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Spring Budget 2023 - The LTA to fall away

The Chancellor of the Exchequer, Jeremy Hunt, has delivered his first Budget, with some high-profile announcements for pensions, particularly around the various tax allowances.

As usual, some of what was announced had been expected, although the Chancellor found room for one big pensions surprise.

Background

The headline pensions news concerned the lifetime allowance (LTA) and the annual allowance (AA) for registered pension schemes. (As a reminder, the LTA is the limit on tax-privileged pension savings that an individual can crystallise from all pension schemes, while the annual allowance (AA) limits the tax privileged accrual that can be made each year.)

While it was anticipated that both the LTA and AA would increase – largely in an effort to counter the number of senior NHS staff retiring early, the Chancellor went further than expected.

LTA to be abolished

The LTA was expected to rise from its current level of £1,073,100, perhaps returning to its previous peak of £1.8m, but it is to be abolished altogether. This could be as early as from 6 April 2024, although the Chancellor is merely stating that it will be scrapped in “a future Finance Bill”.

No more LTA charge

Ahead of the LTA being abolished, the LTA charge (which applies to benefits crystallised when a member either has not enough LTA remaining or has already used all of their LTA) is to be removed from 6 April 2023.

This removes the additional LTA charge of 25% for benefits accessed that are later taxed as income, such as pension or funds designated for drawdown. Where benefits which are accessed as lump sums would have been subject to the LTA charge at 55%, they will instead be taxed at the recipient's marginal rate. This includes lump sums paid on the grounds of serious ill health and certain lump sum death benefits.

Implications for tax-free cash at retirement

The maximum pension commencement lump sum is generally limited to 25% of the standard LTA unless some form of protection applies. The Treasury has confirmed that the maximum pension commencement lump sum will continue to be linked to the current LTA going forward (i.e. £268,275 - 25% of £1,073,100) and frozen at this level.

Members with valid enhanced or fixed protection will retain any higher entitlement to a tax-free lump sum, and can now accrue new pension benefits, join new arrangements or transfer without losing this protection.

Previous Budgets had capped the LTA, and therefore the value of the 25% tax free lump sum, until April 2026. The new proposals indicate a permanent cap on the tax-free cash lump sum, which represents a fundamental change to the tax advantage of future pension saving above the current LTA. The tax-free cash lump sum has been a distinctive benefit of pension saving for decades but will theoretically no longer apply to the value of accrued pensions above £1,073,100. The impact of this will be particularly acute for members of defined contribution (DC) schemes and defined benefit schemes which have an implicit tax-free lump sum promise.

AA to be increased

The AA will rise by £20,000 from 6 April 2023 to £60,000. Members will retain the ability to carry forward any unused AA from the previous three tax years.

Tapered AA

For high earners, the tapered AA currently means that for every £2 of income they have over £240,000, their annual allowance is reduced by £1. The minimum tapered annual allowance will rise from £4,000 to £10,000 from 6 April 2023. The adjusted income threshold for the tapered AA will also be increased from £240,000 to £260,000 at the same time.

Money Purchase AA

The money purchase AA, which applies when a member has flexibly accessed their DC pension savings, is to revert from its current level of £4,000 to its previous rate of £10,000 from 6 April 2023.

Top-ups for non-taxpayers in net pay arrangements

More of a reminder than a new announcement, the Budget confirmed that HMRC will be required, "so far as is reasonably practicable", to make top-up payments to members of pension schemes using net pay arrangements to deduct tax from contributions (i.e. most occupational pension schemes) with earnings below the personal allowance for income tax.

This measure will come into force from April 2024 and will look to give some parity to these members compared with non-taxpayers contributing to personal pension schemes which automatically provide basic rate tax relief on contributions.

The payments will be made as soon as possible after the tax year in which the contribution is paid and will be subject to income tax.

Unlocking investment for science and technology

The government is looking at ways to unlock DC pension scheme investment for the benefit of the UK's innovative science and technology companies. Currently, these schemes are under-invested in venture capital and growth equity relative to comparators such as Canada and Australia, despite the significant opportunity to enhance returns for their members and diversify their portfolios.

The Treasury is consulting on its Long-term Investment for Technology and Science (LIFTS) initiative, which seeks to establishing new investment vehicles to crowd-in investment from institutional investors, particularly DC pension schemes, to the science and technology sector.

Comment

The headline grabbing news about the LTA initially appeared to represent, to use a term from 20 years ago, "pensions simplification". While aimed at senior doctors in the NHS, the complete abolition of the LTA will be welcomed by many, who have come to view it as a tax on positive investment (something which in the DC world especially, should not be discouraged). But the devil is in the detail, and there will be some complex decisions for some individuals to take as a result of these changes – particularly those impacted by the tapered annual allowance and those who expect their pension savings to exceed the current LTA.

We should be mindful, however, of where we are in the electoral cycle. Scrapping the LTA does not have universal support, with the Labour Party coming out in opposition to the proposal, amid accusations of tax breaks for the rich. With a general election expected sometime next year, it remains to be seen whether the LTA's days are numbered or not.

The increase in the AA is also welcome, although it should be noted this does appear to be a one-off increase, rather than a sign that it will be raised again in future years.

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