

First Briefing, March 2023

Spring Budget 2023 – LTA abolished in pensions tax shake-up

On Wednesday 15 March 2023, the Chancellor, Jeremy Hunt, delivered the Spring Budget 2023.

It had been widely reported in the press before the Budget that he would announce increases to the maximum amount of tax-relieved pension savings that an individual may make.

However, the actual announcements made were more dramatic, with the lifetime allowance (LTA) to be abolished completely. The annual allowance is to rise to £60,000.

Background to pensions tax relief

To encourage saving for later life, government offers tax incentives for saving into a pension scheme. In particular, individuals get relief from income tax on pension contributions. However, there are limits on the amount of tax-relieved pension savings:

- **Lifetime allowance (LTA):** the maximum amount of tax-relieved savings that an individual can build up over their lifetime
- **Annual allowance (AA):** the maximum amount an individual can pay into tax-relieved pension savings in each tax year.

The LTA is currently set at £1,073,000, and the AA is at £40,000. Where one or both of these limits are exceeded, there may be tax consequences, such as a tax charge.

When these limits were introduced back in 2006, they were initially set at significantly higher levels:

- The LTA was £1.5 million, rising to £1.8 million in 2010
- The AA was £215,000, rising to £255,000 in 2010.

However, both were then reduced significantly.

Where an individual aged 55 or older uses the pension freedoms introduced in 2015 to access Defined Contribution (DC) pension savings, their AA reduces from £40,000 to £4,000. This is known as Money Purchase AA and it limits their scope to build up further pension savings. Similarly, the AA can be reduced for certain higher earners. This is known as Tapered AA.

Concerns have been expressed that the current levels of the LTA and the AA may act as an incentive for certain older individuals (NHS doctors in particular) to reduce the hours that they work or even take early retirement, in order to avoid incurring these tax charges.

Changes to pensions tax relief announced

In the Budget, the Chancellor announced the following changes which will take effect from **6 April 2023**:

- The LTA tax charge will be **removed**
- The AA will increase from £40,000 to **£60,000**
- The maximum tax-free cash that can be taken on retirement will be **frozen** at its current level of **£268,275** (except where protections apply)
- The Money Purchase AA and the Tapered AA will each rise from £4,000 to **£10,000**
- The (adjusted) income threshold from which the Tapered AA will apply will also increase.

The taxation of certain other lump sums paid from tax-relieved pension schemes will also be reduced from 55% to the member's marginal tax rate.

The wording used by the Government seems to suggest the LTA will in effect remain in legislation for the time being but at a zero rate. A future finance bill will completely remove the LTA from pensions tax legislation.

Public service schemes

A change to the AA was also announced for public service schemes, with the aim of increasing retention in the workforce of the public sector. For the purpose of calculating AA tax charges, open and closed public service schemes for a given workforce will be considered linked. This means that negative real growth for AA purposes in legacy schemes can be used to offset AA growth in the linked public service scheme. This will apply from the 2023/24 tax year.

What do First Actuarial's specialists think?

Insofar as an announcement about pensions tax can be dramatic, the Chancellor scrapping the LTA is something of a plot twist, not least because stories in the press in the build-up to the Budget suggested a significant increase.

However, Labour has already said that it would reverse the abolition of the LTA, and has suggested that it would instead try to address specific issues around doctors' pensions.

This change seems to produce a potential cliff-edge in tax regimes for individuals taking benefits before and after 6 April 2023. Individuals who are taking significant benefits before 6 April 2023 may wish to review their circumstances.

If the maximum tax-free cash sum that can be taken does indeed remain frozen, then its value is likely to gradually diminish in real terms. Rather than simply cutting the tax-free cash allowance – as is often speculated around budget time – it may simply be left to wither over time.

As draft legislation covering the announced changes is not available at the time of writing, some points of detail remain unclear. In particular, it's not obvious what precisely the administration implications are of the LTA not being completely removed from the legislation until some point in the future.

Further information

For further information, please contact your usual First Actuarial consultant.