Tax limits – Lump Sum Allowances

This guide explains the Lump Sum Allowances available from 6 April 2024. These could affect anyone saving towards their retirement. But they are most likely to affect those with relatively high levels of pensionable pay and long periods of service in their pension schemes.

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These are the new Lump Sum Allowances

Before 6 April 2024 there was a limit on the amount of pension savings you could build up before you paid extra tax. This limit was known as the Lifetime Allowance (LTA) and was £1,073,100 for the 2023/2024 tax year. There was a LTA tax charge to pay on any pension savings that were over the LTA. You can read more about the LTA in the 'Lifetime Allowance tax limits' guide.

In the Spring Budget 2023, the government announced the removal of the LTA charge, on pension savings built up in excess of the LTA, from 6 April 2023 before abolishing the LTA altogether from 6 April 2024.

From 6 April 2024 there is no limit on the amount of pension savings you can build up. However, three new lump sum allowances have been introduced:

- **The Lump Sum Allowance (LSA)** - For most people this limits the tax-free cash or lump sum you can receive from all your pensions to £268,275 (the amount being the same as 25% of the LTA at abolition)

- **The Lump Sum and Death Benefits Allowance (LSDBA)** - A limit on the total amount of tax-free cash you can get in your lifetime and that can be paid when you die of £1,073,100 (i.e. the LTA at abolition), in most cases

- **Overseas Transfer Allowance (OTA)** - This only applies to transfers out to a Qualifying Recognised Overseas Pension Scheme. The OTA limit will be the same as the LSDBA (i.e. £1,073,100 for most people).

Your benefits will normally be tested against the LSA and LSDBA when you become entitled to a pension lump sum or if a lump sum death benefit is paid in respect of your membership. You may be able to take a bigger lump sum, but you will pay tax on any excess.

Benefits that exceed the LSA or the LSDB are subject to income tax at the recipient's marginal rate, as are the 'income' parts of any benefits taken, such as an annual pension, annuity or income taken from a drawdown plan.

The marginal rate of income tax means the amount being paid out is added to your income and taxed accordingly. For example, if you earn £50,000 your marginal rate of tax is 40%. This is because, for the next pound that you earn, you will be paying tax at 40%.

If you have an LTA protection, you may have higher allowances than those set out above.

The Lump Sum Allowance (LSA)

The LSA is a limit on the amount of tax-free lump sum you can receive from all your pension arrangements. A lump sum paid under this allowance is most commonly a Pension Commencement Lump Sum (PCLS).

The standard LSA is £268,275. This allowance is reduced by the value of any “relevant lump sum” paid to you. For example, any previous PCLS paid when taking a pension are taken into account when working out your available LSA.

When you claim your pension benefits, you will normally be able to take a lump sum payment, often referred to as a PCLS. The maximum tax-free lump sum when you take your benefits is the lower of:

- the LSA (£268,275) minus previous relevant lump sums received; or
- 25% of the value of the benefits coming into payment

In a defined benefit arrangement, such as those in the Railways Pension Scheme or the British Transport Police Force Superannuation Fund, the “value of the benefits coming into payment” is 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 amount is your fund value when you take your benefits.

The most you can take as a tax-free lump sum from all of your pension arrangements is £268,275. If the only pension arrangement you are a member of is the railways pension schemes, you only need to consider whether the total tax-free lump sum you want to take from all of your RPS pension benefits is more than the LSA. If all your pension lump sums you receive are below the LSA, these will be paid tax-free.

If you have an LTA protection, you may have a higher LSA.

Example 1 – How it works for a Defined Benefit member

Amy retires on 1 June 2024 and has not taken any other pension benefits at this date.

Amy requests a lump sum of £85,000, with an annual pension of £13,491.68.

The maximum tax-free lump sum, also called the PCLS, that can be paid as part of her retirement is the lower of:

- the LSA minus previous lump sums; or
- 25% of the value of the benefits coming into payment

Amy does not have any Lifetime Allowance protections in place. This means that the Standard LSA of £268,275 applies.

25% of the value of the benefits* coming into payment is calculated as follows:

((£13,491.68 x 20) + £85,000.00) x 0.25 = £88,708.40

*To calculate the overall value of a DB annual pension it is multiplied by 20, plus the amount of any lump sum.

Amy’s maximum PCLS for this retirement is therefore £88,708.40, as this is the lower amount.

As Amy’s requested lump sum is lower than the maximum PCLS, there is no tax charge and the £85,000 will be paid tax-free.

Example 2 – How it works for a Defined Contribution member

Andrew retires on 1 June 2024 and has not taken any other pension benefits at this date.

His Personal Retirement Account is valued at £500,000 and he wants to take £100,000 as a lump sum.

The maximum PCLS that can be paid as part of the retirement is the lower of:

- the LSA minus previous lump sums; or
- 25% of the value of the benefits coming into payment

Andrew does not have any Lifetime Allowance protections in place. This means that the Standard LSA of £268,275 applies.

25% of the value of the benefits coming into payment is calculated as follows:

£500,000 x 0.25 = £125,000

Andrew's maximum PCLS for this retirement is therefore £125,000, as this is the lower amount.

As the lump sum requested is lower than the maximum PCLS, there is no tax charge and the £100,000 will paid tax-free.

What happens if your lump sum exceeds your LSA?

Any amount of lump sum paid in excess of the available LSA will be taxable like any other income. Visit gov.uk for more information on tax.

Example 3 – LSA exceeded

Sarah retires on 30 October 2024.

Sarah requests a lump sum of £150,000 (25% of the value of the benefits coming into payment) and an annual pension of £25,000.

She has already taken benefits from other pension arrangements, after 5 April 2024, with tax-free lump sums totalling £200,000.

Sarah does not have any Lifetime Allowance protections in place. This means that the Standard LSA of £268,275 applies.

Sarah's available LSA for this retirement is therefore £68,275 (£268,275 - £200,000).

As the lump sum being paid is greater than the available LSA, either the lump sum will need to be restricted (with a higher pension payable) or the excess lump sum will be taxed. If Sarah decides to take the excess as a lump sum, the lump sum will need to be split into two separate payments:

- A PCLS of £68,275, which is the maximum amount of tax-free lump sum that can be paid to Sarah; and
- A Pension Commencement Excess Lump Sum (PCELS) of £81,725, which is the taxable amount of lump sum being paid in excess of the available LSA (£150,000 – £68,275).

The tax charge will be calculated based on the Sarah's marginal rate of income tax; if this is unknown at the point the payment is made, the emergency tax code will be used (currently 1257L wk1/month1). Sarah could claim any overpaid tax back from HM Revenue and Customs (HMRC) or arrange to pay any underpaid tax to HMRC.

In other scenarios, it may not be possible for a PCELS to be payable, in which case any proposed lump sum in excess of the PCLS would be converted to pension.

2. Transitional rules – where you have taken benefits before 6 April 2024

If you have already taken some of your pension benefits before 6 April 2024 there will be two possible methods of calculating the available LSA when you take a relevant lump sum on or after 6 April 2024.

The standard transitional calculation

By default, we have to assume you took 25% of the LTA used up before 6 April 2024 as a tax-free lump sum. This amount will be deducted from your LSA.

For example, if someone has used 60% of their LTA before 6 April 2024, their available LSA will be reduced by £160,965 (25% of £1,073,100 x 0.6) to £107,310 (£268,275 – £160,965).

Example 4 – standard transitional calculation

George retires on 8 August 2024 and requests a lump sum of £50,000.

George does not have any Lifetime Allowance protection in place. This means that the Standard Lump Sum Allowance of £268,275 applies.

He has already claimed a pension from another provider on 20 September 2023 which accounted for 85% of his LTA.

Therefore, under the standard transitional calculation, his available LSA is reduced by 25% of the value of the LTA he has already used (£1,073,100 x 85% = £912,135, and 25% of £912,135 = £228,033.75).

The available LSA to him is £40,241.25 (£268,275 less £228,033.75).

As the lump sum being paid is greater than the available LSA, a tax charge is applicable. The lump sum will need to be split into two separate payments:

- A PCLS of £40,241.25 which will be payable tax-free, and
- A PCELS of £9,758.75, which is the taxable amount of lump sum being paid in excess of the available LSA (£50,000 – £40,241.25).

The tax charge will be calculated based on George’s marginal rate of income tax.

The transitional calculation with a transitional tax-free amount certificate

George could also ask any scheme of which he is a member to provide a transitional tax-free amount certificate. This certificate confirms his “lump sum transitional tax-free amount”. This is the total of any relevant lump sum they took before 6 April 2024.

This will give George a “bespoke” reduction to his LSA, based on his actual circumstances, rather than the standard calculation (25%) under the standard approach.

If someone has used some of their LTA before 6 April 2024, but has a transitional tax-free amount certificate which shows they took no lump sum under the transitional method, they would still have the full £268,275 LSA available.

Example 5 – transitional calculation with a transitional tax-free amount certificate

This is the same scenario as example 4, but this time George has applied for and received a transitional tax free amount certificate which certifies he actually received a lump sum of £100,000, not the £228,033.75 assumed under the default transitional calculation method, when he took his pension benefits in September 2023.

In this example his available LSA is £168,275 (£268,275 less £100,000).

Therefore, his Lump Sum Allowance is enough for him to receive the £50,000 lump sum tax-free.

Transitional tax-free amount certificates

Most members won't need to apply for a transitional tax-free amount certificate. The standard calculation will normally accurately reflect the tax-free lump sums they have taken prior to 6 April 2024.

However, it may be beneficial if you have used less of your available LTA as tax-free lump sums than under the standard calculation — for instance you did not take your maximum PCLS and you are close to your LSA.

An individual, or their personal representatives if the individual has died, may apply for a certificate to any registered pension scheme of which they are a member.

Complete evidence about previous benefits taken must be submitted when applying for a tax-free transitional certificate. The application can be refused without it. Complete evidence must always account for the total amount of LTA used so that a scheme administrator can determine the portion of the pension benefits that were taken as tax-free lump sums.

It's important to note that you would need to apply and receive the certificate before you take your first relevant lump sum on or after 6 April 2024.

When a scheme receives an application, they must either issue a certificate or provide the applicant a notice of refusal within three months of receiving the application.

HMRC have confirmed they will publish guidance on the transitional tax-free amount certificates for members on Gov.uk once these changes are finalised.

The Lump Sum Death Benefit Allowance (LSDBA)

This is the limit on the tax-free lump sum that can be paid to, or in respect of, a member of a pension scheme. If the value of lump sum death benefits means that the LSDBA will be exceeded, the excess will be taxed at the marginal rate of income tax of the person receiving it.

The standard LSDBA is £1,073,100. This is the maximum amount of tax-free lump sum that can be paid in life and death, to or in respect of an individual.

If you have an LTA protection, you may have a higher LSDBA.

The tax-free lump sums tested against the LSDBA include:

1. Any PCLS amounts paid.

2. Any serious ill-health lump sum paid (payable to an individual with a life expectancy less than 12 months).

3. Any uncrystallised funds pension lump sum from a Defined Contribution pension scheme.

4. Any defined benefit lump sum death benefits paid.

If all pension lump sums paid to you, or in respect of you, are below the LSDBA then these will normally be paid tax free.

There will be some people that have had pension benefits paid prior to 6 April 2024. These people will need to rely on transitional rules to calculate their LSDBA availability from 6 April 2024.

How Lifetime Allowance protections affect the allowances

Although the LTA no longer applies from 6 April 2024, the various forms of LTA protection can often protect the amount of tax-free cash that can be paid to, or on behalf of, an individual.

There are different forms of protections:

Primary Protection

You can only have Primary Protection if you 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.

If you have primary protection, but no separate lump sum protection, your LSA will be £375,000 and your LSDBA will be £1,800,000. If applicable, these will be subject to the transitional LSA and LSDBA arrangements.

Enhanced Protection

You could claim enhanced protection regardless of the value of your pension rights at 5 April 2006. To benefit from enhanced protection, you needed to have applied for it before 6 April 2009.

If you have enhanced protection, but no separate lump sum protection, the initial LSA will be £375,000 and, if applicable, will be subject to the transitional lump sum allowance calculations. If you have enhanced protection and additional lump sum protection of £375,000 or over you will not be subject to the transitional LSA calculation.

For those with enhanced protection their LSDBA will be an amount equal to the value of their uncrystallised pension rights on 5 April 2024.

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.

If you have fixed protection 2012, your LSA will be £450,000 and your LSDBA will be £1,800,000 and, if applicable, will be subject to the transitional LSA and LSDBA calculations.

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 gave 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.

If you have individual protection 2014, the LSA will be the lesser of £375,000 or 25% of the value of your pension savings on 5 April 2014; and your LSDBA will be the lesser of £1,500,000 or the value of their pension savings on 5 April 2014. If applicable, these will be subject to the transitional LSA and LSDBA calculations.

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 worked in a similar way to Fixed Protection 2012, but gave people a protected LTA of £1.5 million from 6 April 2014.

If you have fixed protection 2014, your LSA will be £375,000 and your LSDBA will be £1.5 million and, if applicable, will be subject to the transitional LSA and LSDBA calculations.

Individual Protection 2016

Individual Protection 2016 gave 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 have individual protection 2016, the LSA will be the lesser of £312,500 or 25% of the value of your pension savings on 5 April 2016; and your LSDBA will be the lesser of £1.25 million or the value of their pension savings on 5 April 2016. If applicable, these will be subject to the transitional LSA and LSDBA calculations.

Fixed Protection 2016

Fixed Protection 2016 allowed someone to retain a LTA of £1.25 million after 5 April 2016 in a similar way to the previous forms of fixed protection (see above).

If you have fixed protection 2016, your LSA will be £312,500 and your LSDBA will be £1.25 million and, if applicable, will be subject to the transitional LSA and lump sum and LSDBA calculations.

Overseas Transfer Allowance

Before 6 April 2024, a qualifying recognised overseas pension scheme (QROPS), was tested against the LTA. From 6 April 2024, the amount transferred to a QROPS is tested against the overseas transfer allowance (OTA).

Yours initial OTA is an amount equal to your initial LSDBA and will therefore be £1,073,100 unless you hold a valid LTA protection.

If the amount transferred from a UK registered scheme to a QROPS is more than the OTA, the excess may be subject to an overseas transfer charge of 25%.

Overseas transfers will not affect the availability of the Lump Sum Allowances.

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.
