The Lifetime Allowance

Factsheet 1: The Lifetime Allowance and Benefit Crystallisation Events

June 2015

Pension simplification – introduced in April 2006 – ushered in a new set of pension rules. Replacing the previous convoluted rules for occupational and personal pensions, it was predicated on there being a simple test on the amount people could invest (and receive tax relief on), and the amount of money they could draw from a pension (without any tax penalties).

There is no limit placed on the amount people can build up under a pension scheme. But, everyone has a set level of 'fund' they can draw from all their pension schemes in their lifetime in a tax-efficient manner – this is the lifetime allowance.

- **This factsheet** covers how and when the lifetime allowance is calculated,
- **Factsheet 2** outlines how people can protect their pension funds from the lifetime allowance using the original 2006 protections;
- **Factsheet 3** summarises the newer protections introduced after 2006; and
- **Factsheet 4** explores the relationship between lifetime allowance and defined benefits.

What is the lifetime allowance?

When the lifetime allowance was introduced in 2006 it was £1.5 million, with promised increases to £1.8 million. But it has been reduced twice since 2011/12, and the new Conservative Government has plans to reduce it further to £1 million from April 2016.

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(1)

(1) *proposed legislation expected to be included within the Finance (Number 2) Bill 2015*

How are pensions measured against the lifetime allowance?

Every time a pension scheme member draws – or crystallises - benefits from a pension scheme, the value of these benefits are measured, and expressed as a percentage of the lifetime allowance for that tax year. That percentage is added to the percentages values calculated on previous crystallisation occasions from the same or different pension schemes, and then the total is measured against the member's available lifetime allowance. If the total of these percentages is 100% or less then there are no implications. But if the member draws more than that amount then there is a tax charge on the excess (or 'chargeable amount').

Example – lifetime allowance usage

Mike crystallises his pension benefits in October 2006 with a capital value of £150,000. The lifetime allowance at that time is £1.5 million, so the percentage used up is 10%. Mike has 90% of his lifetime allowance still available.

In December 2010, Mike crystallises a further £450,000 when the lifetime allowance is £1.8 million. So Mike has used up a further 25% of the standard lifetime allowance. In total he has used up 35% (10% + 25%) of his lifetime allowance.

Calculating the lifetime allowance used

For personal pensions and other money purchase schemes the measurement is simply the fund value. For example, if a member uses £100,000 to buy an annuity in 20015/16 then they will have used 8% of their lifetime allowance.

For defined benefit or final salary schemes the scheme pension is converted to a notional capital value by multiplying it by a factor of 20, and then added to the value of any tax-free cash taken. For example, if a member in 2015/16 took a pension of £7,500 a year and a tax-free cash sum of £100,000, then they would have used up 20% of their lifetime allowance [(20x£7,500))/ £1,250,000 + £100,000].

To find the value of any pensions taken before 2006, the amount of pension is multiplied by a factor of 25. This is to represent that, in most cases, a pension commencement lump sum would have been taken as well. For drawdown the factor of 25 is applied to the 'maximum GAD' (even if the member has converted their drawdown fund into a flexi-access drawdown after April 2015).

What are BCEs?

Benefit crystallisation events (BCEs) are the circumstances where there is a test against the lifetime allowance. These are when any pension benefits are taken; for example a lump sum, drawing an income, death before age 75, or transferring to a qualifying registered overseas pension scheme (QROPS).

There are also BCEs for when someone reaches age 75, as all registered pension are treated as being fully crystallised at age 75, even if no benefits have been taken.

There are currently 12 BCEs. These are:

Taking pensions

BCE1 Where funds are designated to provide a drawdown pension
BCE2 Where a member becomes entitled to a scheme pension
BCE3 Where a scheme pension is increased beyond an allowable amount
BCE4 Where a member becomes entitled to a lifetime annuity

Unused funds at age 75 or on earlier death

BCE5 Where a member 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 a member reaches age 75 with a drawdown pension fund (also known as a 'second crystallisation event')
BCE5b Where a member reaches age 75 with unused money purchase funds
BCE5c Where a member dies before their 75th birthday, and any uncrystallised funds are designated to provide their beneficiary(ies) with a drawdown pension

Lump sums

BCE6 Where the member becomes entitled to a relevant lump sum

Death

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

Transfer to QROPS

BCE8 Where a member's benefits are transferred to a QROPS

Other

BCE9 Where certain payments are made to or in respect of a member:

- Payments of 'arrears' of pension after death
- Lump sums based on pension errors
- PCLS-type lump sums paid after death

Paying the lifetime allowance tax charge

The 'lifetime allowance tax charge' is set as:

- 25% of any income taken; or
- 55% of any lump sum taken

Under occupational schemes the scheme administrator decides how the benefit will be paid and taxes the payment accordingly. However, a personal pension member can decide themselves to take benefits either as a lump sum or as an income.

During the member's lifetime, the scheme administrator and the member are jointly responsible for paying any lifetime allowance tax charge. But where the tax charge arises because a relevant lump sum has been paid on the member's death, then the recipient of the lump sum is responsible for paying any tax charge.

The example – buying an annuity with drawdown funds

Anne is aged 60, and has a money purchase pension worth £200,000.

On 1 June 2011, she moves her pension fund into flexi-access drawdown. She takes a PCLS of £50,000 and takes a regular drawdown income.

A lifetime allowance test is triggered. There are two BCEs – BCE6 is the payment of a PCLS, and BCE1 is the designation of funds for drawdown.

Anne has used up 11.11% of her lifetime allowance of £1.8 million for 2011/12 tax year (£200,000/£1,800,000).

Four years later on 25 May 2015, Anne decides to buy an annuity. She is still under age 75.

Where a lifetime annuity is bought with drawdown funds before the member reaches age 75, the amount crystallising under BCE4 is reduced to reflect that all (or part of) the funds being used have already been tested for the lifetime allowance.

So, if Anne's fund is worth £120,000 at 25 May 2015 then, as this is lower than the £150,000 originally designated for drawdown, there is no further lifetime allowance has been used up.

But if Anne's drawdown fund is now worth £180,000, then £30,000 (£180,000 - £150,000) will be tested, and Anne will have used up another 2.4% of her lifetime allowance, bringing her total to 13.51%.

If Anne had bought the annuity with drawdown funds after the age of 75 there would be no BCE4, as Anne's drawdown fund would have already been tested at age 75 under BCE5a.

Of course, if Anne had moved her funds to flexi-access drawdown she would have been able to take a withdrawal of £30,000 before buying her annuity to bring down the value of the drawdown fund. She could have done this if she had been in the position of having used up her lifetime allowance and having to pay tax on any excess fund taken.

The points to remember:

- The lifetime allowance is a set limit on the amount of 'funds' members can withdraw from pensions without any penalties. If people withdraw more than the lifetime allowance they have to pay a tax charge on the excess amount.
- Every time a member crystallises benefits, the value of these benefits are measured, and expressed as a percentage of the lifetime allowance for that tax year.
- The circumstances where there is a test against the lifetime allowance are known as benefit crystallisation events (BCEs). There are 12 in total.