Tax limits – Lifetime Allowance

This guide provides you with information about the Lifetime Allowance. This tax limit could potentially affect anyone who saves towards their retirement but is most likely to affect those with relatively high levels of pensionable pay and long periods of service in their pension schemes. This is only a broad summary of pension taxation law. Any requirement for you to pay tax charges on pension savings is governed by legislation, not this or other leaflets.

In this guide you will find more information about:

What the Lifetime Allowance is

You can save as much as you like towards your pension, but there is a limit on the amount of pension savings you can build up before you pay extra tax. This limit is known as your 'Lifetime Allowance' (LTA). If you build up pension savings worth more than the LTA you must pay a tax charge on the excess. Information on what tax would be payable on the excess is shown later in this guidance.

The LTA is set at £1,073,100 for the 2020/21 tax year and will increase every tax year in line with inflation (using the Consumer Prices Index from the previous September). However, the government may decide to change these limits and/or the way they are calculated in the future.

Further details about the LTA can be found on the HM Revenue & Customs (HMRC) website at: https://gov.uk/tax-on-your-private-pension/lifetime-allowance

How the Lifetime Allowance affects you

The test against the LTA is usually carried out when you retire, based on the actual benefits paid to you.

The LTA of £1,073,100 is effectively equivalent to:

- An annual pension at retirement of £53,655, if no cash lump sum is taken; or
- A maximum cash lump sum of £268,275 and an annual pension of £40,241.25.

If your pension savings are worth more than the LTA when you retire, then you must pay a tax charge on the excess savings above the LTA.

Further details of when benefits will be checked against the LTA can be found at:
https://gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm088100

How to check your pension savings against the Lifetime Allowance

The way any pension savings are valued against the LTA will depend on the type of pension arrangement you are a member of. There are two main types of pension arrangements available:

- Defined benefit (also known as 'final salary' or 'career average'); and
- Defined contribution (also known as 'money purchase')

For defined benefit arrangements (such as the Shared Cost sections of the Railways Pension Scheme and the British Transport Police Force Superannuation Fund) the amount of LTA used is worked out using both your pension and any lump sum amounts. It is based on:

- 20 times the value of your yearly pension; plus
- the amount of any lump sum.

For defined contribution arrangements (such as the Industry-Wide Defined Contribution section of the Railways Pension Scheme), the value of your Personal Retirement Account is tested against the LTA at the time you take your benefits.

Benefits that you build up in all of your pension arrangements will be used to work out how much of the LTA you have used up. Calculations will be performed separately at the time the benefits become payable from each of your arrangements.

Therefore, you will need to take account of any other pension arrangements you may have in addition to your membership of the Railways Pension Scheme and the British Transport Police Force Superannuation Fund.

Example – working out the Lifetime Allowance in a defined benefit arrangement

Someone whose benefits are now payable may work out how much allowance is used like this:

Benefit details from the Scheme or Fund	
Pension a year	£20,000
Lump sum	£35,000
BRASS funds	£12,000
Lifetime Allowance limit (2020/2021)	£1,073,100
Lifetime Allowance used is worked out as:	
Pension x 20 (£20,000 x 20)	£400,000
plus Lump sum and BRASS funds	+ £47,000
Lifetime Allowance used =	£447,000
Percentage Lifetime Allowance used =	41.66%
(Lifetime Allowance used ÷ Lifetime Allowance limit) x 100	
(£447,000 ÷ £1,073,100) x 100	
Benefit details from a previous pension arrangement or another Section of the Railways Pension Scheme	
Pension a year	£10,000
Lump sum	£30,000
Lifetime Allowance used is worked out as:	
Pension x 20 (£10,000 x 20)	£200,000
plus Lump sum	+ £30,000
Lifetime Allowance used =	£230,000
Percentage Lifetime Allowance used =	21.44%
(Lifetime Allowance used ÷ Lifetime Allowance limit) x 100	
(£230,000 ÷ £1,073,100) x 100	
Lifetime Allowance left for other pension benefits	
Total Lifetime Allowance available	100.00%
less amount used by benefits from the Scheme	-41.66%
less amount used by a previous pension arrangement	-21.44%
Percentage Lifetime Allowance left for other pension benefits =	36.90%

If you do exceed the Lifetime Allowance (LTA), then the excess pension saving is subject to a tax charge (the LTA charge). This is typically 55% of the excess pension savings if the excess is taken as a lump sum and 25% if it is taken in the form of pension (as income tax will also be paid on the pension instalments). An example in the later section outlines how this operates in practice.

Important note

In a defined benefit arrangement, the amounts measured against the LTA are the actual benefits taken. Therefore, if the value of your accrued benefits is greater than the LTA, this does not necessarily mean that you will exceed the LTA because:

- If you retire early, any reduction for early payment will reduce the value of benefits for LTA purposes; and
- Any conversion of pension benefits to cash at retirement will reduce the value of your benefits for LTA purposes (provided that the factor used for conversion is below 20).

However, under the government's current plans for increasing the LTA in future tax years, the impact of price inflation and pay inflation may erode the value of the LTA in 'real terms' if your date of retirement is in the future.

Therefore, when considering how the value of your pension savings may compare to the LTA, you will need to consider:

- When you expect to take your benefits;
- How your accrued benefits will increase between now and then, which in turn will require you to make estimates of aspects such as your future salary inflation; and
- Any impact of early retirement factors and conversion of pension benefits to cash at retirement (or vice versa).

Protection of your Lifetime Allowance

Many people will not have pension savings worth more than the Lifetime Allowance (LTA). However, if you do, or if you are at risk of exceeding the limit by the time you come to take your benefits, there are certain LTA protections that you should be aware of.

There are different forms of protection, some of which you are still able to apply for. Most of the protections are now historic, but are listed here for reference.

Protection that applies from 6 April 2016

The government made two types of transitional protection available for people as part of the reduction in the LTA on 6 April 2016 (from £1.25 million to £1 million), to ensure that the change was not retrospective. These are Fixed Protection 2016 and Individual Protection 2016.

To apply for either of these protections you will need to create an account for HM Revenue & Customs' (HMRC) online services (if you don't already have one) and then complete HMRC's online application form at gov.uk/guidance/pension-schemes-protect-your-lifetime-allowance.

Fixed Protection 2016

'Fixed Protection 2016' will allow someone to retain a LTA of £1.25 million after 5 April 2016 and works in a similar way to the previous forms of fixed protection (see below). In particular, one of the requirements for Fixed Protection 2016 is that no further pension savings are made by, or on behalf of, that person after 5 April 2016. Therefore, if you intend to apply for Fixed Protection 2016, you must have provided an opt-out notice to the Railways Pension Scheme or British Transport Police Superannuation Fund no later than 28 February 2016 if you had been an active member, in order to ensure that no further pension savings were made after 5 April 2016.

Individual Protection 2016

'Individual Protection 2016' will give someone a personalised LTA amount equal to the value of their pension savings at 5 April 2016, subject to an overall maximum of £1.25 million. If you are granted Individual Protection 2016, then you will be allowed to make further savings into your pension scheme after 6 April 2016, but any pension savings in excess of your protected LTA will be subject to a LTA charge.

Historic protections

Primary Protection

'Primary Protection' gives you an increased LTA, which means you can have more pension savings without paying the LTA charge. You can only have Primary Protection if you had built up pension savings of more than £1.5 million before 6 April 2006. To benefit from Primary Protection, you needed to have applied for it before 6 April 2009.

Enhanced Protection

If you have 'Enhanced Protection' you won't have to pay a LTA charge, but there are restrictions on what you can do with your pension savings after 6 April 2006. To benefit from Enhanced Protection, you needed to have applied for it before 6 April 2009.

Fixed Protection 2012

'Fixed Protection 2012' was introduced when the LTA was reduced from £1.8 million to £1.5 million from 6 April 2012. People with Fixed Protection 2012 have a protected LTA of £1.8 million but cannot:

- make any further contributions to a money purchase arrangement after 5 April 2012; and/or
- increase their benefits in a defined benefit arrangement above a prescribed percentage.

This means that, normally, people had to opt-out of active membership of any registered pension scheme by April 2012 if they want to maintain Fixed Protection 2012. Where Fixed Protection 2012 is lost, a person reverts back to the standard LTA. You had to apply before 6 April 2012 to get Fixed Protection 2012.

Individual Protection 2014

When the LTA was reduced from £1.5 million to £1.25 million from 6 April 2014, the government introduced a form of protection called 'Individual Protection 2014'. Individual Protection 2014 gives people a protected LTA equal to the value of their pension savings on 5 April 2014, subject to an overall maximum of £1.5 million.

Unlike some other forms of protection, you will not lose Individual Protection 2014 by making further savings in your pension scheme, but any pension savings in excess of your protected LTA will be subject to a LTA charge. To benefit from Individual Protection 2014, you had to apply for it before 5 April 2017.

Fixed Protection 2014

When the LTA was reduced from £1.5 million to £1.25 million from 6 April 2014, as well as introducing Individual Protection 2014 (see above), the government introduced 'Fixed Protection 2014'. Fixed Protection 2014 works in a similar way to Fixed Protection 2012 but gives people a protected LTA of £1.5 million from 6 April 2014.

To benefit from Fixed Protection 2014, you had to have applied for it before 6 April 2014 and you will have needed to opt-out of active membership of any registered pension schemes with effect from 6 April 2014 if you wish to maintain it.

How your benefits can be treated if you exceed the Lifetime Allowance

If you do exceed the Lifetime Allowance (LTA), then the excess pension saving is subject to a tax charge (the LTA charge). This is typically 55% of the excess pension savings if the excess is taken as a lump sum and 25% if it is taken in the form of pension (as income tax will also be paid on the pension instalments).

The following example shows how the excess pension savings are calculated, considering firstly if the excess is taken as cash (option 1) and secondly if it is taken as a pension (option 2). In practice, the excess could be taken as a mixture of both cash and pension.

Benefit details from the Scheme (before any Lifetime Allowance charge)	
Pension per year	£50,000
Lump sum	£80,000
BRASS funds	£200,000
Lifetime Allowance (2020/2021)	£1,073,100
The value of benefits measured against the Lifetime Allowance is worked out as:	
Pension x 20 (£50,000 x 20) =	£1,000,000
plus Lump sum and BRASS funds =	+ £280,000
Lifetime Allowance used:	£1,280,000
Amount in excess of the Lifetime Allowance (£1,280,000 - £1,073,100) =	£206,900
Benefits payable within the Lifetime Allowance – assuming the member opts to take the maximum tax-free lump sum	
Maximum tax-free lump sum is worked out as:	
25% x £1,073,100 (Lifetime Allowance) =	£268,275
Pension per year is worked out as:	
Remaining amount under the Lifetime Allowance / 20 =	
(£1,073,100 - £268,275) / 20 =	£40,241.25
Excess benefits before any Lifetime Allowance charge	
Pension per year (£50,000 - £40,241.25) =	£9,758.75
BRASS funds =	£0
Lump sum (£80,000 – (£268,275 - £200,000)) =	£11,725
Option 1: Excess benefits taken as cash	
Scheme commutation factor[1]	12:1
Chargeable amount (using Scheme commutation factor):	
£9,758.75 x 12 + £11,725 =	£128,830
Lifetime Allowance charge (55% x £128,830) =	£70,856.50
Net lump sum payable to member (£128,830 - £70,856.50) =	£57,973.50
Total benefits payable to member:	
Pension per year	**£40,241.25**
Lump sum (£268,275 + £57,973.50)	**£326,248.50**

Option 2: Excess benefits taken as pension	
Pension per year before tax charge (using Scheme commutation factor): £9,758.75 + (£11,725 / 12) =	£10,735.83
Value of pension for Lifetime Allowance charge purposes (£10,735.83 x 20) =	£214,716.60
Total Lifetime Allowance charge (25% x £214,716.60) =	£53,679.15
Lifetime Allowance charge as deduction to annual pension (£53,679.15 / 12) =	£4,473.26
Pension per year payable to member (£10,735.83 - £4,473.26) =	£6,262.57
Total benefits payable to member:	
Pension per year (£40,241.25 + £6,262.57)**:**	**£46,503.82**
Lump sum:	**£268,275**

[1] For this example, it has been assumed that a factor of 12:1 is used to convert cash lump sum to Scheme pension and vice-versa (i.e. £12 of cash can be converted to £1 per year of Scheme pension and vice-versa)

Both RPMI and you will be 'jointly and severally liable' for any Lifetime Allowance charge. This means that RPMI will pay HMRC the tax, but you will have to report this amount in your Self Assessment tax return.

More information

If you are considering applying for a LTA protection, it is strongly recommended that you consult an independent financial adviser regulated by the Financial Conduct Authority. Details of independent financial advisers in your local area can be found at unbiased.co.uk