LTA-Day – new regulations arrive to fix issues in tax legislation

Alert | 18 October 2024

Introduction

Just before the LTA's removal on 6 April 2024 ("LTA-Day"), HMRC issued Newsletter 158 warning that certain members may wish to delay transferring or taking benefits pending regulations to fix issues in the tax legislation. Those regulations have now been published and are set to come into force on 18 November 2024 but, subject to some specific transitional provisions, will take effect retrospectively from the beginning of this tax year.

Key points

- With the LTA's demise first announced at the Spring Budget 2023, the legislation had to develop quickly, and continues to do so. A first set of amending regulations, ironing out some of the wrinkles in the Finance Act 2024, was introduced in March 2024.
- Various corrections are still to be made to the legislation, including in relation to the calculation of trivial commutation lump sums, transfers for members with enhanced protection ("EP"), the potential PCLS available for members with EP or primary protection ("PP") who have protected lump sum rights of more than £375,000, transfers to a QROPS, and the payment of a PCLS where the member has a scheme-specific lump sum protection.
- Following an informal consultation over the summer, two new sets of tax regulations are now due to come into force: the Pensions (Abolition of Lifetime Allowance Charge etc) (No. 2) Regulations 2024 ("No. 2 Regulations") and the draft Pensions (Abolition of Lifetime Allowance Charge etc) (No. 3) Regulations 2024 ("No. 3 Regulations"). The No. 3 Regulations will need to be approved by Parliament before they are finalised.
- The new regulations are expected to correct many known errors in the legislation, but there are some remaining areas where further change may be needed.

The two new allowances – a quick recap

Following the LTA's demise, there are two new tax-free lump sum allowances: the "lump sum allowance" ("LSA") and the "lump sum and death benefit allowance" ("LSDBA"). The standard LSDBA is £1,073,100, matching the standard LTA as it stood on 5 April 2024, and the standard LSA is £268,275, being 25% of the LSDBA.

The new allowances apply per person across all registered pension schemes, not per scheme, with lump sums exceeding either taxed at an individual's marginal rate. However, individuals holding a valid LTA protection retain their rights to higher tax-free lump sums, as well as to higher tax-free parts of other lump sums and lump sum death benefits.

Key changes being addressed

Calculating trivial commutation lump sums

The current legislation for calculating a trivial commutation lump sum could under-value certain crystallised rights, leading to the possibility of paying larger lump sums than intended. Although not initially on HMRC's radar, the No 3 Regulations will amend this to more closely reflect the tax position that applied before LTA-Day.

Transfers for individuals with EP

Currently, individuals with EP stand to lose their "permitted maximum" tax-free entitlement to certain benefits if they transfer, since the permitted maximum is calculated on a "per arrangement" basis (see our Alert for details). The upcoming changes will enable members with EP to retain their tax protection on a transfer.

To enable this, transferring schemes will be required to provide additional information to receiving schemes, including carrying out calculations to establish the "permitted maximum" in respect of the nine relevant lump sums and lump sum death benefits payable under the tax rules. This is a potentially onerous new requirement and trustees should ensure their administrators are ready to carry out the necessary calculations.

EP or PP with protected lump sum rights

Changes will ensure that members with EP or PP who have protected lump sum rights will be able to take a PCLS in excess of their usual protected LSA of £375,000.

Scheme specific lump sum protection

The No. 3 Regulations are intended to address technical errors in the formulas relating to scheme-specific lump sum protection, ie rights to tax-free cash greater than 25%. This includes issues around calculating the level of protection, the effect of transfers, and reductions to the member's LSA.

Transfers to a QROPS

Back in March, the first set of amending regulations introduced transitional provisions to reduce members' "overseas transfer allowance" by 100% of the value of their LTA used up before LTA-Day. These changes were designed to ensure that members can take tax-free transfers to a QROPS up to the same value as they could have expected to benefit from under the LTA. An overseas transfer charge will then apply to any excess.

The No. 2 Regulations are intended to address issues with the transitional provisions relating to the overseas transfer allowance for members with pre-A-Day pensions in payment, as well as members transferring funds designated to drawdown to a QROPS.

Other changes to note

Several other amendments are being made by the regulations, including:

Transitional tax-free amount certificates ("TTFACs")

Various tweaks will be made to the TTFAC process. Members (or their legal personal representatives ("PRs")) will be required to provide copies of TTFACs to other schemes of which they are a current member (or were a member immediately before death) within 90 days of receiving the certificate and before a relevant benefit crystallisation event occurs. A 90-day notification period will also apply if a certificate is cancelled.

The time limit for PRs to apply for a TTFAC on behalf of a member will be extended to 31 October next following the end of the tax year in which a relevant lump sum death benefit is paid, provided the member had not become entitled to a relevant lump sum on or after LTA-Day.

Information provided by trustees to PRs

The No. 2 Regulations will extend the information that scheme administrators are required to give a member's PRs regarding payment of lump sum death benefits, to include details of the benefit recipients. This appears intended to address the "knowledge gap" that PRs may face when reporting tax liabilities, but we have raised concerns with HMRC about the practical and data protection implications for trustees in sharing this information.

Watch and wait – remaining issues

Lump sum death benefits paid from previously crystallised rights

Certain lump sum death benefits, such as a flexi-access drawdown fund lump sum death benefit, were not previously BCEs under the LTA regime because they are paid from crystallised benefits. However, since LTA-Day, they are "relevant benefit crystallisation events".

To prevent double counting, lump sum death benefits paid from funds which crystallised before LTA-Day do not reduce an individual's LSDBA because the funds have already been tested against the LTA. However, HMRC acknowledged that the current legislation can unintentionally limit the tax-free amount of such benefits.

Newsletter 158 stated that "legal personal representatives may wish to delay requesting the payment" of an LSDBA in these circumstances. We have asked HMRC for clarification that this is being addressed.

Statutory power to amend rules

Where schemes built the LTA into their benefit structure, certain time-limited transitional provisions may help prevent unintended consequences. However, there is no news yet on legislation to help schemes make rule changes, as there was when the system of tax allowances first came into being at A-Day.

What’s next?

Both sets of regulations are due to come into force on 18 November 2024, taking effect retrospectively from 6 April 2024, with the No. 3 Regulations requiring the approval of Parliament before coming into force. In the interim, trustees should check with their administrators that systems will be updated to take account of the retrospective effect of the regulations.

Finally, the other big question is what further pensions tax changes might lie in wait when the new Chancellor delivers the Budget on 30 October…

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