

## Finance Bill 2023-24 draft legislation: Abolishing the pensions lifetime allowance

### Comments by the Chartered Institute of Taxation

#### 1 Executive Summary

- 1.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 19,000 members, and extensive volunteer network, in providing our response.
- 1.2 The CIOT's comments on the draft legislation published on 18 July 2023 abolishing the pensions lifetime allowance from 6 April 2024 is set out below. Our response includes comments on the following matters:
- Considerations for crystallised lump sum death benefits in order to apply consistency to their treatment.
  - The proposal to begin testing payments in respect of small pension pots against the new allowances.
  - The timetable for implementation of the new rules by 6 April 2024 - since the abolition of the Lifetime Allowance (LTA) charges has already taken place we do not think there is any urgency for the subsequent legislative tidy up.
  - The proposal to begin taxing drawdown and annuity proceeds of uncrystallised Defined Contribution (DC) funds following deaths before age 75.
  - Transitioning from the old to the new regime.
- 1.3 We also note that at the Spring Budget 2023, it was announced that tax-free lump sums would be limited to £268,275 'and frozen thereafter', save for cases where protections applied. While the policy paper is silent on the matter, we assume that the intention remains for allowances to be frozen. We would suggest, for simplification, either (i) rounding-up the allowance and/or (ii) periodically reviewing the allowance and indexing it.

#### 2 About us

- 2.1 The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it –

taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

- 2.2 The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.
- 2.3 The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.
- 2.4 Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

### **3 Introduction**

- 3.1 The draft legislation will limit the total amount of tax-free cash an individual can receive to a maximum of £268,275 unless they hold a valid lifetime allowance or lump sum protection. It will also limit the total amount of lump sums an individual can receive before marginal rate taxation applies to £1,073,100 unless they hold a valid lifetime allowance protection.
- 3.2 Our stated objectives for the tax system include:
  - A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
  - Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
  - Greater certainty, so businesses and individuals can plan ahead with confidence.
  - A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
  - Responsive and competent tax administration, with a minimum of bureaucracy.

### **4 Comments on the draft legislation**

#### **4.1 Crystallised lump sum death benefits**

Our understanding is that (i) Annuity Protection Lump Sum Death Benefit, (ii) Pension Protection Lump Sum Death Benefit, (iii) Drawdown Pension Fund Lump Sum Death Benefit, and (iv) Flexi-Access Drawdown Lump Sum Death Benefit, which, currently, do not use up any LTA, will in future count towards the lump sum and death benefit allowance. The current approach of not testing against the LTA was logical since these benefits are derived from rights previously tested against the LTA as pensions. However, as pensions will no longer use up any allowance, these lump sum payments (where otherwise paid tax-free following a death before age 75) should therefore use the lump sum and death benefit allowance – but only where the lump sum relates to a pension that commenced after 5 April 2024. Benefits derived from pensions which were crystallised

before that date will already have been tested against the LTA and any tax charge paid, and so we believe should not be further limited.

- 4.2 We also note that the proposed changes will reduce the amount of tax-free cash paid in some instances. For example, where a member crystallised £1m of DC rights in 2017 at age 55 and had no remaining lifetime allowance. If the member dies just before age 75 and the remaining drawdown fund has grown in that time to £2m, all that fund could presently be paid tax-free to the beneficiaries. However, under the new rules (depending on transitional protections) only just over £0.75m could be paid tax-free. Is this intended?
- 4.3 We have not noted any suggestion that, for deaths before age 75, the tax-free status of death benefits derived from crystallised benefits is to be withdrawn (only limited to the current LTA). However, given the changes proposed for death benefits derived from uncrystallised benefits confirmation of this would be welcome.

#### 4.4 **The inclusion of lump sum payments in lieu of small pensions within the new allowances**

There are several different types of payment that can be made in lieu of administering small pensions. Where they are paid in respect of uncrystallised benefits, one quarter is paid tax-free. At present, the payments do not use up the LTA. However, the legislation appears to propose that the tax-free elements of the payments would begin to use up allowances. If this is the case this change will increase the administrative burden of settling small pensions in this manner.

- 4.5 Because these payments are only ever made in lieu of small pensions, the scope for raising tax revenues is small but the administrative burden could be disproportionately high. We note that the amounts themselves are small, and there are already controls in place to prevent their abuse, and that the individuals who receive such payments are less likely to use up their tax-free allowances. We also note that one of the criteria for payment of a trivial commutation lump sum is that total pension rights across all arrangements are small. It seems at odds with the original policy intent for the introduction of such payments that their tax-free elements should, in future, use up tax-free allowances. We would, therefore, recommend that trivial commutation lump sums and winding-up lump sums should not be 'relevant lump sums' for the purposes of calculating the tax-free lump sum allowances.

#### 4.6 **Timetable of implementation**

In order to implement significant changes to the tax system, such as this overhaul of the pensions tax system, care and time is needed if it is to be carried out without unanticipated anomalies. At present, the intention is that the new rules are due to come into force from 6 April 2024. Ideally most schemes would want to have updated their communications to accommodate the new rules by, at least, December 2023, as, for example, DC schemes need to provide information to members about their retirement options at least four months before their normal pension age (and many would prefer to send that information out six months in advance). But it is unlikely that the legislation will have been finalised and passed by Parliament by then; let alone that HMRC will have published the guidance schemes will need. We, therefore, think that consideration should be given to delaying implementation to avoid delays in schemes processing benefits, and possibly making inadvertent mistakes. If the changes were pushed back to April 2025 and put into legislation before April 2024, this would allow all affected parties to fully understand, assess and implement the changes.

#### 4.7 **Interaction of Clauses 26 and 39**

We note that part of Clause 26 specifically omits paragraphs (b) to (d) of sub-paragraph (6) of Paragraph 4A (Schedule 29). We assume that the intention here is to preserve paragraphs (a) and (e) of that paragraph. Further down the draft provisions, we note that Clause 39 then omits sub-paragraph (6) in its entirety. It is

not clear to us whether this is of any consequence to what was trying to be achieved in clause 26 but we would suggest reviewing these amendments to be sure they work as intended.

#### 4.8 **Clause 37 – Lump sums under registered pension schemes**

We note that in Clause 37, section 637W (Availability of individual's lump sum and death benefit allowance) provides that lump sum death benefits are all treated as crystallising immediately before death (sub-section (8)). In lifetime the member can decide the order (sub-section (7)), but it appears to be simultaneous on death. This is also the case under the LTA provisions, but prior to 6 April 2023 any LTA charge was divided up among beneficiaries on a just and reasonable basis under section 217(4) FA 2004. We do not think that the old rule would work very well with the new regime, as it is not a flat rate charge, but it is not clear who gets the benefit of the allowance. For example, if the member dies with £750,000 of unused allowance but they have a pot of £1m that gets split equally between two people, do those two people each get the benefit of £375,000? Or is it chronological so the person who gets paid last gets lumbered with a tax charge?

#### 4.9 **Clause 66 – Closing of fixed and individual protection**

We note that Clause 66 provides for the closing of fixed and individual protection 2016. However, there does not seem to be an equivalent for Primary Protection or Enhanced Protection. Both protections have reasonable excuse provisions for late applications and when valid reasons are probably extremely rare at this stage, it does seem odd in principle to leave them open when everything else is closed.

### 5 **Additional comments**

#### **The taxation of beneficiaries' drawdown and annuity income following pre-75 deaths**

While the draft legislation does not cover this matter, the policy document published alongside states '*Individuals will still be able to receive the benefits which are currently tested against the LTA at BCEs 5C and 5D, but the values will no longer be excluded from marginal rate income tax under ITEPA, with effect from 6 April 2024*'. This implies that if a member dies before age 75 with uncrystallised funds, then their beneficiaries will be taxed on pension income (from annuity or drawdown) derived from those funds but not if the same assets are instead paid as a lump sum death benefit.

This appears to represent a significant, not previously announced, policy change affecting those who would not have interacted with the LTA. We were surprised that the Summary of impacts in the policy document ignored this change in the section discussing the impact on individual households and families.

Under the current regime, beneficiaries of those who die before reaching age 75 with uncrystallised DC funds may access those funds tax-free. And while the proposal would retain the tax-free status of lump sums, it appears that the intention is to tax as income drawdown and annuity income proceeds. If this is the case then, no doubt, the result would surely be that many individuals would choose to withdraw the whole amount as a lump sum, rather than take an income. But this then discourages those funds from being used as they were originally intended, ie to provide a long-term *income*.

If the intention is to proceed with the policy change, we recommend a thorough impact assessment be undertaken first.

#### 5.1 **Transitional arrangements and valuing benefits taken pre 6 April 2024**

We understand that the CIOT's representative on HMRC's Pensions Industry Stakeholder Forum provided feedback on this area as part of HMRC's workshops earlier this year. Our understanding is that the intention

is for those who claimed benefits prior to the LTA abolition will have less scope to take tax-free cash and not benefit from the full allowances of £268,275 and £1,073,100.

5.2 While one approach might be to reduce starting allowances by the amounts of tax-free cash taken prior to 6 April 2024, we think it would be very difficult to establish details of lump sums taken prior to 6 April 2024 as providers were not required to break down the LTA usage into individual benefit crystallisation events (BCEs). As such, a member in receipt of a pension, will only have been informed of the total percentage of LTA used. We would suggest further consultation on this point. For example, one option would be for members' limits to be based on their available LTA immediately before 6 April 2024, making no further allowance for how that LTA has been used up. This would mean assuming that, for members' benefits taken prior to 6 April 2024, 25% of their LTA usage relates to tax-free cash.

### 5.3 **Rounding-up the tax-free allowances**

We acknowledge that the Government have stated they wish for the limits (of £268,275 and £1,073,100) to remain based on the current LTA. While the policy paper is silent on the matter, we are also given to understand that that the intention is for the allowances to be frozen. We would suggest, to simplify both members' understanding of their options and the administration of pensions, consideration is given to taking the opportunity to round up the tax-free allowances. Alternatively, consideration should be given to raising the allowance in line with inflation (and rounding up as appropriate).

## 6 **Acknowledgement of submission**

6.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

The Chartered Institute of Taxation

15 September 2023