Pensions Tax

Changes to the Annual Allowance and Lifetime Allowance

The information in this document is based on Aon’s understanding of the changes to the pensions tax regime announced in the Budget on 15 March 2023 and subsequent draft legislation. Draft legislation needs to be finalised in Parliament. Therefore, the comments below might be subject to change.

At a glance…what is changing from 6 April 2023

It was announced in the Budget on 15 March 2023 that:

- **The Lifetime Allowance** (the total value of your pension benefits, other than any state pension, above which an additional tax charge applies) will effectively be abolished from the 2023/24 tax year.
- **The maximum tax-free lump sum** (also known as a pension commencement lump sum) for those without earlier protections remains at £268,275 and will be frozen at this level (a limit broadly of 25% of the value of pension benefits put into payment still applies).
- **The Annual Allowance** (the limit on the amount of pension benefits you can build up in a tax year, above which additional tax applies) will increase from £40,000 to £60,000.
- **The tapered Annual Allowance** will now apply to those with an ‘adjusted income’ in excess of £260,000 p.a. (rather than £240,000) - the minimum tapered Annual Allowance will increase from £4,000 to £10,000 and, assuming it follows the same legislation as currently in force, will apply to those with an ‘adjusted income’ in excess of £360,000.
- **The Money Purchase Annual Allowance** (the limit on the amount of money purchase contributions you can make in a tax year, after you have “flexibly accessed” any money purchase pensions savings, above which additional tax applies) will increase from £4,000 to £10,000.

Why bring you this information

The changes announced may provide many individuals with greater scope to make tax-efficient savings for their retirement. We have produced this guide to help you understand the allowances and the changes announced so far.

For individuals with specified levels of income or pension savings, that exceed certain limits, there are implications regarding the tax efficiency of making pension contributions.

This communication is provided for information only, it is not a recommendation to take a particular course of action(s). Saving for your retirement is one area of consideration and you need to be comfortable how this may impact other areas of your personal finances. If you are at all uncertain about making any decisions to do with your finances and benefits, please take advice. Please see later in this document for more details on getting financial advice.

Lifetime Allowance

The Lifetime Allowance is the total value of all your personal and workplace pensions (but not any state pension) which you can build up without paying extra tax. Your pension is tested against this threshold if you retire or retired before 6 April 2023.

Changes from 2023/24 tax year

In the Budget on 15 March 2023, it was announced that the Lifetime Allowance will be abolished. Ahead of legislation being put in place to enable the Lifetime Allowance to be abolished from 6 April 2024, the Lifetime Allowance charge (previously set at an additional 25%) will be removed from 6 April 2023.

Effectively this means that if you retire after 5 April 2023 there will be no Lifetime Allowance charges. However, there may be some nuances as to how retirements are treated before and after the abolition in April 2024. For example, it might still be possible to take a Lifetime Allowance excess lump sum (expected to be taxed as income at the individual's marginal tax rate) before the abolition legislation is enacted.

Pension Commencement Lump Sums

A Pension Commencement Lump Sum (PCLS), often referred to as a tax-free lump sum, since 2006, has been set equal to 25% of the value of an individual's pension benefits at retirement, subject to this not being more than 25% of the standard Lifetime Allowance (or in circumstances where an individual has retired or taken pension benefits from another scheme already, 25% of an individual's remaining Lifetime Allowance).

Some individuals, with certain pension protections, may have been able to protect a higher PCLS.

With the removal of the Lifetime Allowance, it has been announced that the overall maximum PCLS for those without protections will be retained at the 2022/23 level of £268,275 and remain frozen at that level.

The details as to how this will operate in practice have yet to be finalised.

Lifetime Allowance Protections

A number of protections have been made available in the past allowing certain individuals to limit their exposure to the Lifetime Allowance. These include Fixed Protections, Individual Protections, Enhanced Protection and Primary Protection.

With the abolition of the Lifetime Allowance from 6 April 2023, these protections will no longer be required. It has been confirmed that members with a protected right to a higher PCLS will continue to be able to access this right.

HMRC's Pensions schemes newsletter 148 stated that members who hold a valid Enhanced Protection or any valid Fixed Protections, where this protection was applied for before 15 March 2023, will from 6 April 2023 be able to accrue new pension benefits, join new arrangements or transfer without losing this protection. They will also keep their entitlement to a higher PCLS. This is also set out in the draft legislation.

Annual Allowance

The Annual Allowance is the maximum amount of pension saving you can make, or have made for you by your employer, in a single year, that will receive full tax relief

Pension savings tested against the Annual Allowance

For a defined contribution arrangement, these pension savings are equal to the total contributions credited to **all** your UK pension arrangements over the tax year. For a defined benefit arrangement (also known as a 'final salary' arrangement), the pension savings are equal to the pension input amount for the year - broadly 16 times the new pension accrued over the year, net of an allowance for inflation.

Changes from 6 April 2023

From 6 April 2023, the standard Annual Allowance will be £60,000, but will taper down to as low as £10,000 for higher earners. Prior to April 2023, it was between £40,000 and £4,000 depending on your income.

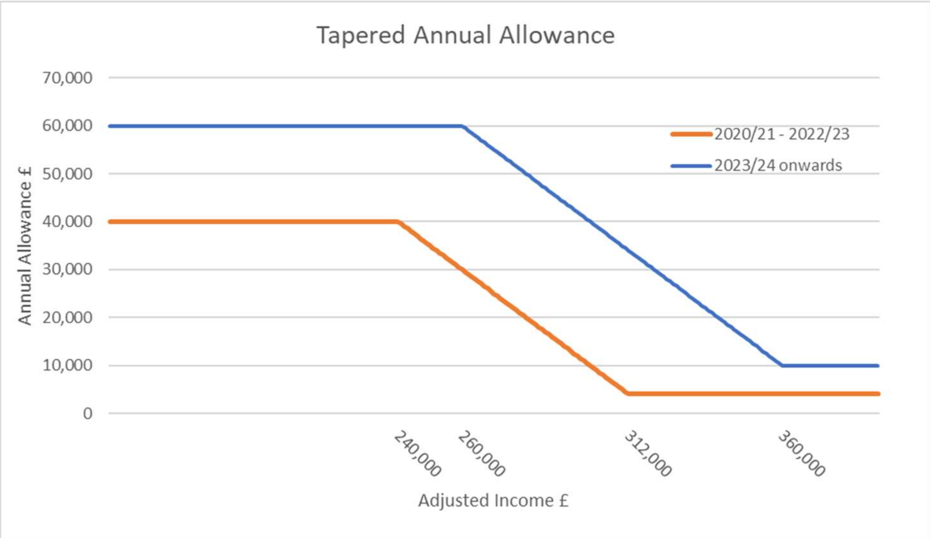
The point at which the Annual Allowance starts to taper down, in line with an individuals' 'adjusted income', is increased from £240,000 to £260,000 (see the next page for what is included in your 'adjusted income').

If you have adjusted income of £260,000 or less, you will have the standard Annual Allowance of £60,000.

Those with adjusted income between £260,000 and £360,000 are expected to be subject to a tapered Annual Allowance; and those with adjusted income of £360,000 or more will be subject to the new minimum tapered annual allowance of £10,000.

As can be seen from the chart below it is expected that the (tapered) Annual Allowance will be greater in the 2023/24 tax year compared to the 2022/23 tax year at an equivalent 'adjusted income'.

This will present many individuals with increased scope to make tax-efficient savings for their retirement.



You are still able to carry-forward any unused Annual Allowance from the previous three tax years, as was the case before these latest changes. Please visit here for information on how the Annual Allowance was determined in earlier years.

How the tapered Annual Allowance worked from 2020/2021 to 2022/2023 tax years

The standard Annual Allowance was £40,000 in 2022/23. Individuals with ‘adjusted income’ (see below) above £240,000 are subject to an Annual Allowance of less than £40,000. For these individuals, the Annual Allowance reduces steadily in proportion to income above £240,000, ultimately reaching £4,000, for those deemed to have an income of over £312,000. The same structure applied from 2016/17 but the tapering operated differently in earlier years – see **here** for more information.

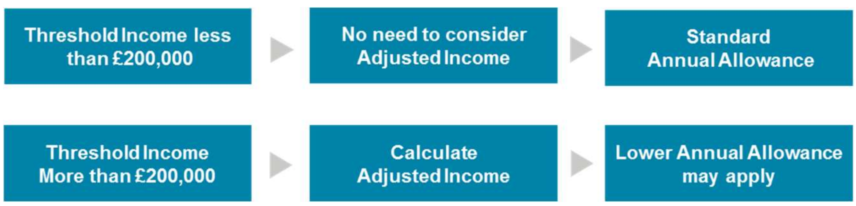
The definition of 'adjusted income'

Broadly, adjusted income is defined as your taxable income from **all** sources (not just employment income) during the tax year plus the value of your pension savings over the year (less any employee contributions with ‘relief at source’). For a defined contribution arrangement, these pension savings are equal to the total contributions credited to your arrangement(s) over the year. For a defined benefit arrangement (also known as a 'final salary' arrangement), the pension savings are equal to the pension input amount (the amount HMRC test against the Annual Allowance) for the year - broadly 16 times the new pension accrued over the year, net of an allowance for inflation.

The definition of 'threshold income'

For some individuals, the reduced Annual Allowance will not apply, even if their adjusted income is above £260,000. If your 'threshold income' is less than £200,000 then your Annual Allowance, from 6 April 2023, will be £60,000 regardless of your adjusted income. 'Threshold income' is broadly equal to your taxable income, excluding the value of pension savings and deducting any member contributions with ‘relief at source’, such as to a personal pension, but adding back any employment income given up in the tax year for pension provision as a result of any salary sacrifice entered into on or after 9 July 2015.

The above is a summary. For full details on how to accurately determine your 'threshold income' and 'adjusted income' please see HMRC guidance here.



Money Purchase Annual Allowance

Please also note that the standard Annual Allowance may be reduced if you have “flexibly accessed” any money purchase funds from any of your pension arrangements on or after 6 April 2015.

Once members were given the ability to access their pension savings flexibly (from 6 April 2015), a money purchase annual allowance (MPAA) was introduced for those members who accessed their savings and wished to continue making further contributions to a money purchase pension, limiting the tax-relief available on these contributions. The MPAA will increase to £10,000 with effect from 6 April 2023. It has been £4,000 since 6 April 2017.

What happens if you exceed the Annual Allowance?

If you exceed the Annual Allowance plus any unused allowances from the three previous tax years you will have to pay an additional tax charge. The tax charge is calculated by adding the amount by which you have exceeded the Annual Allowance (allowing for unused allowances from the three previous years) to your other taxable income - tax will then apply depending on what tax band the excess amount falls into.

You will need to complete your self-assessment tax return to accurately determine whether you are subject to an Annual Allowance tax charge**.** HMRC's guidance on how to do this can be found here**.**

Member example (money purchase)

Anne's basic salary is currently £260,000 and she has no other source of income. Anne pays 5% of her basic salary into her DC occupational pension scheme (which reduces her taxable earnings as it operates ‘net pay’ rather than ‘relief at source’) and her employer pays 15%.

Annual Allowance from 2023/24

Anne's pension savings over the tax year were £52,000, of which she paid £13,000 and her employer paid £39,000. Her taxable income was therefore £247,000 and above the £200,000 threshold, meaning the reduced Annual Allowance applies to her.

Her adjusted income for assessing the Annual Allowance is taken to be her taxable earnings (£247,000) plus the value of her pension savings over the year (£52,000) - i.e. £299,000.

As her adjusted income exceeds £260,000 by £39,000, her Annual Allowance will be reduced by 50% of this - i.e. £60,000 - 50% x £39,000 = £40,500. So, Anne had pension savings of £52,000 but an Annual Allowance of only £40,500.

This means that she will have exceeded her reduced Annual Allowance by £11,500 and will be subject to an Annual Allowance charge of £5,175 (based on a marginal tax rate of 45% and assuming that she has no carry-forward available).

Scheme Pays

In certain circumstances, a pension scheme is obliged to pay the Annual Allowance tax charge on behalf of an individual, this is known as Mandatory Scheme Pays. If an individual does not have a right to Mandatory Scheme Pays, many pension schemes offer what is known as Voluntary Scheme Pays. A pension scheme may set its own criteria for when Voluntary Scheme Pays can be used.

If a pension scheme pays an individual’s tax charge on their behalf, the individual's benefits in that scheme would be reduced to reflect the scheme pays payment.

Finding out more

The tax changes – you can find more details of the current rules on the HM Revenue & Customs website at https://www.gov.uk/tax-on-your-private-pension/pension-tax-relief

and the proposed changes here:

https://www.gov.uk/government/publications/abolition-of-lifetime-allowance-and-increases-to-pension-tax-limits/pension-tax-limits

Your pension benefits – any questions regarding your pension benefits should be directed to your usual pension contact.

Getting advice – If you do not currently have an IFA, there is information on how to find one on the MoneyHelper website. There is also a directory of IFAs who are regulated by the Financial Conduct Authority. Go to www.moneyhelper.org.uk and search for ‘Find a retirement adviser’

You can also check the details of any IFA you are thinking of using on the Financial Conduct Authority website at https://register.fca.org.uk/. Alternatively, phone their contact centre on 0800 111 6768 and ask them to check for you.

Remember that you may have to pay a charge for any advice that you receive.

Aon holds no responsibility for any information provided on or via any weblink or telephone number referred to in this document.