

Reduced Lifetime Allowance and Fixed Protection

DECEMBER 2011

Background

The Lifetime Allowance (LTA) is being reduced from £1.8m to £1.5m on 6 April 2012. It has not been indicated if, or when, this will be reviewed.

The Government has offered some transitional protection – known as Fixed Protection (FP) – enabling you to retain a “protected” LTA of £1.8m. However, the legislation is complex and that protection can be lost.

FP is available if you do not have either Enhanced or Primary Protection¹. If your total existing pension savings (including any that are already in payment) are expected to have an HMRC value above £1.5m when you take them, you might benefit from FP.

How does Fixed Protection work?

If you have FP, the protected LTA of £1.8m will be used when testing to see if you are due to pay the “LTA charge” (eg when you start to draw your pension). If your benefits have an HMRC value greater than £1.5m you may pay less tax. There are conditions which, if broken, mean you lose FP and LTA tests thereafter will use the “reduced” LTA.

What can cause your protection to be lost?

If you are a member of a defined contribution (DC) scheme:

Any contribution² (including AVCs) made to a scheme after 5 April 2012 will cause FP to be lost.

If you are a member of a defined benefit (DB) scheme:

Any “excess” increase in your benefits after 5 April 2012 could cause FP to be lost.

If you have already become a deferred member before 6 April 2012 the increases added to your pension before retiring will not normally count as “excess” increases.

Additional benefits built up after 5 April 2012 due to additional pensionable service and/or an increase in pensionable salary could count as “excess” increases and cause your protection to be lost. However, the application of the tax rules is complex.

You will generally lose FP if you join any new pension arrangement after 5 April 2012. If, as a result of Government changes, you are “auto-enrolled” into a scheme, you can unwind this within one month. If you lose your protection you have to tell HMRC within 90 days (or risk a £300 penalty).

If the standard LTA is ever increased above £1.8m FP will fall away.

SUMMARY

Fixed Protection enables you to retain a “protected” LTA of £1.8m.

Without FP the reduction in the LTA could represent a retrospective tax.

With FP you could save as much as £75,000 tax and take more of your benefits as a tax-free lump sum.

You may need to opt out before 6 April 2012 to benefit from FP but you should take advice before taking any action.

¹ These are the protections introduced when the pensions tax rules changed in 2006, which had to be registered for by 2009. Enhanced Protection can be given up.

² An exception is made for contributions deemed to represent “contracting out rebates”.

Would I benefit from Fixed Protection?

This will depend very much on your personal circumstances.

DC case study: John

John's pension fund is currently £1.4m and he plans to start drawing it in five years' time. By applying for FP his benefits will be tested against an "unreduced" LTA of £1.8m. If by then his fund has grown to £1.9m, he will have to pay the LTA tax charge on £100,000 (without protection, the additional tax would be charged on £400,000). As it will not be possible for any contributions to be paid (either by himself or his employer) after 5 April 2012, John needs to consider whether the tax saving outweighs the value of "lost" future contributions.

DB case study: Jane

Jane has an accrued pension of £80,000 pa payable from age 60 (HMRC would value this at £1.6m). She is planning to retire early - in a few years' time - when she reaches age 57. Allowing for extra pensionable service after 6 April 2012, and the "fair value" reduction that the scheme applies for early payment of pension, she estimates that her actual retirement pension will be £75,000 pa (with an HMRC value of £1.5m - ie no more than the standard "reduced" LTA). If this proves to be the case, FP would not have benefitted Jane and she may have had to leave the scheme at 5 April 2012 to get FP, missing out on the extra service.

As well as your current scheme benefits - the size and when you plan to draw them - other factors to consider include:

- Will the (reduced) standard LTA change again by the time you start drawing benefits?
- Will opting out of your scheme impact other benefits (eg life cover)?
- Will an employer offer any compensation (eg a "cash" supplement) if you have to give up future pension benefits to retain FP?
- If you have benefits in several schemes, what the options are under each (eg if you are age 55 or more, options to draw benefits before 6 April 2012).
- Careful allowance for what benefits you have drawn before 6 April 2012.

What do I need to do?

If you believe that you may be affected by the change in LTA, you should consider taking independent financial advice, taking into account your personal circumstances. HMRC has published guides for individuals on their website:

www.hmrc.gov.uk/pensionschemes/lifetime-allowance/index.htm
www.hmrc.gov.uk/pensionschemes/newsletter50.pdf

How do I apply?

You should complete HMRC's application form APSS227, and get it to HMRC by 5 April 2012. The form (and accompanying notes) can be found on HMRC's website at www.hmrc.gov.uk/pensionschemes

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