

Lifetime Allowance

What could the further reduction mean to your retirement income?

The Government has introduced comprehensive reforms to the pension rules over the previous few years. One important change, which may have been overlooked by some savers, is the reduction of the Lifetime Allowance that applies to pension savings. This further reduction means that you may be affected.

Your private pension contributions are tax-free up to certain limits. This applies to most private pension schemes, for example, workplace pensions, personal and stakeholder pensions, and overseas pension schemes that qualify for UK tax relief. The Lifetime Allowance is a limit on the value of payouts from your pension schemes – whether lump sums or retirement income – that can be made without triggering an extra tax charge.

INFLATIONARY INCREASES

The Government has indicated that this allowance will increase each year in line with inflation (CPI) but only from 6 April 2018. It was reduced from £1.25m down to £1m from 6 April 2016. If you have more than £1m in your pension pot, you can apply to protect it against reductions to the Lifetime Allowance.

TAKING ACTION

Whilst some people may not be affected by the Lifetime Allowance, it's important to take action if the value of your pension benefits are approaching, or are above, the Lifetime Allowance. As pensions are a long-term commitment, what might appear modest today could exceed the Lifetime Allowance by the time you want to take your benefits.

TAX CONSEQUENCES

Exceeding the Lifetime Allowance could have significant tax consequences, for example, any lump sum withdrawals you take from the excess amount within your pension are taxed at 55%, and if you retain the excess amount within your pension fund a 25% tax charge is made (and any income taken from the fund will be taxed at your marginal rate of Income Tax).

PROTECTION BENEFITS

If you could be affected by the reduction in the Lifetime Allowance, there are some actions you could take to help protect yourself from this potential tax charge.

When the Lifetime Allowance was introduced in 2006 (and in subsequent years when it has been reduced), following pension reforms, those with benefits valued in excess of the Lifetime Allowance have been able to apply for 'protection' to protect the value of benefits they have built up (and future benefits that may accrue) from tax charges.

If you have accrued pension benefits since 6 April 2016, Fixed Protection will not be available, so you should obtain professional financial advice to look at the options available to you.

TAKING BENEFITS

If you are already taking benefits from a pension, this will also impact your Lifetime Allowance. It is important to note that the allowance applies to the value of your pension when you eventually come to draw money from it (and not the value on 6 April 2016). This means that even if your pensions are currently worth well short of the new £1m limit, you could still be affected by the reduction and may need to take action now – even if you think the reduction does not really affect you currently. ■

WILL YOU BE SUBJECT TO THE LIFETIME ALLOWANCE TAX CHARGE?

While £1m may sound like a generous sum, it is surprisingly easy to breach this limit, meaning that you could be subjected to a tax bill of up to 55% on some of your pension pot. Whether you're a saver in the middle of your working life or nearing retirement, it's crucial you know if you're on track to breaching the Lifetime Allowance. If you have any concerns and would like to discuss your situation, please contact us.