Intelligent Pensions Guide to the Lifetime Allowance

June 2015
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1. What is the LifeTime Allowance (LTA)?

   i) Introduction

Before 2006 there were different rules for different types of pensions. Occupational Schemes generally allowed unlimited contributions, but limited the benefits payable in terms of both tax-free cash and pensions. By contrast Personal Pensions and their predecessors Retirement Annuities limited contributions, but only limited benefits in terms of the maximum tax-free cash which could be taken.

The rules for maximum benefits were complex before 1987, when the government introduced a new regime that applied to people who joined schemes after the budget in March except for some people who could qualify if they joined before June. Then in 1989 there was another budget and another new regime, this one including an ‘earnings cap’. So complex rules were made more complex!

Meanwhile contributions to retirement annuities were subject to age-related limits, whilst contributions to personal pensions were subject to different age-related limits. And contributions to personal pensions were also caught by the earnings cap, but those to retirement annuities were not. And after 2001, personal pensions could not use ‘carry forward’ of unused relief, or ‘carry back’ of contributions, but retirement annuities could! And after 2001 personal pensions could use ‘basis years’ to calculate the maximum contributions.

It was clear that Simplification was called for, and following two Consultations in 2002 and 2003 legislation was passed in 2004 to bring about this Simplification. In future there would be one set of rules for all pensions, and these would be based on a maximum total “fund” of £1.5m for all pensions. (We explain how to convert an annual pension into a fund in section 2.)

Under Simplification there is no limit placed on the amount of benefits an individual can build up under a registered pension scheme. However, everyone has a set level of “fund” that they can draw from all registered pension schemes in their lifetime – or can be paid to beneficiaries on their death - and this is called the LifeTime Allowance. Note that the LTA does not apply to schemes which are not UK registered, such as EFRBS (previously known as FURBS) or overseas schemes.

Whereas before April 2006 excessive funds had to be returned, since then because there is no limit there can be no return, but instead there is a LifeTime Allowance Charge (see Section 7).

   ii) What the LTA is

When introduced the LTA was set at £1.5m but with set increases taking it up to £1.8m by 2010/11. Since then it has been reduced twice and is about to be reduced a third time.

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With all of these changes people could have been caught out, so there are a series of ‘protections’ which can be applied for. (See Section 10)
2. How are pensions measured against the LTA?

When a member becomes entitled to draw benefits from a registered pension scheme, they use up a proportion or percentage of their lifetime allowance. That is how the lifetime allowance test works, by reference to percentages of the individual’s lifetime allowance used up in particular circumstances.

There is no measure for lifetime allowance purposes of any benefits held by the individual until entitlement to those benefits arises. The main exceptions to this rule is where the member reaches age 75 without having taken benefits, and any undrawn entitlement is tested for lifetime allowance purposes at that time.

In addition, where the member reaches age 75 having previously designated funds after 5 April 2006 in a money purchase arrangement as available for the payment of drawdown pension (known as unsecured pension before 6 April 2011), the amount by which the value of their drawdown pension fund at that time exceeds the value of the funds previously designated is tested for lifetime allowance purposes.

The circumstances where a lifetime allowance test occurs are referred to in the legislation as benefit crystallisation events (BCEs). At each BCE a capital value is attributed to the benefits that crystallise. This capital value (the amount crystallising) is converted into a percentage of the standard lifetime allowance for the tax year the BCE occurred in. That percentage is then measured against the member’s available lifetime allowance at the point of testing.

The percentage of the member’s lifetime allowance being used up as a consequence of a BCE is added to any percentage used up previously by the member, whether under the same scheme or a different registered pension scheme. Where the total of these percentages exceeds the individual’s lifetime allowance, the excess (or the chargeable amount) is subject to a specific tax charge (the lifetime allowance charge).

There are different rules for pensions already in payment in April 2006 (known as pre-existing pensions) and for pensions commencing after 5 April 2006. There are also different rules for different types of pension.

For pre-existing pensions the amount of pension is multiplied by 25. This factor reflects the fact that in most cases the pensioner will have taken some tax-free cash, and avoids the need to trawl back through the records to ascertain how much was paid. If tax-free cash was not taken the factor of 25 still applies. For drawdown the factor of 25 is applied to ‘maximum GAD’, the maximum income permitted under Capped Drawdown. This calculation still applies where the member has converted a pre-existing pension into Flexi-Access Drawdown after 5 April 2015.

For personal pensions and other defined contribution or money purchase schemes the measurement simply uses the fund value converted to income and converts this to a percentage of the LTA at that date. No allowance is made for any guaranteed annuity rate taken, nor is any allowance made for the shape of the annuity. A fund of £150,000 “crystallised” (see Section 4) to buy an annuity of any amount on 1 May 2006 used up 10% of the then LTA. The same amount on 1 May 2011 only used up 8.33%, but crystallised on 1 May 2015 it used up 12% and on 1 May 2016 it will use up 15%!

For defined benefit or final salary pensions any tax-free cash is taken as the value paid, whilst any “scheme pension” is taken as being 20 x the initial rate of pension. No allowance is made for the age of the pensioner or the rate of increases the pension includes (but see BCE3 in Section 4 below). Similarly the pension has the same value for LTA purposes regardless of whether widows’ and/or dependants’ pensions are included.
3. When are pensions measured against the LifeTime Allowance?  

In most cases this is relatively simple as the measurement takes place when the benefits commence.

i) Pre-existing pensions (see also Section 5)

Special rules apply for pre-existing pensions, which are valued on the first crystallisation event after 5 April 2006. This means that the percentage of the LTA used could depend on the date of a future crystallisation.

A pre-existing non-increasing pension of £6,000 p.a. used up 25 x £6,000 = £150,000 of LTA. If it was valued following a crystallisation on 1 May 2006 it used up 10% of the then LTA. However, if it was valued following a crystallisation on 1 May 2011 it only used up 8.33%. If it was valued following a crystallisation on 1 May 2015 it used up 12% and if it is valued following a crystallisation on 1 May 2016 it will use up 15%!

If the pre-existing pension increases in payment, then it is the rate of the pension in payment on the date of the first post 5 April 2006 which is used. In the example above if the pension has increased to £12,000 p.a. by 1 May 2016 it will use up 30% of the LTA.

With most pre-existing pensions increasing and the LTA decreasing, it is clearly important to trigger the LTA calculation as soon as possible!

ii) Age 75

Even if no benefits have been taken all registered pensions are deemed to be fully crystallised at age 75. There is a series of crystallisation events 5, 5A and 5B which apply at this date (see Section 4).

4. Benefit Crystallisation Events

Benefit crystallisation events (BCEs) occur when people take pensions or lump sums, when they reach age 75 or die before age 75 and when they transfer to a Qualifying Recognised Overseas Pension Scheme (QROPS).

There are currently 12 BCEs, 4 of which have been added in the last few years, including BCE5C which was added from 6 April 2015. They are:

i) Taking pensions

- BCE 1 Where funds are designated to provide a member with a drawdown pension
- BCE 2 Where a member becomes entitled to a scheme pension, whether from a defined benefits arrangement or a money purchase arrangement
- BCE 3 Where a scheme pension already in payment to a member is increased beyond a permitted margin
- BCE 4 Where a member becomes entitled to a lifetime annuity under a money purchase arrangement

ii) Unused funds at age 75 or prior death
• BCE 5 Where a member reaches their 75th birthday under a defined benefit arrangement without having drawn all or part of their entitlement to a scheme pension and / or lump sum.
• BCE 5A Where a member reaches age 75 with a drawdown pension fund or flexi-access drawdown fund. This is often known as a "second crystallisation event", as benefits which were tested under BCE1 are retested.
• BCE 5B Where a member reaches age 75 under a money purchase arrangement in which there are remaining unused funds
• BCE 5C Where a member dies before their 75th birthday and unused uncrystallised funds remaining at death are designated, on or after 6 April 2015 but before the end of a two-year period, to dependants’ flexi-access drawdown pension or nominees’ flexi-access drawdown pension.
• BCE 5D Where a member dies before their 75th birthday and unused uncrystallised funds remaining at death are used, on or after 6 April 2015 but before the end of a two-year period, to secure a dependants’ annuity.

iii) Lump sums
• BCE 6 Where the member becomes entitled to a relevant lump sum. Not all the “authorised” lump sum payments are relevant lump sums.

iv) Death
• BCE 7 Where a relevant lump sum death benefit is paid on the death of the member. Not all the “authorised” lump sum payments that may be paid on the death of the member are relevant lump sum death benefits.

v) Transfer to QROPS
• BCE 8 Where a member’s benefits or rights are transferred to a qualifying recognised overseas pension scheme (QROPS)

vi) Other
• BCE 9 Where certain payments are made to or in respect of a member that constitutes an event that is prescribed in regulations. These are currently:
  o payments of ‘arrears’ of pension after death
  o lump sums based on pension errors
  o PCLS-type lump sums paid after death.

Until 6 April 2011, BCE1 also arose where the member reached age 75 still holding uncrystallised funds in a money purchase arrangement. This is now replaced by BCE 5B. Also, on that date unsecured pensions and alternatively secured pensions were replaced by drawdown pensions.

5. Examples of BCEs occurring

BCE 1: Whenever a member designates that funds held in a money purchase arrangement should be made available to provide a drawdown pension a lifetime allowance test is triggered through BCE 1. This happens whenever funds are first designated under an arrangement as being available to provide a drawdown and a drawdown pension fund is first created under the arrangement. It also happens at any later date whenever all or part of any uncrystallised funds still held in that arrangement are absorbed into the drawdown pension fund through additional fund designation.
The value for LTA purposes is simply the market value of the assets that are designated for drawdown including any tax free cash entitlement.

**BCE 2** occurs when a member becomes entitled to the payment of a scheme pension under a registered pension scheme before the age of 75. This event catches all registered pension schemes, as both a defined benefits arrangement and a money purchase arrangement may potentially provide a scheme pension. The scheme pension is caught by this BCE whether it is going to be paid direct from the scheme or the future liability to that pension is secured through the involvement of an insurance company.

**BCE 3:** If a scheme pension in payment is increased at any point beyond a certain level a lifetime allowance test is triggered through BCE 3. A scheme pension paid before the normal minimum pension age on grounds of ill-health is tested for lifetime allowance purposes through BCE 2 at the point entitlement arises. At a later date payment of that scheme pension may be stopped by the scheme because the member’s health recovers. Where that pension re-commences any increase in that pension level since the point it was stopped is within the scope of BCE 3.

**BCE 4:** A lifetime allowance test is triggered through BCE 4 every time a lifetime annuity contract is purchased under a money purchase arrangement before the member has reached age 75. A lifetime allowance test is triggered through BCE 4 whether the lifetime annuity is purchased before age 75 from uncrystallised funds or from a drawdown fund. In the case of the latter the amount crystallising through BCE 4 will be lower in value (to reflect the fact that the creation of those funds was tested previously for lifetime allowance purposes through BCE 1).

The capital value of the lifetime annuity contract crystallising for lifetime allowance purposes is easily established where purchased from uncrystallised funds. It is the cost of purchasing the lifetime annuity from the insurance company. Where a chargeable amount arises, any lifetime allowance charge paid by the scheme administrator effectively forms part of that chargeable amount. The amount crystallising through BCE 4 will be the actual amount used to purchase the lifetime annuity (and related dependants’ annuity), net of any deduction made by the scheme administrator to cover any lifetime allowance charge due. The chargeable amount will be what crystallises (net) through BCE 4 (and any other BCE), over and above the member’s available lifetime allowance, plus the charge paid by the scheme administrator.

The purchase of a short-term annuity from a drawdown pension fund is not caught through BCE 4 (or any other BCE). This is because the initial designation of funds into the drawdown pension fund would have been tested through BCE 1, and the short-term annuity is simply a means of securing the resulting drawdown pension.

**BCE 5:** The amount crystallising for lifetime allowance purposes under BCE 5 is calculated by reference to the level of benefits the member would become entitled to on their 75th birthday if benefits were paid under the defined benefits arrangement at that point. BCE 5 only covers defined benefits arrangements and a prospective entitlement to a scheme pension and (in some cases) a separate, stand-alone entitlement to a lump sum benefit.

Lump sums provided by commutation, giving up pension benefits, are not caught by BCE 5. The crystallised value of the potential scheme pension entitlement payable is calculated by multiplying the annual level of pension the member would become entitled to on their birthday by a conversion factor. This is done by using the standard relevant valuation factor (RVF) of 20, or another higher non standard RVF where agreed with HMRC.

Before 6 April 2011, there was no need to catch money purchase arrangements through BCE 5 given that under a money purchase arrangement any uncrystallised funds held at age 75 were deemed to be designated into unsecured pension fund at that time. A lifetime allowance test was therefore triggered at that point through BCE 1.
BCE 5A: Where a member reaches age 75 having previously designated funds as available to provide drawdown (before 6 April 2011 unsecured) pension

It may happen that a member had earlier designated funds as available to provide an unsecured pension and reached age 75 without either having taken a lifetime annuity (in which case BCE 4 would have occurred) or a scheme pension (in which case BCE 2 would have occurred). Or such a lifetime annuity or scheme pension has been taken, but only by application of part of the unsecured pension fund. So part of the unsecured pension fund was still in place when the member reached age 75.

BCE 5A applied such that the amount crystallised on the member reaching age 75 would be the amount of the sums or assets representing the unsecured pension fund of the member less the amount (or the appropriate amount) of the amounts originally crystallised under BCE 1 when the member designated funds as available for unsecured pension.

It can be seen therefore that BCE 5A merely performed the same function of a further lifetime allowance test as occurred when a lifetime annuity or a scheme pension arose from an unsecured pension fund. And the prevention of overlap rules applied to ensure that it was only net growth (investment growth less payments of income made) in the unsecured pension fund remaining since the original designation(s) that was tested.

The amount to be reduced under BCE1 for the purpose of BCE5A was the amount originally designated as available for unsecured pension but which had not since been applied as a lifetime annuity or scheme pension.

There will be no BCE 4, BCE 2 or BCE 5A in respect of so much of a lifetime annuity or scheme pension that is purchased from an unsecured pension fund that represents unsecured pension in payment on 5 April 2006.

BCE 5B occurs where a member reaches age 75 and has remaining unused funds in the arrangement. The amount of the remaining unused funds when the member reaches age 75 is the amount crystallising for the purposes of BCE 5B.

BCE 5C and 5D were introduced following the Pension Freedoms introduced from April 2015. They are used to catch unused (i.e. uncrystallised) funds on death before age 75. Previously although Lump Sums on death were caught under BCE7 it was possible to avoid a LifeTime Allowance tax charge by using excess funds to secure widow’s and/or dependant’s pensions. This is no longer possible.

BCE 6: A lifetime allowance test is triggered through BCE 6 whenever a member becomes entitled under a registered pension scheme to

- a pension commencement lump sum paid before age 75, when uncrystallised benefits are drawn under an arrangement
- a serious ill-health lump sum paid before age 75, where the individual falls into serious ill health
- an uncrystallised funds pension lump sum, or
- a lifetime allowance excess lump sum, where a chargeable amount has been identified because the individual’s lifetime allowance has been fully used up

These are referred to collectively in the legislation as a ‘relevant lump sum’.
The date **BCE 6** is triggered will be the date the actual entitlement to the linked pension benefit or special type of trivial lump sum arises.

There is no BCE 6 where a pension commencement lump sum is paid in relation to a money purchase arrangement after 6 April 2011, and the individual becomes entitled to it before reaching the age of 75 but it is not paid to them until after they have reached age 75.

The amount that crystallises through BCE 6 is the amount of relevant lump sum paid to the individual. The scheme administrator compares this amount (and the capital value of any other benefits crystallised at that point) with the individual’s available lifetime allowance at that point. Where a chargeable amount arises, any lifetime allowance charge paid by the scheme administrator effectively forms part of that chargeable amount. The amount crystallising through BCE 6 will be the actual amount of relevant lump sum paid, i.e. after any deduction made by the scheme administrator to cover any lifetime allowance charge due. The chargeable amount will be what crystallises, i.e. after any deduction by the scheme administrator through BCE 6 (and any other BCE), over and above the individual’s available lifetime allowance, plus the charge paid by the scheme administrator.

**BCE 7: The payment of a lump sum death benefit**

A BCE 7 occurs when a member of a registered pension scheme dies and what the legislation calls a ‘relevant lump sum death benefit’ is paid in respect of that member.

This BCE still represents a test on the member’s available lifetime allowance, although any lifetime allowance charge that arises is chargeable on the recipient of the payment and the responsibility for carrying out the test lies on the member’s personal representatives, rather than the scheme administrator.

A BCE 7 can only occur if the member died before reaching age 75 because no BCE other than BCE 3 can occur after an individual has reached that age.

If a defined benefits lump sum death benefit or an uncry stallised funds lump sum death benefit is paid where the member dies on or after their 75th birthday, the lump sum is subject to the special lump sum death benefits charge at a rate of 45 per cent.

**A BCE 8** occurs when a member, before they reach age 75, transfers funds from a registered pension scheme to a qualifying recognised overseas pension scheme (QROPS). This means that the values of transfers overseas from all types of arrangement are tested against the lifetime allowance.

**A BCE 9** occurs in relation to the payment of any of the following authorised member payments prescribed in regulations:

- Payments of arrears of pension instalments determined after the death of the member
- Certain lump sums determined after the death of the
- Certain lump sums paid as a result of specified kinds of errors while the member is still alive

The making of any of the payments covered by the pages linked above constitutes a BCE 9.

Despite BCE 9 occurring, whether for the pension or lump sum or both after the member’s death, the process for establishing how much of the member’s lifetime allowance has been used up at the BCE, and if there is chargeable amount, is the same as it would be during the member’s life. The
scheme administrator would still have a joint liability with the deceased member (through the member’s personal representatives).

6. **Pre April 2006 Benefits**

There will be no BCE4 or BCE 2 or BCE 5A in respect of so much of a lifetime annuity or scheme pension that is purchased from a drawdown pension fund that represents unsecured pension in payment on 5 April 2006.

Any pension being paid to a member aged under 75 on 5 April 2006 as income withdrawal from a personal pension scheme, or direct from the funds of a small self-administered scheme (SSAS) from a money purchase arrangement in a scheme that becomes a registered pension scheme on 6 April 2006 became an unsecured pension from 6 April 2006 onwards.

The unsecured pension fund for these benefits in payment on 6 April 2006 will be held in a separate arrangement to any other unsecured pension fund held in respect of the member in the same registered pension scheme.

A pension benefit in payment from a tax approved source that started being paid before 6 April 2006 is only considered for lifetime allowance purposes the first time a BCE is triggered in respect of the member on or after 6 April 2006.

Such a pension is referred to in the legislation as a ‘pre-commencement pension’. The reason such pensions need to be considered in this way is because, as these pensions in payment arose before 6 April 2006, they will not have been tested for lifetime allowance purposes when they began to be paid.

Only a pension paid to the individual as an actual member of a scheme is caught within this definition. A widow(er), surviving civil partner or dependant pension is not treated as a pre-commencement pension.

The way the legislation considers a pre-commencement pension is by saying that, where the first BCE is triggered on or after 6 April 2006, the amount of lifetime allowance available at that first (and subsequent) BCE(s) will be reduced as if another BCE had occurred immediately before that first BCE, which caught the crystallised value of any pre-commencement pensions in payment to the member at that time.

For the avoidance of doubt where the first benefit crystallisation event that occurs after 5 April 2006 is BCE 7 - the payment of a lump sum death benefit - the pre-commencement pension will be a deemed BCE. The member’s available lifetime allowance will be reduced accordingly before the BCE 7.

If no BCE is triggered on or after 6 April 2006, the pre-commencement pensions will never be considered for lifetime allowance purposes. This is obviously important to someone who retired before April 2006; if they recommence employment or self-employment and have any new pension this will bring them into the post 2006 regime and all of their pensions will be measured against the LTA.

The amount of lifetime allowance used by a pre-commencement pension should not be included in the BCE statement or annual statement issued by the scheme administrator of the scheme with the first BCE. This is to ensure there is no uncertainty about whether a statement includes the amount of lifetime allowance used by the pre-commencement pension or not. Instead, once the amount of lifetime allowance used by the pre-commencement pension is identified, the member will be able to provide that information to scheme administrators of schemes where BCEs occur in future.
The purpose of the deemed BCE is to limit the level of available lifetime allowance at that first (and subsequent) BCE. It is not a BCE in its own right. No chargeable amount will actually crystallise in relation to any pre-commencement pension in payment at that first BCE. The legislation only ensures that pensions in payment are adequately reflected in the individual's post 5 April 2006 level of lifetime allowance.

If the amount crystallising at that deemed BCE comes to over 100% of the member’s level of lifetime allowance this simply means that the member has no available lifetime allowance at that first BCE. No chargeable amount actually crystallises at that deemed BCE, and the level of chargeable amount arising at that first actual BCE is not increased simply because the crystallised value of the pre-commencement pension is more than 100% of the member’s actual lifetime allowance figure. All it will mean is that everything crystallising at that first BCE will represent a chargeable amount.

7. **How are payments in excess of the LTA taxed?**

The tax payable depends on whether the excess is taken as cash or as income. Under occupational schemes the administrator decides how the benefit will be paid and taxes it accordingly.

The rates of tax are:

- **Lump Sums** 55%
- **Income** 25%

For an additional rate taxpayer the income rate will be 45% in addition to the 25% LTA tax, giving a total rate of 58.75%. Conversely a basic rate taxpayer (unlikely to be paying basic rate and facing a LTA charge!) would only pay 40%.

8. **Examples of BCEs resulting in a tax charge**

Anne is aged 60 and has benefits worth £200,000 held as uncrystallised funds in a money purchase arrangement. On 23 July 2006 she draws benefits from half her uncrystallised funds. She takes the maximum pension commencement lump sum (£25,000) and uses the remaining £75,000 to secure a lifetime annuity contract through the open market option.

At that point a lifetime allowance test is triggered. There have been two BCEs on that date. These are BCE 6 - the payment of the pension commencement lump sum and BCE 4 - the purchase of a lifetime annuity.

The scheme administrator calculates the capital value of the benefits crystallised on the date as £100,000. This is based on the actual lump sum paid (£25,000) and the £75,000 cost of purchasing the lifetime annuity. This represents 6.66% of the standard lifetime allowance for the 2006/07 tax year (£1.5 million).

The legislation provides rules to ensure that benefits are not tested through a BCE more than once. This is referred to in the legislation as prevention of overlap.

Where a lifetime annuity is purchased, before the member reaches the age of 75, following a period of drawdown pension i.e. purchased from drawdown pension fund rather than uncrystallised funds, the amount crystallising under BCE 4 is reduced to reflect that all (or part of) the funds being used
have effectively already been tested for lifetime allowance purposes. Funds from the drawdown pension fund would have been tested through BCE1, when uncrystallised funds were originally designated into that fund to provide a drawdown pension.

In this circumstance the legislation provides for the reduction of the amount crystallising through BCE 4 by the amount that crystallised at the earlier event (or events) where funds were designated to provide drawdown pension. So the amount crystallising through BCE 4 will be reduced by what previously crystallised though BCE 1 when uncrystallised funds were introduced into the drawdown pension fund.

If the amount crystallising through BCE 4 is reduced to ‘nil’ or a negative amount then no amount has been crystallised and no lifetime allowance has been used up. This will be the case where the drawdown pension fund has not grown in value over time (as the pension drawn from the fund has been greater than any growth of the underlying assets). A negative result does not mean that the member’s available lifetime allowance is increased.

Where the lifetime annuity is purchased after the member has reached age 75 there is no BCE 4 as the only BCE that can occur after age 75 is a BCE 3.

9. How has the LifeTime Allowance Changed? Return to Index

When introduced the LTA was set at £1.5m but with set increases taking it up to £1.8m by 2010/11. Since then it has been reduced twice and is about to be reduced a third time.

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10. Explanation of the different Protections Return to Index

Primary Protection

An individual could claim for primary protection where their pension and lump sum rights in a tax privileged scheme or contract were valued at more than £1.5 million at 5 April 2006. Individuals with primary protection can continue to make tax relieved contributions or to accrue further benefits under registered pension schemes after 5 April 2006.

Individuals with primary protection have a personal lifetime allowance which is greater than the standard lifetime allowance. This personal lifetime allowance is set by the value of their pension rights on 5 April 2006. The lifetime allowance charge will apply only to benefits paid after their personal lifetime allowance has been used up. Until 5 April 2012, personal lifetime allowances
under primary protection were adjusted annually in the same way as the standard lifetime allowance.

From 6 April 2012, the personal lifetime allowance is adjusted by reference to £1.8 million where this figure is greater than the standard lifetime allowance applying at the time benefits are taken.

Enhanced Protection

Enhanced protection could be claimed by any individual with pension or lump sum rights in a tax privileged scheme or contract including those with pension rights of less than £1.5 million on 5 April 2006.

Enhanced protection fully protects the value of an individual's pension rights on 5 April 2006. Such rights will not be subject to the lifetime allowance charge when they are brought into payment. Effectively, this means that if the value of the rights increases faster than the increase in the standard lifetime allowance, the individual will still be protected from the lifetime allowance charge. This is the main difference between primary and enhanced protection.

However, there are constraints on what can be protected. These constraints apply after 5 April 2006. Broadly, there must be no further accrual of defined benefits or cash balance rights above a specified level of indexation, and no contributions can be paid to other money purchase arrangements.

Once a member told HMRC they planned to rely on enhanced protection they received a certificate with details of their protection. However, unlike primary protection a member can choose to give up enhanced protection. They do this by:

- Failing to comply with the conditions for enhanced protection – for example by paying a money purchase pension contribution; or
- Notifying HMRC they no longer wish to be covered by enhanced protection.

If a member has enhanced protection on 6 April 2012 then they cannot benefit from fixed protection (see below). However, if a member has enhanced protection only (without primary protection) then so long as they give this up before 6 April 2012 they can apply for fixed protection.

If a member holds both primary and enhanced protection and they choose to give up enhanced protection, they will still have their primary protection. As a member cannot give up primary protection, this will stop them from benefitting from fixed protection.

Once an individual has given up enhanced protection they cannot change their mind. Enhanced protection cannot be re-instated. If a member gets fixed protection by giving up enhanced protection and later finds they made the wrong decision they cannot get their enhanced protection back.

Fixed Protection

Where an individual has fixed protection their standard lifetime allowance could be higher than the amounts shown above. For such individuals, all references to the standard lifetime allowance should be read as being references to their protected lifetime allowance. This will be £1,800,000 from tax year 2012-13 onwards, while their protection remains valid and for so long as the standard lifetime allowance remains less than £1,800,000.

On 6 April 2012 the lifetime allowance was reduced to £1.5 million from the level of £1.8 million in 2011-12. As members might have already built up savings of more than £1.5 million or had planned to do so in the expectation that the lifetime allowance would not reduce from the 2011-12 level, a new form of protection called “fixed protection” was introduced.
If a member expects their pension savings might be more than £1.5 million (including taking into account past crystallisations) when they come to take their benefits on or after 6 April 2012 fixed protection can help reduce or mitigate the lifetime allowance charge. Fixed protection (2012) allows individuals to crystallise benefits worth up to £1.8 million without paying the lifetime allowance charge, although the ability to accrue future benefits is limited.

People requiring fixed protection (2012) had to notify HMRC by 5 April 2012.

If someone has fixed protection (2012) their lifetime allowance will be fixed at £1.8 million rather than the standard lifetime allowance, which will be £1.5 million from 6 April 2012. If, in the future, the standard lifetime allowance rises to be more than £1.8 million the member’s fixed protection will stop. Their lifetime allowance will then be the higher standard lifetime allowance.

Anyone who did not have either primary protection or enhanced protection could apply for fixed protection. They did not need to have already built up pension savings of more than £1.5 million to apply. If someone wanted to apply for fixed protection then they had to meet certain conditions. These are that on 6 April 2012 they were a member of a registered pension scheme, did not have primary protection, and did not have enhanced protection.

Once a member has fixed protection there are restrictions on what they will be able to do with their benefits. For example, they will normally need to stop building up benefits under every registered pension scheme that they belong to by 5 April 2012 and if this is not the case then they will not be able to rely on fixed protection. As a result their lifetime allowance will be the standard lifetime allowance of £1.5 million, and if their benefits are worth more than this when they take them they will be liable to a lifetime allowance charge.

To keep fixed protection a member cannot start a new arrangement under a registered pension scheme other than to accept a transfer of existing pension rights, cannot have benefit accrual, and will be subject to restrictions on where and how they can transfer benefits. If the member breaks one of these conditions then they will lose their fixed protection. A member must tell HMRC if they lose fixed protection.

It is possible that the changes to the annual allowance may mean that a member becomes liable to an annual allowance charge in the same year that their benefits are tested against the lifetime allowance. If the member is liable for an annual allowance charge in the year that they exceed the lifetime allowance, they will still need to pay the lifetime allowance charge if their total benefits are more than their lifetime allowance. There will be no reduction in the amount of lifetime allowance charge due because the member is also liable to the annual allowance charge. See our Annual Allowance Guide for more information about the annual allowance.

Paying benefits to someone with fixed protection

If a member has fixed protection and wants to rely on it to reduce or eliminate a lifetime allowance charge when they take benefits, they must tell their scheme administrator that they have fixed protection. Even where the member does not want to crystallise benefits in excess of the standard lifetime allowance they should tell the scheme administrator they have fixed protection. This will enable the scheme administrator to calculate the percentage used of the lifetime allowance based on £1.8 million (FP2012).

The member must give their scheme administrator the fixed protection certificate reference number; this is the legal minimum requirement. The scheme administrator may ask to see a copy of the fixed protection certificate.

- A member could lose fixed protection if: they have benefit accrual,
- they start a new arrangement other than to accept a transfer of existing pension rights,
• there is an impermissible transfer into an arrangement or
• a transfer is made that is not a permitted transfer.

Fixed protection will be lost from the date the event above occurred and the member can no longer rely on the fixed protection certificate that was issued to them. A member must tell HMRC if they lose fixed protection.

When a scheme administrator starts to pay benefits to a member they need to satisfy themselves that there is no lifetime allowance charge due. If the lifetime allowance charge is due the scheme administrator needs to know how much is due. The scheme administrator is jointly and severally liable to the lifetime allowance charge where the event triggering the lifetime allowance test is not the payment of a death benefit. Unless a scheme administrator is told otherwise they must proceed on the basis that the member has no form of protection from the lifetime allowance charge.

When a scheme administrator is given details of a member’s fixed protection (2012) they proceed on the basis that the member has a standard lifetime allowance of £1.8 million. This means that as long as the member’s total benefits are not worth more than £1.8 million there is no lifetime allowance charge

If the member does not have scheme specific lump sum protection (see our Guide to Lump sums: Scheme specific protection) their maximum pension commencement lump sum will be the lower of 25 per cent of the available lifetime allowance set by fixed protection or 25 per cent of the amount crystallising under the scheme at that time. This means that if a member has not previously taken any benefits and is crystallising £1.8 million or more their maximum pension commencement lump sum will be £450,000.

If using fixed protection means that the member has no lifetime allowance charge (but would have done if they had no fixed protection), or a smaller amount liable to the lifetime allowance charge after crystallising benefits the scheme administrator must give the member a statement showing how much of the standard lifetime allowance has been used up by the benefit crystallisation. The percentage shown on the certificate should be calculated as a percentage of the member’s standard lifetime allowance, i.e. for FP2012 the (underpinned) lifetime allowance of £1.8 million from 6 April 2012.

A member may lose their fixed protection if on or after 6 April 2012 they have benefit accrual under a registered pension scheme or there is an impermissible transfer from their arrangement or there has been a transfer of sums and assets that is not a permitted transfer; or they have made a new arrangement other than in permitted circumstances. Once fixed protection is lost, all subsequent benefit crystallisation events in relation to a member are tested by reference to the prevailing standard lifetime allowance.

If an employer is subject to the automatic enrolment duty and automatically enrols an employee into a new pension scheme under the provisions of Pensions Act 2008, the employee will have one month from the enrolment date to opt out of the new scheme. If they opt out within that one month period then the law treats them as if they were never a member of the pension scheme. So if an employee is subject to automatic enrolment under the Pensions Act 2008 provisions and opt out within one month they will keep their fixed protection. If they do not opt out in time then they will lose their fixed protection.

**Fixed Protection 2014**

From 6 April 2014 the lifetime allowance was reduced to £1.25 million from the level of £1.5 million in tax year 2013-14. For members who have already built up pension savings of more than £1.25 million or planned to do so in the expectation that the lifetime allowance would not reduce from the 2013-14 level, there is a new form of protection called “Fixed Protection 2014” (FP2014).
The legislation for FP2014 applies from 6 April 2014 and broadly follows that for the existing fixed protection which was introduced when the lifetime allowance was reduced from £1.8 million to £1.5 million in 2012-13.

If a member expects their pension savings to be more than £1.25 million (including taking into account past benefits crystallised) when they come to take any benefits on or after 6 April 2014 they can use FP2014 to help reduce or mitigate the lifetime allowance charge. FP2014 will allow the member to crystallise benefits worth up to £1.5 million without paying the lifetime allowance charge, although the ability to accrue future benefits is very limited.

If a member has FP2014 their lifetime allowance will be fixed at £1.5 million rather than the standard lifetime allowance, which will be £1.25 million from 6 April 2014. If, in the future, the standard lifetime allowance rises to be more than £1.5 million, they will no longer need to rely on FP2014 and instead their lifetime allowance will be the higher standard lifetime allowance.

Members do not need to have already built up pension savings of more than £1.25 million to apply for FP2014, but they must meet certain conditions:

- they are a member of a registered pension scheme on 6 April 2014;
- they do not have primary protection;
- they do not have enhanced protection and
- they do not have fixed protection.

Once a member has FP2014 there are restrictions on what they will be able to do with their future pension savings. For example, they will normally need to stop building up benefits under every registered pension scheme they belong to by 5 April 2014.

When the scheme administrator is given details of the member’s fixed protection they will proceed on the basis that they have a standard lifetime allowance of £1.5 million or the actual standard lifetime allowance if this has risen to more than £1.5 million when they come to take their benefits. This means that while the standard lifetime allowance remains below £1.5 million as long as your benefits are not worth more than £1.5 million there is no lifetime allowance charge

If they do not have **scheme specific lump sum protection** (see our **Guide to Lump sums: Scheme specific protection**) your maximum pension commencement lump sum will be the lower of 25% of the available lifetime allowance set by FP2014 which will be £1.5 million and 25% of the amount crystallising under the scheme at that time. This means if they have not previously taken any benefits and are crystallising £1.5 million or more their maximum pension commencement lump sum will be £375,000.

If using FP2014 means that the member has no lifetime allowance charge (but would have done if they had no FP2014), or a smaller amount liable to the lifetime allowance charge their scheme administrator must tell HMRC that they have used FP2014.

They will also need to include on their self-assessment return the amount of any lifetime allowance charge due and the amount of lifetime allowance charge paid by the scheme administrator.

After crystallising benefits the scheme administrator must give the member a statement showing how much of the standard lifetime allowance has been used up by the benefit crystallisation. The percentage shown on the certificate should be calculated as a percentage of your protected lifetime allowance of £1.5 million from 6 April 2014 and not the standard lifetime allowance of £1.25 million.
A member cannot give up fixed protection 2014 (FP2014), however they may lose their FP2014 if on or after 6 April 2014:

- they have benefit accrual under a registered pension scheme,
- there is an impermissible transfer from their arrangement,
- there has been a transfer of sums and assets that is not a permitted transfer; or
- they have made a new arrangement other than in permitted circumstances.

Once FP2014 is lost, all subsequent benefit crystallisation events in relation to a member are tested by reference to the prevailing standard lifetime allowance.

**Individual Protection 2014**

If you expect your total pension savings in registered pension schemes to be valued at more than £1.25 million (including taking into account past benefits crystallised) when you come to take any benefits on or after 6 April 2014 you can use individual protection 2014 (IP2014) to help reduce or mitigate the lifetime allowance charge.

You can apply for IP2014 from August 2014. HMRC must receive your application by 5 April 2017 at the latest.

IP2014 gives you a protected lifetime allowance equal to the value of your pension savings on 5 April 2014, subject to an overall maximum of £1.5 million. You won’t lose IP2014 by making further savings in to your registered pension schemes but when you crystallise any pension savings in excess of your protected lifetime allowance, that excess will be subject to a lifetime allowance charge.

IP2014 is available even if your pension savings in registered pension schemes on 5 April 2014 have a value of more than £1.5 million. As the maximum protected lifetime allowance you can have with IP2014 is £1.5 million, any savings in excess of this will not be protected and will be subject to the lifetime allowance charge when you crystallise your benefits.

You can apply for IP2014 even if you already have enhanced protection, fixed protection (2012), or fixed protection 2014. In such cases HMRC will inform you if they accept the notification but will not issue a certificate - your IP2014 will be dormant unless and until the other protection is lost. But you can’t apply for IP2014 if you have primary protection, or both enhanced protection and (dormant) primary protection.

An application for IP 2014 must be received by HMRC by 5 April 2017 and can be made online. An email confirmation of receipt of the application will be received following the online submission.

Once HMRC has accepted and processed the member’s online application they will send a certificate to state that they have IP 2014. This certificate will have with a unique reference number stating that the member has IP 2014 and the amount protected. The member will need to keep this certificate safe so that they can give this information to their pension scheme(s) if they want to rely on this protection when they come to take their benefits.

Where the member’s IP 2014 is dormant because they have one of enhanced protection, fixed protection or fixed protection 2014 then HMRC will write to them confirming that their IP 2014 application has been accepted. As these other protections are more favourable than IP 2014, the IP 2014 certificate won’t be issued unless and until the member’s IP 2014 becomes active because they have lost the other form of protection and notified HMRC of this, as they are required to do.
Mike crystallises benefits with a capital value of £150,000. The standard lifetime allowance at that point is £1.5 million, so the percentage used up is 10%. If Mike had not crystallised any other benefits previously, he will have 90% of his lifetime allowance still available for the next BCE.

The same process occurs when Mike crystallises benefits at a future date.

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

**Fixed Protection 2016**

This will be available from 6 April 2016, but HMRC has said it will not be possible to apply in advance as the necessary online forms will not be available. FP2016 will allow a member of a registered pension scheme to retain a LTA of £1.25m subject to no further contribution being paid and no ‘relevant benefit accrual’ in a DB scheme.

**Individual Protection 2016**

IP2016 will also be available from 6 April 2016, and it will protect sums between £1m and £1.25m built up by 5 April 2016. You won’t lose IP2016 by making further savings in to your registered pension schemes but when you crystallise any pension savings in excess of your protected lifetime allowance, that excess will be subject to a lifetime allowance charge.

**11. Accounting For LTA Usage**

The percentage of the standard lifetime allowance used up at a particular BCE in a particular tax year remains constant year by year even though the standard lifetime allowance is changed in subsequent tax years. So the 10% of the standard lifetime allowance used up in the example above when the standard lifetime allowance is £1.5 million remains constant at 10% in the later year when the allowance has risen to £1.8 million. This process ensures that the original crystallisation amount of £150,000 maintains a fixed percentage, despite subsequent changes to the lifetime allowance.

When calculating the percentage of the standard lifetime allowance being used up at any BCE the scheme administrator need only be concerned with the benefits currently being tested under their particular scheme. They do not require specific details of any other benefits the member may have (which in turn avoids the need to obtain details of other rights when the individual joins the scheme). However, in order to calculate whether the member has enough available lifetime allowance to cover the amount crystallising at that BCE (and whether or not a lifetime allowance charge is due) the scheme administrator may well require details from the member of the previous percentages of the 'standard lifetime allowance’ they have used up under other registered pension schemes at earlier BCEs.

Where the BCE occurs whilst the member is alive

Whilst the member is alive, the process of establishing how much of that individual’s lifetime allowance has been used up at a BCE, and whether or not a chargeable amount has arisen, should take account of the fact that the scheme administrator is separately and jointly liable (with the member) for any lifetime allowance charge that arises at a BCE on any chargeable amount that crystallises, and is required to account for that due charge to HMRC. It is a matter for the scheme to
decide how to go about obtaining information in order to be able to determine if a lifetime allowance charge arises.

The scheme administrator has three basic responsibilities before, at and after a BCE occurs in the member’s lifetime:

1. establishing whether or not a chargeable amount arises at the BCE,
2. accounting to HMRC for the lifetime allowance charge due on any chargeable amount that arises at the BCE, and
3. providing the member after the BCE with a statement confirming the total level of the member’s lifetime allowance that has been used up under the scheme, expressed as a percentage of the standard lifetime allowance, and if a chargeable amount has arisen, a notice confirming the level of chargeable amount that arose at the BCE and the lifetime allowance charge due on this amount (and whether they have accounted for the due charge, or intend to do so in due course)

Where a lifetime allowance test takes place the capital value of those benefits (the amount crystallising) must be established in order for a comparison to be made against the member’s available lifetime allowance. If a lump sum benefit is being paid this value is easy to establish.

Establishing the capital value of a crystallising pension benefit is not so easy.

If a scheme provides money purchase benefits the capital value of the pension can sometimes be easily established as there is a known fund value backing up the pension benefit; either the drawdown pension fund, or the funds used to purchase the lifetime annuity from the insurance company.

Where a scheme provides benefits on a defined benefits basis there are no funds specifically earmarked to provide those benefits. To work out the capital value of defined benefit pension some form of conversion factor needs to be applied to the pension coming into payment.

The legislation differentiates between the different types of pension benefits as each must be valued differently in order to establish the appropriate value of the benefit. Where schemes provide pensions direct from the scheme (as a scheme pension) watch out for real value increases in the pension level once in payment, as the scheme can uplift the level of scheme pension payable at a future date through additional funding without a clearly established event occurring. This cannot happen where a lifetime annuity is purchased or where a fund has been designated to provide a drawdown pension (where no new funds can be introduced to boost the pension level, without an additional BCE being triggered).

The first four BCEs provided for by the legislation catch the three differing forms of pension benefit that can be provided before age 75, as well as increases in a scheme pension in payment beyond a set level, valuing each form of benefit on the most appropriate basis.

The first and fourth BCEs cover two exclusive forms of money purchase pension provision - a drawdown pension and the purchase of a lifetime annuity. The capital value of the benefit can be established here by reference to the underlying fund value involved (the drawdown pension fund or the cost of the annuity).

The second BCE covers all scheme pensions, whether being provided from a defined benefit or a money purchase arrangement. Here the pension needs to be valued by multiplying the pension in payment by a conversion factor to establish its capital value.

The third BCE covers increases of a scheme pension in payment where the increase is above an exempted (cost of living) margin.
Philippa crystallises £750,000 in 2006-07. This uses up 50 per cent of the standard lifetime allowance. Philippa is sent a certificate each year showing she has used up 50 per cent of the SLA.

In April 2012, Philippa applies for fixed protection.

In August 2012, Philippa decides to take £600,000 benefits. As Philippa has fixed protection her standard lifetime allowance is £1.8 million.

The benefits crystallised use up 33.33% of her standard lifetime allowance at the time. Philippa’s scheme gives Philippa a certificate showing she has used up 33.33 per cent of the standard lifetime allowance.

Philippa’s available LTA before this latest BCE is calculated as

\[
\text{£1.8 million} - (\text{£750,000} \times \frac{1.8}{1.5}) = \text{£900,000.}
\]

After taking benefit Philippa will have £300,000 remaining LTA. That is 16.67 per cent left.

In May 2013, Philippa starts to contribute to another money purchase scheme and loses her fixed protection. Her standard lifetime allowance reverts to £1.5 million for the future.

Third benefit crystallisation event - August 2014. Assuming an SLA of 1.5 million Philippa’s available LTA is now

\[
\text{£1.5 million} - (\text{£750,000} \times \frac{1.5}{1.5} + \text{£600,000} \times \frac{1.5}{1.8}) = \text{£250,000}
\]

This is 16.67 per cent of Philippa’s SLA.

Philippa has BCE certificates adding up to 83.33 per cent. So the scheme can see from Philippa’s existing BCE certificates that she only has 16.67 per cent SLA left.

Examples of how the amount crystallising through BCE 4 is calculated where a lifetime annuity is purchased from the drawdown pension fund

Example 1

Andy is aged 55 and has benefits worth £200,000 held in a money purchase arrangement. On 5 August 2006 Andy draws all his benefits, taking a pension commencement lump sum of £50,000 and using the remaining funds to provide an unsecured pension.

Two BCEs have occurred - BCE 1 for the designation of funds for an unsecured pension and BCE 6 for the provision of the pension commencement lump sum. A lifetime allowance test is triggered.

The amount crystallised through BCE 1 is £150,000 (i.e. what becomes unsecured pension fund at that point). The amount crystallising through BCE 6 is £50,000. The scheme administrator calculates that the benefits taken represent 13.33% of the standard lifetime allowance (£1.5 million for that tax year).

On 5 August 2011, Andy decides to use all the drawdown pension fund to purchase a lifetime annuity contract. Andy has drawn very little drawdown pension and so his drawdown pension fund has grown to £180,000 at that time.
A lifetime allowance test is triggered through BCE 4 when the annuity contract is purchased. The amount crystallised is reduced by £150,000 to reflect the amount that crystallised previously through BCE 1 when the funds were originally designated to provide unsecured pension.

The amount crystallised is therefore only £30,000 (£180,000 - £150,000).

Example 2

As above, but the drawdown pension fund used to buy the lifetime annuity stands at £120,000 (as Andy has been drawing a higher level of unsecured pension).

BCE 4 is triggered, but nothing crystallises at that point (so Andy uses up no lifetime allowance). This is because the £120,000 notional amount crystallising through BCE 4 is reduced by the £150,000 that crystallised through BCE 1 in August 2006, on the creation of the unsecured pension fund that has been used to purchase the lifetime annuity. So the £120,000 annuity purchase price is cancelled out.