# Explanatory Note

# Clause 12 and Schedule: Standard lifetime allowance from 2016 to 2017

## Summary

1. This clause amends the Finance Act 2004 (FA2004), as it relates to the lifetime allowance for UK tax relieved pension savings and provides for it to be increased in line with increases in the consumer prices index.

2. The Schedule to Clause 12 introduces transitional provisions to protect pension savers affected by this reduction to the lifetime allowance and makes a number of consequential amendments to FA 2004 relating to the reduction in the lifetime allowance.

## Details of the clause and schedule

### Clause 12

3. Subsection (2) replaces sections 218(2) and (3) FA 2004 to provide for the standard lifetime allowance to be £1,000,000 for the tax year 2016 to 2017 onwards and replaces the power to make regulations at section 281(3) with a requirement for the Treasury to make regulations before the start of tax year 2018-19 and each subsequent tax year, specifying the amount of the standard lifetime allowance for the year. The amount of the standard lifetime allowance will be, where the consumer prices index (CPI) for the year to the previous September is higher than it was 12 months earlier, the standard lifetime allowance for the earlier year, increased by CPI, but rounded up to the nearest £100. If CPI is not higher in that 12 month period, then the standard lifetime allowance for the tax year will be same as the standard lifetime allowance for the previous tax year.

4. Subsection (3) inserts new subsections 5BC and 5BD into section 218 of FA 2004.

5. New subsection 5BC provides that where an individual has a lifetime allowance enhancement factor under sections 220, 222, 223 or 224 FA2004, (which apply a lifetime enhancement factor in respect of pension credits, relevant overseas individuals and transfers from recognised overseas pension schemes), and a benefit crystallisation event ("BCE") occurs between 6 April 2014 and 5 April 2016, then in calculating the individual's lifetime allowance the lifetime allowance enhancement factor is multiplied by £1,250,000 if this is greater than the standard lifetime allowance.

6. New subsection 5BD provides the order of precedence where an individual has more than one lifetime allowance enhancement factor.

7. Subsection (4) inserts new subsection 5E into section 218 FA 2004, which provides for the

reference to the standard lifetime allowance to be replaced by a figure of £1,250,000 where certain lump sum death benefits are paid (a 'benefit crystallisation event 7' occurs) on or after 6 April 2016 in respect of the death of the individual in either tax year 2014-15 or 2015-16.

8. Subsection (6) inserts new subsection 3 into section 282 FA 2004. Subsection 3 provides that regulations made under the power in subsection 2D of section 218 FA 2004 are not subject to affirmative resolution procedures before the House of Commons.

9. Subsection (7) provides for the amendments made in subsections 2 to 4 of this clause to have effect for the tax year 2016-17 onwards.

10. Subsection (8) introduces the Schedule to Clause 12 which contains provision for transitional protection from the lifetime allowance charge.

# The Schedule to Clause 12

# Part 1: Fixed Protection 2016

11. Part 1 introduces a new type of transitional protection ("fixed protection 2016") for individuals who believe they may be effected by the reduction in the lifetime allowance from 6 April 2016.

12. Paragraphs 1 and 2 set out that individuals with fixed protection 2016 will have a protected lifetime allowance of £1.25 million and the general conditions of when this protection will apply. Individuals with fixed protection under paragraph 14 of Schedule 18 to FA 2011, fixed protection 2014 under paragraph 1 of Schedule 22 to FA 2013, primary protection or enhanced protection at any date on or after 6 April 2016 will not be able to hold fixed protection 2016 at that date, as these other transitional protections, if maintained, will always provide the individual with a higher protected lifetime allowance..

13. Paragraph 3 sets out certain events known as "protection cessation events". Where any of these events occur on or after 6 April 2016, the individual will not be entitled to fixed protection 2016 from the date of the event. The events are:

- where there is benefit accrual (as defined in paragraph 4)
- where there is an impermissible transfer (as defined in paragraph 5)
- where there is a transfer of sums or assets that is not a permitted transfer (as defined in paragraph 6)
- where a new pension arrangement relating to the individual is made otherwise than in permitted circumstances (as defined in paragraph 7)

14. Subparagraph 4(1) provides definitions of benefit accrual for each type of arrangement and that for money purchase arrangements other than cash balance arrangements, any relevant contribution will mean there is benefit accrual.

15. Subparagraphs 4(2) and (3) provide how to determine the increase in the value of the individual's rights under a cash balance or defined benefit arrangement, and a hybrid arrangement under which cash balance or defined benefits may be provided.

16. Subparagraph 4(4) provides a definition of when a relevant contribution is paid.

17. Subparagraph 4(5) provides that increases in an individual's rights under an arrangement are to be ignored for the purposes of determining whether benefit accrual has occurred if they don't exceed the relevant percentage in a tax year. This applies for defined benefits and cash balance arrangements as well as hybrid arrangements where the benefits to be provided may be defined benefits or cash balance benefits.

18. Subparagraph 4(6) provides that the relevant percentage is an annual rate of increase specified in the scheme rules (predecessor scheme rules if this is more favourable to the individual) as at 9 December 2015, plus any relevant statutory increase percentage as defined in paragraph 4(8) that may apply. Where there isn't a rate of increase specified in the scheme rules, the relevant percentage is either the annual percentage increase in the consumer prices index ('CPI') for September In the previous tax year, or if it is higher, the relevant statutory increase percentage.

19. Subparagraph 4(7) provides a definition of "predecessor arrangement" and "predecessor registered pension scheme".

20. Subparagraph 4(8) provides a definition of "relevant statutory percentage increase".

21. Subparagraph 4(9) provides that paragraph 4(10) applies when the individual's rights are under a deferred annuity contract and that contract limits increases in rights to annual increases in the retail prices index (RPI).

22. Subparagraph 4(10) provides that where paragraph 4(9) applies, the relevant percentage in subparagraph (6)(b)(i), which allows for CPI increases, is replaced by the annual rate of increase in the value of the individual's rights during the tax year.

23. Subparagraph 4(11) provides further detail on the calculation of the annual increase in RPI for the purposes of paragraph 4(9).

24. Paragraph 5 defines impermissible transfers.

25. Paragraph 6 defines permitted transfers.

26. Paragraph 7 defines permitted circumstances.

27. Subparagraph 8(1) provides that paragraph 3 applies in relation to individuals who receive UK tax relief on pension savings in non-UK schemes, as if the non-UK scheme were a registered pension scheme, but that this is subject to sub-paragraphs (2) to (4).

28. Subparagraph 8(2) provides that where the individual has an arrangement under a non-UK pension scheme, then the definition of benefit accrual is set out in sub-paragraphs (3) and (4) for the purposes of paragraph 3(a), and paragraph 4(1) does not apply.

29. Subparagraph 8(3) provides that benefit accrual occurs at the end of the tax year where the pension input amount for a tax year is greater than nil.

30. Subparagraph 8(4) provides that there is also benefit accrual if an individual takes some or all of their benefits during a tax year and the pension input amount for the period up to the time the benefits were taken is greater than nil.

# Part 2: Individual Protection 2016

31. Part 2 introduces a further type of transitional protection for those who think they may be

effected by the reduction in the lifetime allowance from 6 April 2016. This is known as individual protection 2016.

32. Paragraph 9 sets out who can rely on individual protection 2016, how their pension rights are valued and the level of protected lifetime allowance that they will be entitled to.

33. Subparagraph 9(1) provides that individuals can rely on individual protection 2016 if they have pension rights (their "relevant amount"), as defined in paragraph 9(4) of greater than £1 million on 5 April 2016 and they do not have primary protection as set out in paragraph 7 of Schedule 36 to FA2004, and they have a reference number issued by HMRC for the purposes of sub-paragraph 2.

34. Subparagraph 9(2) provides that where an individual has individual protection 2014 their standard lifetime allowance is the greater of their relevant amount (subject to an overall limit of £1.25 million) and the standard lifetime allowance at that time.

35. Subparagraph 9(3) provides a definition of relevant arrangement for the purposes of paragraph 9(1).

36. Subparagraph 9(4) defines the relevant amount as the sum of amounts A to D which are defined in paragraphs 10 to 13. This is the value on 5 April 2016 of the individual's pensions in payment plus their pension savings, not yet taken, that have benefited from UK tax relief.

37. Subparagraph 9(5) provides that where an individual who has notified HMRC that they intend to rely on individual protection 2016 has one of five specified existing protections, individual protection 2014 does not apply.

38. Subparagraphs 9(6) to (9) deal with the position where the pension rights of an individual with individual protection 2016 are subject to a pension debit, as a result of the sharing of the individual's pension rights following a divorce, on or after, 6 April 2016. In such a case, the individual's relevant amount is reduced by the amount of the debit. However, for individual protection 2016 purposes the amount of debit is reduced by 5 per cent for each complete tax year between 5 April 2016 and the date of the pension debit. The reduction is intended to reflect any increase in the individual's total pension rights between 5 April 2016 and the time of the pension debit. Where the individual's relevant amount is reduced below £1 million as a result of the pension debit, they will no longer be entitled to rely on individual protection 2016.

39. Paragraph 10 sets out how to calculate amount A, which is the value of the pensions that the individual was receiving on 6 April 2006 (A-day), which is the day when Finance Act 2004 including the lifetime allowance first applied from.

40. Subparagraphs 10(2) to (5) apply where a BCE has occurred, in respect of the individual on or before 5 April 2016, for example when an individual has taken some of their pension benefits. In this case Amount A is 25 times the annual rate of the pre A-day pension immediately before the BCE, multiplied by a factor of £1.25 million (the standard lifetime allowance for 2014-15) over the standard lifetime allowance at the date of the BCE. The factor is applied to take account of any change in the standard lifetime allowance since the BCE, so that that percentage of the standard lifetime allowance used up by the pre A-day pension is the same on 5 April 2016 as it was on the date of the BCE.

41. Subparagraphs 10(6) and (7) apply where no BCE has occurred in respect of the individual

since A-day, in which case amount A is 25 times the annual rate at which the pre A-day pension is payable on 5 April 2016.

42. Subparagraphs 10(8) and (9) define expressions used in sub-paragraphs (2) to (7).

43. Paragraph 11 sets out how to calculate amount B, which is the value of any BCEs in respect of the individual occurring on or before 5 April 2016. Amount B is the aggregate of the value of each BCE, multiplied by a factor of £1.25 million (the standard lifetime allowance for 2015-16) over the standard lifetime allowance at the date of the BCE.

44. Paragraph 12 sets out how to calculate amount C, which is the value of any uncrystallised pension rights that the individual has in a registered pension scheme on 5 April 2016. Amount C is calculated In accordance with the method set out in section 212 of Finance Act 2004.

45. Paragraph 13 sets out how to calculate amount D, which is the value of any uncrystallised pension rights that the individual has under relieved non-UK pension schemes on 5 April 2016. To calculate amount D, it is assumed that there is a BCE in respect of those rights at that date and the amount that would have been crystallised in accordance with paragraph 14 of Schedule 36 to Finance Act 2004.

## Part 3: Reference numbers

46. Part 3 sets out when a valid application for fixed protection 2016 or individual protection 2016 is made, and the issue by HM Revenue and Customs (HMRC) of a reference number that the individual can use to prove that they are entitled to that protection when they take any benefits on or after 6 April 2016.

47. Paragraph 14 makes provision for individuals to apply for a reference number, and the form of that application, for fixed protection 2016 and individual protection 2016, and for HM Revenue and Customs (HMRC) to issue a reference number.

48. Subparagraph 14(1) defines that an individual has a reference number for the purposes of fixed protection 2016 or individual protection 2016 if one has been issued by HMRC and it has not been withdrawn.

49. Subparagraph 14(2) defines the form of the reference number and when it will be issued.

50. Subparagraph 14(3) sets out what information is required in order for an application to be a valid application.

51. Subparagraph 14(4) requires HMRC to notify the individual if their application for a reference number for fixed protection 2016 or individual protection 2016 is unsuccessful or, in the case of individual protection 2016 the application was successful but a reference number is not being issued because the protection is dormant.

52. Subparagraph 14(5) defines the terms relevant arrangement, appropriate amount and transfer day for the purposes of paragraph sub-paragraph (3)(f)(iii).

53. Subparagraph 14(7) defines what is meant by "dormant basis" for the purposes of individual protection 2016, that is the application would have been successful but for the fact that the individual held another form of transitional protection at the time of the application. Where an application is on a dormant basis, should the other protection become invalid, then the

individual protection 2016 will cease to be dormant and a reference number will be issued.

54. Subparagraph 14(8) sets out the prior provisions which would result in the dormant basis.

55. Paragraph 15 sets out the circumstances in which HMRC may withdraw a reference number and requires HMRC to tell the individual the reasons for doing so.

56. Paragraph 16 provides for an appeal against the non-issue or the withdrawal of a reference number.

57. Paragraph 17 sets out the requirement for individuals who have a reference number, or a pending application for a reference number, for the purposes of fixed protection 2016 or individual protection 2016 to notify HMRC within 90 days if a protection-cessation event, as set out in paragraphs 3 to 8, occurs. Paragraph 17(3) sets out when an application is pending for the purposes of this paragraph, which is intended to cover the period between an application being submitted and a decision being made by HMRC, or where there is an appeal against a decision by HMRC.

58. Paragraph 18 sets out the requirement for individuals who have a reference number, or a pending application, for the purposes of individual protection 2016, to notify HMRC within 60 days if they receive a discharge notice related to a pension debit. Paragraph 18(3) defines what a discharge notice is.

59. Paragraph 19 provides for personal representatives of deceased individuals to apply for fixed protection 2016 and individual protection 2016.

## Part 4: Information

60. Part 4 sets out the information requirements in connection with fixed protection 2016 and individual protection 2016 through changes to existing secondary legislation.

61. Paragraph 20 sets out that individuals who have a reference for the purposes of individual protection 2016 are required to preserve the documents that have been used in the calculation of their relevant amount, for 6 years from the date of application.

62. Paragraphs 21 to 24 make various amendments to The Registered Pension Schemes (Provision of Information) Regulations 2006 (S.I. 2006/567) to include references to fixed protection 2016 and individual protection 2016. These changes ensure that where an individual relies on fixed protection 2016 or individual protection 2016 then similar information is required to be provided by the member to the scheme administrator and from the scheme administrator to HMRC as for the similar existing lifetime allowance protection regimes.

63. Paragraph 25 inserts new paragraph 14C into S.I. 2006/567 which sets out that scheme administrators of registered pension schemes are required to provide information to enable a member to calculate their relevant amount, if they request it as long as the request is received by the scheme administrator before 6 April 2020. Scheme administrators may if they choose to provide this information for requests received, after this date but there is no requirement to do so.

## Part 5: Amendments in connection with protection of pre-6 April 2006 rights

64. Part 5 sets out changes to FA2004 in respect of primary protection and enhanced protection to ensure that certain individuals with one of these protections are able to receive the right amount of tax free lump sums intended by legislation.

65. Subparagraph 27(1) amends paragarph 2(10) of Schedule 29 to FA 2004 and applies where an individual has primary protection under paragraph 7 of Schedule 36 to FA2004 or enhanced protection under paragraph 12 of Schedule 36 to FA2004, but no lump sum protection. In these circumstances, if the member becomes entitled to a pension commencement lump sum after 6 April 2014, when making the adjustment to the relevant amount for a previous BCE that also occurred after 6 April 2014, where £1.5 million is greater than the standard lifetime allowance at the time of the previous BCE, PSLA (the standard lifetime allowance at the time of the earlier BCE) is treated as being £1.5 million.

66. Subparagraph 27(2) amends paragraph 28(3) of Schedule 36 to FA 2004 and applies where an individual has primary protection under paragraph 7 of Schedule 36 to FA 2004 with lump sum protection. If this applies, where more than one BCE occurs after 6 April 2012, and a further BCE occurs on or after 6 April 2014, the definition of PSLA for the purposes of revaluing the earlier BCEs is the greater of £1.8 million and the standard lifetime allowance at the time the individual became entitled to the lump sum.

## Part 6: Interpretation and Regulations

67. Part 6 sets out the interpretation of expressions used in the Schedule and provides a power to make regulations amending Parts 1, 2 and 3 of the Schedule.

68. Paragraph 30 provides power to make changes to Parts 1, 2 and 3 of this Schedule by regulations. Such regulations may be retrospective providing they do not increase any person's liability to tax and do not have effect before 6 April 2016.

# Background note

69. Individuals can save as much as they like in a registered pension scheme subject to overall limits on the amount of tax relief their pension savings can benefit from. These limits are the lifetime and annual allowances. The lifetime allowance is the maximum amount of pension and/or lump sum that an individual can take from pension schemes that benefit from UK tax relief, including any tax relieved savings the individual has in a relieved non-UK pension scheme.

70. When an individual becomes entitled to their pension benefits, these benefits are tested to see if they exceed the individual's lifetime allowance. If they do, the excess is subject to the lifetime allowance charge. The rate of the charge will depend on how the individual takes their benefits. Any amount over the lifetime allowance taken as a lump sum is taxable at 55 per cent, whilst any amount taken as a pension is taxable at 25 per cent, and the income will be taxable at the individual's marginal rate.

71. The government announced at March Budget 2015, and confirmed at Summer Budget 2015, that legislation would be introduced to reduce the standard lifetime allowance to £1 million for the tax year 2016 to 2017 onwards. It also announced that two transitional protections would be introduced to protect individuals from potentially retrospective tax charges arising from the reduction.

72. Clause 12 and the Schedule to Clause 12 restrict tax relief for pension savings by reducing the level of the lifetime allowance provided for in section 218 of FA2004.

73. The level of the standard lifetime allowance is reduced to £1 million with effect from 6 April 2016. Two new transitional protections 'fixed protection 2016' and 'individual protection 2016' come into force on the same date. Individuals with fixed protection 2016 have a lifetime allowance of the greater of £1.25 million and the standard lifetime allowance. Individuals with individual protection 2016 will have a lifetime allowance of the greater of the value of their pension savings at 5 April 2016, subject to an overall maximum of £1.25 million, and the standard lifetime allowance.

74. The Schedule to Clause 12 also makes a number of consequential changes to the existing pensions legislation in FA2004.

75. If you have any questions about this change, or comments on the legislation, please contact Samantha Skill on 03000 564149 (email: pensions.policy@hmrc.gsi.gov.uk).