- The lifetime allowance charge is 55% if the excess is taken as a lump sum, and 25% if the excess is paid as an income.
- The scheme administrator will work out if any lifetime allowance charge is due. The scheme administrator and the pension scheme member are jointly responsible for paying this.

The lifetime allowance

When the lifetime allowance was introduced in April 2006, as part of the pensions simplification changes, it was £1.5 million. It steadily increased to £1.8 million by 2010, but was subsequently reduced in 2012, 2014 and 2016. From April 2018, the lifetime allowance increases again each year in line with CPI (consumer price index). It is currently £1,073,100 for the 2020-21 tax year.

Tax Year	Standard lifetime allowance
2006-07	£1.5 million
2007-08	£1.6 million
2008-09	£1.65 million
2009-10	£1.75 million
2010-11	£1.8 million
2011-12	£1.8 million
2012-13	£1.5 million
2013-14	£1.5 million
2014-15	£1.25 million
2015-16	£1.25 million
2016-17	£1 million
2017-18	£1 million
2018-19	£1.03 million
2019-20	£1.055 million
2020-21	£1,073,100

Benefit crystallisation events (BCEs)

At each BCE, the pension plan administrator must check how much lifetime allowance the pension benefits crystallised use up, and compare this against the individual's available lifetime allowance. (Where the individual has died, the personal representatives may be responsible for carrying out this comparison.) If the amount being crystallised is greater than the available lifetime allowance, then a lifetime allowance charge is worked out on the excess.

The lifetime allowance

There are 13 BCEs. These are:

Taking pensions

BCE 1 Where funds are designated to provide a drawdown pension

BCE 2 Where an individual becomes entitled to a scheme pension

BCE 3 Where a scheme pension is increased beyond an allowable amount

BCE 4 Where an individual becomes entitled to a lifetime annuity

Unused funds at age 75 or on earlier death

BCE 5 Where an individual reaches age 75 under a defined benefit arrangement without having drawn all or part of their entitlement as a scheme pension and/or lump sum

BCE 5a Where an individual reaches age 75 with a drawdown pension fund

BCE 5b Where an individual reaches age 75 with unused money purchase funds

BCE 5c Where an individual dies before their 75th birthday and any uncrystallised funds are designated to provide their beneficiaries with a drawdown pension

BCE 5d Where an individual dies before their 75th birthday and any uncrystallised funds are used to provide a purchased dependants or nominees annuity*

Lump sums

BCE6 Where an individual becomes entitled to a relevant lump sum

Death

BCE7 Where a relevant lump sum death benefit is paid on the death of an individual

Transfer to Qrops

BCE8 Where an individual's benefits are transferred to a Qrops

Other

BCE9 Where certain payments are made to or in respect of an individual:

- Payments of 'arrears' of pension after death
- Lump sums based on pensions errors
- Pension commencement lump sum (PCLS) – paid after death

* The death must have occurred on or after 3 December 2014 with the entitlement arising on or after 6 April 2015 but before the end of a two-year period.

Normally, BCEs use up an individual's available lifetime allowance in the chronological order in which they happen. Where BCEs occur simultaneously the individual must decide the order the BCEs take for the purpose of the lifetime allowance test. The exception to this is where the individual becomes entitled to a pension commencement lump sum (which is paid free of income tax). The BCE for this always happens immediately before the BCE for the associated pension benefit, which is taxable.

BCEs over time

The percentage of the individual's lifetime allowance being used up as a consequence of a BCE is added to any percentage used up previously under the same or any other registered pension scheme.

Case study – David

David has a SIPP worth £210,000. He moves £150,000 into drawdown in March 2014 (when the lifetime allowance is £1.5 million). This uses up 10% of the lifetime allowance, leaving 90% unused.

In May 2019 (when the lifetime allowance is £1.055 million) he buys an annuity with his remaining fund which is now worth £94,950. This uses up a further 9%, meaning David still has 81% unused.

Age 75 benefit crystallisation events

Reaching age 75 means two important financial planning issues for individuals who have pension plans. First the tax treatment of pensions on death changes, meaning recipients of pension death benefits will now have to pay tax at their marginal rate. The second issue is individuals who have not secured a scheme pension or lifetime annuity will have their benefits (uncrystallised funds or drawdown funds) tested against the lifetime allowance.

For those who have already designated drawdown, this means a second crystallisation event. This effectively tests any investment growth against the lifetime allowance by deducting the original amount designated for drawdown (not including any PCLS) from the current value of the drawdown plan.

Case Study – Stella

Stella has a SIPP worth £400,000.

She moves £200,000 into drawdown in March 2015 (when the lifetime allowance is £1.25 million). This uses up 16% of the lifetime allowance, leaving 84% unused. She takes her PCLS of £50,000. She withdraws £10,000 from her drawdown plan over the next two years.

In February 2018 it is Stella's 75th birthday. Stella's drawdown fund is now worth £190,000, and her uncrystallised SIPP funds are valued at £230,000. The lifetime allowance is £1,000,000.

The lifetime allowance

There are two BCEs at her 75th birthday:

For BCE 5a the crystallisation amount is the current value of the drawdown less the amount originally designated for drawdown (not including the PCLS):

£190,000 - £150,000 = £40,000

This uses up 4% of Stella's lifetime allowance.

For BCE 5b, there are unused funds worth £230,000, so 23% of the lifetime allowance is used up.

So Stella's final unused lifetime allowance is 57% (84% - 4% - 23%)

Pre A-day pensions and drawdown

Pensions and drawdown taken out before 6 April 2006 (A-day) also have to be counted as part of the lifetime allowance test.

When an individual crystallises other benefits for the first time after A-day, then a notional value is worked out for the pre A-day benefits as 25 x the pension in payment at the time of drawdown, and 25 x 120% of GAD for the value of the drawdown in the year when crystallisation takes place.

The lifetime allowance charge

Any excess over the individual's available lifetime allowance will be subject to the lifetime allowance charge. The tax rate depends on how the excess is paid:

If the excess is taken as a lump sum (taken out of the pension plan) then the tax charge is 55%

If the excess is paid as an income (remains within the scheme) then the tax charge is 25%

The scheme administrator and the individual are jointly responsible for paying the lifetime charge. Nucleus deducts the tax charge before a 'retirement' payment. However, if the charge arises on the member's death, the recipient of the payment is liable to pay the charge.

Defined benefit schemes

Defined benefits are usually valued using a factor of 20 – so 20 x scheme pension plus tax-free cash. (Although the scheme administrator could agree a higher factor with the HMRC.)

Where there is a lifetime allowance charge, the scheme needs to decide how to meet this. It can offer the member a reduced scheme pension (with the scheme meeting the cost of 25% x the excess). Or the scheme could allow the member to commute some of their scheme pension which could be paid out as a lump sum after deduction of the 55% tax charge.

Reporting and monitoring

When an individual crystallises benefits, it's the pension plan administrator's responsibility to calculate how much lifetime allowance is used up and if any charge is due.

The pension plan administrator issues a statement for every BCE showing how much lifetime allowance has been used up, the value of any lifetime charge due, and whether the pension plan administrator has accounted for the charge due, or intends to.

The individual must as part of their self-assessment, confirm the value of the benefits in excess of the available lifetime allowance, and the tax charge paid by the pension plan.

The pension plan administrator also sends out an annual statement showing the percentage of the standard lifetime allowance the individual has used up.

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