Broadstone

Lump Sum Allowance

Final Rules

December 2024

Introduction

The abolition of the Lifetime Allowance has been a difficult process for HMRC and the industry. Announced with a very short implementation period, there was great pressure on all parties to make the complex changes required. As a result, holes in the Finance Act 2024 meant that the latest regulations ensuring the rules work as intended came into force on 18 November 2024, over 6 months after the abolition of the Lifetime Allowance.

This note confirms the new rules and some of the new aspects of the Lump Sum Allowance and the Lump Sum and Death Benefit Allowance that you should be aware of.

Lump Sum Allowance

Summary of the rules

- The Lump Sum Allowance is set at £268,275. There is currently no provision in the regulations for the Allowance to increase over time. If the member holds a valid Lifetime Allowance protection available before 6 April 2024, they could have a higher Lump Sum Allowance.

- Any tax-free Pension Commencement Lump Sum (PCLS) payments from the scheme will use up the Lump Sum Allowance. A Stand-alone Lump Sum or the tax-free element of an Uncrystallised Funds Pension Lump Sum will also use up the Allowance.

- There is a standard calculation for converting benefits that crystallised before 6 April 2024 to an amount of Lump Sum Allowance used up. This effectively takes 25% of the crystallised value applied to the Lifetime Allowance as at 5 April 2024.

    - For example, if a member crystallised 20% of their Lifetime Allowance, you take 20% of £1,073,100 and divide this by 4 – the member's previous event will have used up £53,655 of their Lump Sum Allowance. This does assume the member took the maximum tax-free cash under the final value of the Lifetime Allowance, which may not be the case for some members. More on this later: see 'Transitional Tax-Free Amount Certificate'.

    - The standard calculation will also be used to advise members who crystallised benefits under the Lifetime Allowance regime of their available Lump Sum Allowance on the annual statement we must provide: see 'Relevant Benefit Crystallisation Event statements'.

- If a lump sum is paid over the Lump Sum Allowance, it is taxed at the member's marginal rate of income tax at the time of payment: see 'Pension Commencement Excess Lump Sums'.

- The retirement process is similar to the pre-6 April 2024 regime, whereby we need details of the protections held and benefits previously taken by members to ensure we apply any tax charge appropriately.

Transitional Tax-Free Amount Certificate

As noted above, the standard calculation for transposing the old Lifetime Allowance percentages into the new rules assumes that the member took the maximum tax-free cash while the Lifetime Allowance was £1,073,100. If they did not, it may be in their interest to request that the result of the standard calculation is replaced with the amount of tax-free cash they have actually crystallised, to ensure they can benefit fully from the Lump Sum Allowance.

To do this the member can apply to any pension scheme they are a member of and provide evidence of the lump sums they did (or did not) take. The scheme can then issue a Certificate confirming their available Lump Sum Allowance.

This is something that schemes will have to comply with, and which could be time consuming when reviewing the evidence.

Broadstone comment – clients should be aware that there will be a cost for preparing this Certificate for the member.

Pension Commencement Excess Lump Sums

Schemes may pay out a lump sum over the Lump Sum Allowance or Lump Sum and Death Benefit Allowance as a Pension Commencement Excess Lump Sum (PCELS). There are certain rules that apply to such a payment (some of which are the same as for a regular PCLS):

- The member must become entitled to it in connection with becoming entitled to a relevant pension.
- It cannot be paid from contracted-out rights (so GMP and section 9(2b) rights).
- It is paid during a period beginning six months before, and ending 12 months after, the member becomes entitled to it.
- It is not possible for the member to be paid any other category of authorised lump sum. This generally prevents payment of a PCELS from a money purchase arrangement on the basis that they could pay the benefit as an Uncrystallised Funds Pension Lump Sum instead.

In addition, the scheme rules should be reviewed to ensure that they permit benefits to be paid in this way. Trustees are not obliged to permit payment of a PCELS and have the following options in their approach:

Option 1 – do not pay a PCELS. In this case, where the member's Lump Sum Allowance is used up the member cannot receive a lump sum and instead benefits would have to be paid as a pension.

Option 2 – if the Trustees do wish to pay a PCELS, they can pay out the scheme entitlement as per the rules and share the lump sum between the available Lump Sum Allowance as a PCLS and the excess lump sum as a PCELS.

Option 3 – the scheme could re-shape the benefits so that the PCLS would be paid from the available Lump Sum Allowance, with the attaching pension ensuring the PCLS equals 25% of the crystallising pension. Any excess pension could be commuted for a PCELS.

Option4 – where the Lump Sum Allowance has already been used up in full, the Trustees could allow members to commute most of their pension for a PCELS and provide a small attaching pension, perhaps to cover contracted out rights or at another level. A pension must be paid but the lump sum could be large – albeit all taxable.

Broadstone comment – clients should consider what they intend to do should a member use up their Lump Sum Allowance and a lump sum is payable. Scheme rules should also be reviewed to ensure that a PCELS can be paid, if that's what the Trustees wish to do.

Relevant Benefit Crystallisation Event statements

Since April 2006 schemes have had to provide an annual statement to advise members of the percentage of the Lifetime Allowance they used up when they crystallised benefits in their scheme.

From 2024/25 the annual statement will advise the amount of Lump Sum Allowance and Lump Sum and Death Benefit Allowance used up. This will require a one-off exercise to convert the percentage of the Lifetime Allowance to a Lump Sum Allowance equivalent using the standard calculation noted above.

Broadstone comment – we will be undertaking this exercise in bulk for all our clients and you will be charged a fee for this work. Please discuss with your usual Broadstone contact for more information.

Lump Sum and Death Benefit Allowance

Summary of the rules

- The Lump Sum and Death Benefit Allowance is set at £1,073,100. There is currently no provision in the regulations for the Allowance to increase over time. If the member holds a valid Lifetime Allowance protection available before 6 April 2024, they could have a higher Lump Sum and Death Benefit Allowance.
- The lump sums that counted towards the Lump Sum Allowance also count here, plus:
    - Serious Ill Health Lump Sums
    - Lump sums on death (when death occurred before age 75 and/or paid within two years of death) including:
        - Death in service
        - Return of fund
        - 5-year guarantee (where the member retired after 5 April 2024)
        - Refund of contributions
- Benefits paid in excess of the Lump Sum and Death Benefit Allowance will be subject to income tax on the recipient.
- The standard calculation to convert benefits that crystallised before 6 April 2024 to an amount of Lump Sum and Death Benefit Allowance used up takes 25% of the crystallised value applied to the Lifetime Allowance as at 5 April 2024 (like for the Lump Sum Allowance), unless:
    - The member became entitled to a Serious Ill Health Lump Sum before age 75; or
    - The member died before 6 April 2024 whilst under age 75 and a lump sum death benefit was paid in respect of the member before 6 April 2024.

  In these circumstances, the member's Lump Sum and Death Benefit Allowance is reduced by 100% of the amount of Lifetime Allowance used up by any Benefit Crystallisation Events which occurred before 6 April 2024.

- If a Transitional Tax-Free Amount Certificate is in force, it overrides the standard calculation for the member's remaining Lump Sum and Death Benefit Allowance as well as their remaining Lump Sum Allowance.

Trivial Commutation

Some of the most complex changes following the abolition of the Lifetime Allowance were to the trivial commutation rules. We won't waste time discussing what went wrong, but serious issues arose when valuing already crystallised benefits against the £30,000 limit.

The most recent amendments to the regulations have resolved this issue and, for completeness, we summarise the test here. Please note that there are other criteria for the payment of a trivial commutation lump sum, but we don't include them all here.

Uncrystallised rights – benefits that have not yet come into payment at the valuation date.

- Defined Benefit – the annual pension at date of calculation (ignoring any early retirement reduction factor) x 20, plus any cash in addition.

- Defined Contribution – the value of the fund.

Crystallised rights (post 6 April 2006) – benefits in payment at the valuation date.

- Defined Benefit – the initial annual pension that came into payment x 20, plus any cash taken.

- Defined contribution – the value of the fund used to purchase the annuity, plus any cash taken.

Broadstone comment – as noted above there are other criteria for the payment of trivial commutation lump sums: one was the member having available Lifetime Allowance. This has been replaced in the regulations with a requirement for the member to have available Lump Sum Allowance. However, scheme rules may need to be updated to remove the reference to the Lifetime Allowance. We would recommend that Trustees invite their lawyers to review their scheme's rules.

Summary of actions

The legislation and regulations now essentially operate as intended. For brevity we have not touched on the Overseas Transfer Allowance, but this too has been introduced and affects members looking to transfer benefits overseas.

On the Lump Sum Allowance and Lump Sum and Death Benefit Allowance Trustees should:

- Ensure their scheme rules have no inconsistences with the new regulations which could restrict the payment of benefits, for example trivial commutation.
- Check whether their scheme rules allow the payment of a PCELS. If permitted, consent may be required, and it should be clarified who can provide such consent.
- Be aware that the trivial commutation rules have changed, which could mean some members who previously qualified no longer qualify, and vice versa.
- Note that the Government intends to include almost all lump sums payable on death in Inheritance Tax with effect from 6 April 2027, with this potentially impacting the Lump Sum and Death Benefit Allowance in the future.
- Be conscious of the requirement for the amount of the Allowances used in their scheme to be reported to members annually, with Broadstone performing the necessary work to convert the old Lifetime Allowance percentages in bulk.
- Understand that provision of Transitional Tax-Free Amount Certificates where requested will entail chargeable work by Broadstone.

Find out more

For more information on how Broadstone can help you, please contact your Broadstone consultant or use the details below.

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