

# Will your pension be hit by the lifetime allowance?

## LIFETIME ALLOWANCE

Since 6 April 2006 the government has restricted the tax-breaks on pensions by applying a 'lifetime allowance' (LTA). If the combined value of your pensions exceeds this allowance you could face tax charges you weren't anticipating.

### IN THIS GUIDE WE COVER:

---

- **Who is affected**
- **How to calculate the value of your pensions**
- **What steps those affected can take to minimise tax bills**



### **What is the lifetime allowance?**

---

This is the total amount you can build up in pension benefits over your lifetime that will enjoy full tax benefits. If you go over the allowance you will generally pay a tax charge on the excess when you take a lump sum or income from your pension pot, transfer overseas or reach age 75 with unused pension benefits. The lifetime allowance includes both company and private pensions, such as SPPs and final salary pensions. It doesn't include the value of your state pension though.

### **How much can I have in a pension?**

---

For the current tax year the lifetime allowance is £1,073,100.

### **Will my pensions exceed the lifetime allowance?**

---

If you have a generous workplace pension or have saved significant amounts into personal pensions, it is worth checking the value of these pensions against the LTA to ensure you don't go over this limit.

This isn't always straightforward as the method used to determine the value of your pensions depends upon the type of pension arrangements you have and whether they are paying out yet or not.

### Defined Contribution (DC) pension

This type of pension is often built up from personal and employer contributions that are invested over your lifetime to provide a pot of money for retirement.

Here you just need the total fund value, which can be found on your annual statement (you may wish to get an update depending on how old your statement is).

If you have more than one DC pension you need to add these totals together.

Remember it is the size of the pension fund, not just the contributions you or your employer have made that is relevant for the LTA, so this includes investment growth.

### Defined Benefit (DB) pension

With these pensions, your retirement income is based on salary, and the length of time you worked for your employer. Rather than showing a 'fund value', your annual statement shows the pension you are on track to receive at retirement.

For LTA purposes you need to multiply this annual pension by 20 to get the theoretical 'fund value'. So those on track for a pension of £18,000 a year, would be deemed to have a fund worth £360,000 (18x20).

Many final salary schemes also pay a tax-free lump sum, this needs to be added as well.

### Pensions already paying out

If you have started taking an income from a DC or DB pension since the LTA was introduced on 6 April 2006, you should have been assessed already. Your provider will be able to confirm the figure that was calculated.

If you were already in receipt of a pension before 6 April 2006, but have continued to save into another pension since then, different rules apply:

- For final salary (DB) pensions the calculation is 25 times your current annual pension.
- For drawdown pensions the calculation is 80% of 25 times your current annual drawdown limit. ('Drawdown' or 'income drawdown' is where you take income or tax-free cash from your pension and keep the remaining pot invested.)

## Important information

The value of investments and the income from them can go down as well as up so you may get back less than you invest. Tax treatment depends on individual circumstances and all tax rules may change in the future. Withdrawals from a pension product will not normally be possible until you reach age 55.

This information is not a personal recommendation for any particular investment. If you are unsure about the suitability of an investment you should speak to an authorised financial adviser.



## When does the LTA come into force?

Neither the tax authorities, nor your pension providers, are checking the value of your pensions against the LTA on a daily basis. Don't expect a warning letter as you approach this limit as it's your responsibility to check.

### But your pension funds ARE tested against the LTA at key dates:

- From the age of 55 you are now free to cash in or access part, or all, of your pension. Once you take a lump sum or income from your pension it is tested against the LTA. At this stage it's important to know that it is the TOTAL value of the pension that you ACCESS that is assessed against the LTA, not your total fund value. For example, if you have a pension fund worth £100,000 and wish to take the tax-free cash sum of £25,000, you will need to access the full £100,000 which will use up 9.31% of your LTA (based on an LTA of £1,073,100). However, if you wanted to take a lump sum from your pension of say £25,000 where 25% (£6,250) would typically represent the tax-free cash sum and 75% (£18,750) would typically represent taxable income, as only £25,000 in total is being accessed, you will only use up 2.32% of your LTA at that time.
- On your 75th birthday, any pensions you've not cashed in or accessed are tested against the LTA. In addition, any existing drawdown pensions will be re-tested against their original value.
- If you die before the age of 75 any untouched pensions will be tested against the LTA to ensure this limit has not been breached.
- If you transfer some, or all, of your pension into a 'Qualifying Recognised Overseas Pension Scheme' before the age of 75, only the value of the funds transferred are tested against the LTA.

## How much tax will I pay out?

If, when tested, the value of your pension exceeds the LTA you'll face a tax charge on the amount that is over the limit. The exact charge will depend on how this excess is paid out.

- If the excess is paid out as lump sum it is subject to a 55% tax charge.
- If it is paid in the form of a pension income, this 'excess' is subject to a 25% tax charge, in addition to the income tax charged on this pension. Remember taking this excess as income, on top of other earnings/pension income, can push you into the next tax bracket.

You can still put money into a pension once you exceed the LTA limit, but will face tax charges on this excess.

## My pension could exceed the LTA. What do I do next?

Each time the government has reduced the LTA, it has set up various 'protection schemes' to safeguard those in this position.

There are a number of schemes in place, but in essence these give savers their own personal LTA. The exact amount will depend on the value of their pensions when these new rules came into force and the protection they applied for. Savers have to apply to get this protection. If you don't you could be hit with tax charges.

You need to look at the terms carefully as in some cases you may not be able to make further pension contributions if you want to protect this higher LTA. This may require certain actions on the part of you, the individual.

## What are my options?

**On 6 April 2016 the government introduced two new forms of protection.**

### Fixed Protection 2016

This gives you a LTA of £1.25m, or the current LTA, whichever is higher.

This effectively allows you to lock your LTA into the higher rate, but also means that if the current LTA increases to more than £1.25m in the future you will not be disadvantaged.

However, for this to be valid you cannot have made further pension contributions or actively accrued further pension benefits in a final salary pension scheme, on or after 6 April 2016.

### Individual Protection 2016

This gives you a personal LTA equal to the value of your pensions on 5 April 2016, the day before the lower allowance was introduced, subject to a maximum of £1.25m.

The value of your pensions must have been in excess of £1m on 5 April 2016 to qualify. Unlike Fixed Protection you can continue to make contributions, but any pension in excess of the relevant LTA will be taxed when tested.

## How do I apply for the protection?

The application process is online at [www.gov.uk/guidance/pension-schemes-protect-your-lifetime-allowance](https://www.gov.uk/guidance/pension-schemes-protect-your-lifetime-allowance). If you are unable to use the online service you can contact the HMRC Pensions helpline for applications. There will be no application deadline for these protections, however, to rely on the relevant protection, you must have applied and received a reference number from HMRC before your pension is tested against the LTA and must have adhered to the relevant conditions. This applies even when the benefits being taken are worth less than £1,073,100. A guide on how to value your pensions for Individual Protection 2016 is also available from HMRC. <https://www.gov.uk/guidance/pension-schemes-value-your-pension-for-lifetime-allowance-protection>

**This is a complex area. If you think your pensions are likely to exceed this limit we'd encourage you to speak to a financial adviser or seek specialist tax advice.**

## Think about the future

If you are still several years from retirement, think about how these funds might grow in the future and whether that means they could exceed the LTA. If so you may want to consider limiting future contributions, although be aware that this may mean losing valuable employer contributions.

# HOW CAN FIDELITY HELP?

---



Just call our

Workplace Investing Service Centre on **0800 368 6873**

## Guidance from the government: Pension Wise

The government offers a free and impartial guidance service to help you understand your options at retirement. This is available via the web, telephone or face-to-face through government approved organisations, such as The Pensions Advisory Service and the Citizens Advice Bureau. You can find out more by going to **pensionwise.gov.uk** or by calling Pension Wise on **0800 138 3944**.





## Workplace Investing

