Teachers' Pensions

Basic guidance on the Lifetime Allowance (LTA)

Relevant from: **6 April 2006, with further changes from 6 April 2016**

Relevant to: Members of the TPS
Employers participating in the TPS
Financial and Taxation Advisers

December 2015

Key points

- Tax efficient pension saving in registered pension schemes is limited to the Lifetime Allowance.
- When benefits are crystallised they are tested against the Lifetime Allowance.
- The Lifetime Allowance is reducing to £1 million in for the tax year 2016/17.
- Overriding legislation allows for benefits paid in excess of the LTA to be paid as pension taxable at 25% or as a LTA excess lump sum taxable at 55%. The TPS regulations do not permit lump sums to be paid in excess of the 'permitted maximum' and, therefore, excess over the LTA is payable as a pension with a 25% LTA charge.
- Prior to 1 October 2015, the reduction that was made to pension on account of the TPS paying the LTA charge on the member's behalf was based on a standard factor of 20:1. From the 1 October, the reduction on account of the LTA is based on factors provided by the Scheme Actuary.

Introduction

Since 6 April 2006 there has been no absolute limit on the level of benefits an individual can be provided with under a registered pension scheme such as the TPS. Instead each individual has an allowance - a Lifetime Allowance (LTA) – in respect of all their pension benefits before they become subject to tax charges at the point of taking benefits.

Any benefits above the LTA will be subject to a tax charge, known as a "Lifetime Allowance charge". The rate of tax charged will depend on whether the excess is taken in pension or lump sum form.

The LTA increased for the first 5 years of its existence, but since then, the LTA has steadily reduced. The historic level of the LTA and the proposed level for 2016/17 is set out below:

Tax Year	Lifetime Allowance
2006/07	£1.5m
2007/08	£1.6m
2008/09	£1.65m
2009/10	£1.75m
2010/11	£1.8m
2011/12	£1.8m
2012/13	£1.5m
2013/14	£1.5m
2014/15	£1.25m
2015/16	£1.25m
2016/17	£1m *

Protection against the LTA Charge

Some members may have protection against the LTA that is higher than the standard.

When the LTA is tested and other provisions

Benefit Crystallisation Events (BCEs)

When a member becomes entitled to draw benefits from a registered pension scheme, they will use up a percentage of their LTA.

A BCE happens when the pension rights that have been built up by an individual are realised, most commonly through the start of a pension benefit or where a lump sum benefit is paid.

There are twelve BCEs each triggering a LTA test, which include:

- Becoming entitled to a scheme pension or lifetime annuity;
- Becoming entitled to a relevant lump sum, e.g. a retirement lump sum from the TPS or other pension commencement lump sum (PCLS);
- A member reaching age 75 without crystallising funds/benefits;
- The payment of a relevant lump sum death benefit; and
- The transfer of benefits to a qualifying recognise overseas pension scheme (QROPS). This is only permitted in the TPS if a person transfers to an occupational defined benefits scheme overseas, where there is no access to the benefits before the age of 55.

When determining the value of the BCE and the percentage of the LTA used up, the scheme needs to establish the capital value of the benefits that are crystallising. HMRC prescribes how to value benefits for LTA purposes.

Valuing benefits

The capital value of benefits being measured for LTA purposes is dependent upon how the benefits are being taken:

- Where a scheme pension is to be taken from a DB arrangement an equivalent value needs to be established for that benefit. The conversion factor to be used is 20:1 (£20 for each £1 of pension taken). E.g., a scheme pension worth £40,000 p.a. is valued as crystallising £800,000 of benefit;
- Where a PCLS (or other lump sum) is taken, the capital value is simply the amount actually paid.

Exceeding the LTA

Once the LTA has been exhausted, tax charges are payable for excess benefits as follows:

- 25% tax charge if the benefit is taken as a pension. The pension actually paid is also subject to income tax at the recipient's marginal rate of tax; or
- 55% tax charge if the benefit is taken as a lump sum (with no further tax payable).

Whilst the overriding legislation provides for lump sums to be paid in excess of the LTA taxable at 55%, the TPS regulations do not permit lump sums to be paid in excess of the 'permitted maximum'. Consequently, in the TPS, excess benefits over the LTA are payable as a pension with a 25% LTA charge, with no provision for a LTA excess lump sum.

Calculation of the reduction in benefits on account of the LTA charge

Prior to 1 October 2015, the reduction in a member's pension would be based on a factor of 20:1. This is a reduction of £1 in pension for every £20 of LTA charge paid by the scheme on a member's behalf. With effect from 1 October 2015, new factors apply in respect of benefits which exceed the standard LTA or, if applicable, a person's enhanced LTA. (where the person has successfully applied for protection against a previous reduction in the LTA). While the factor for valuing pensions against the LTA remains at £20 for every £1 of pension, the factors for reducing benefits are now age related. Different factors also apply if the member is retiring on the grounds of ill-health.

https://www.teacherspensions.co.uk/members/resources/factors.aspx

The reduction in pension on account of the LTA charge will not affect any future entitlement to a survivor's adult or child's pension. In addition, for members with a Normal Pension Age of 60, the factors will also apply a reduction to the member's lump sum as well as pension.

Impact of the reduced LTA on lump sums payable from the TPS

As a result of the LTA reducing to £1 million, this further restricts the retirement lump sum a member can take from the TPS. The permitted maximum is 25% of the lower of:

(1) The available LTA (i.e. £1 million or such other protected LTA if higher less the value of any benefits crystallised); and
(2) 25% of the value of the member's retirement benefits coming into payment.

Consequently, a member with large pension benefits in the TPS, with no LTA protection and who has not previously crystallised any pension benefits cannot receive a retirement lump sum from the TPS of more than £250,000 for the 2016/2017 tax year. Those members with a large pension will not be able to convert pension to lump sum if (1) above is exceeded, as set out in Example 1 below:

Example 1

Dr Will F Lower-Lumpson has a normal pension age of 65 and has no other pension benefits elsewhere. He does not have any LTA protection. Will has an accrued pension in the TPS of £60,000 per annum, but wants to take the maximum lump sum available from the TPS. The rate for converting pension to lump sum is £1 of pension for every £12 of lump sum.

Prior to 6 April 2016, would have been able to take a lump sum of £257,142.86 and a residual pension of £38,571.43 per annum.

As a result of the reduction in the LTA, Will is not able to take a lump sum in excess of £250,000 (i.e. his maximum lump sum is restricted by £7,147.86 due to the reduction in the LTA from April 2016). Consequently, Will would receive a lump sum of £250,000 and a slightly higher pension of £39,166.67 per annum as a result of the maximum lump sum limit.

There is also an increased risk that those members with a normal pension age of 60 will not be able to take the full value of the automatic lump sum from of 3 times their salary from the TPS as shown below:

Example 2
Mr Ray Strict has a normal pension age of 60, no LTA protection and no previous crystallisations from other pension schemes. He is due to take benefits on attaining normal pension age in September 2016.

The pension coming into payment is £88,000 per annum and his automatic lump sum would ordinarily have been £264,000. The automatic lump sum, however, now needs to be restricted to £250,000.

The excess over £250,000 (i.e. £14,000) will instead be converted to a further amount of annual pension using factors supplied by the scheme actuary.

Interim process

The Government recognises that the reduction of the LTA will potentially have a retrospective impact on members who already have benefits valued over £1 million. The Government's solution is to offer 'transitional protection' to members whose benefits are already in excess of £1 million or are likely to exceed £1 million when they reach their normal retirement age, as they have done on previous occasions where the LTA has reduced, since the LTA was first introduced on 6 April 2006.

From 6 April 2016, there will be two new types of protection:

- Fixed Protection 2016 (FP16)
- Individual Protection 2016 (IP16)

There will be a period between the new protection regimes becoming available in April 2016 and the introduction of the new online self-service in July 2016. For this period we will introduce an interim process for pension scheme members who want to take benefits before the introduction of the new online service. Scheme member will be able to write to HMRC between April 2016 and July 2016 and we will check the details of the protection and respond to the member in writing. This can be presented to the Scheme administrator in advance of the full application being made after July 2016.

To do

- Scheme members who have total accrued pension rights valued in excess of, say, £750,000 as a capital amount may wish to review their arrangements with their professional financial adviser.
- Employers should consider what steps they should take to alert members to the possibility of a LTA charge in the future and the availability of LTA protections from HMRC.

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