EXPLANATORY MEMORANDUM TO

THE PENSIONS (ABOLITION OF LIFETIME ALLOWANCE CHARGE ETC) (NO. 3) REGULATIONS 2024

2024 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by His Majesty's Revenue and Customs (HMRC) and is laid before the House of Commons by Command of His Majesty.

1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

2. Declaration

2.1 Tulip Siddiq MP, Economic Secretary to the Treasury confirms that this Explanatory Memorandum meets the required standard.

2.2 Helen Page, Deputy Director for Pensions, Individuals Policy Directorate at HMRC confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Catherine Batey at HMRC Telephone: 03000 512336 or email: pensions.policy@hmrc.gov.uk can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 This instrument amends Schedule 29 to the Finance Act 2004 in respect of calculating the applicable amount.

4.2 This instrument amends Schedule 36 to the Finance Act 2004 in respect of the overseas transfer allowance, where the member has pre-commencement pension rights, and pension credit factors.

4.3 This instrument amends Schedule 36 in respect of scheme specific lump sum protection, pre-commencement benefit rights, and pension commencement lump sums.

4.4 This instrument amends The Taxation of Pension Schemes (Transitional Provisions) Order 2006[1] in respect of stand-alone lump sums, and The Registered Pension Schemes (Authorised Payments) Regulations 2009[2] in respect of lump sums paid in reliance on incorrect transitional tax-free amount certificates.

[1] S.I. 2006/572
[2] S.I 2009/1171

4.5 This instrument also provides transitional arrangements for when a payment of a trivial commutation lump sum payment is made between 6 April 2024 and the day before the day these Regulations come into force.

Where does the legislation extend to, and apply?

4.6 The extent of this instrument (that is, the jurisdiction(s) of which the instrument forms part of the law) is the United Kingdom.

4.7 The territorial application of this instrument (that is, where the instrument produces a practical effect) is the United Kingdom.

5. Policy Context

What is being done and why?

5.1 The lifetime allowance was a mechanism for limiting tax-favoured pension savings in registered pension schemes. It was the maximum amount of tax-relieved pension savings an individual could benefit from over the course of their lifetime.

5.2 At Spring Budget 2023, the Government announced that it would abolish the lifetime allowance. This was intended to incentivise those considering retirement to remain in employment and to encourage those who had already left the workplace to return. The Finance (No.2) Act 2023 removed the lifetime allowance charge and delivered some changes to support the removal of the charge.

5.3 Finance Act 2024 provided further changes to remove the lifetime allowance from legislation with effect from 6 April 2024. The changes also clarified the tax treatment of pension savings and introduced new allowances to ensure that individuals would not be able to receive unlimited tax-free lump sums from pension savings which had already benefited from tax relief.

5.4 The Pensions (Abolition of Lifetime Allowance Charge etc) Regulations 2024[3] made technical and consequential provisions to make the pensions tax regime operate correctly following the removal of the lifetime allowance.

5.5 Since this legislation was enacted, HMRC has identified further technical amendments necessary to ensure the correct operation of the pensions tax regime following the abolition of the lifetime allowance.

5.6 This instrument will affect all individuals affected by the removal of the lifetime allowance. It will ensure all individuals are in the correct tax position and the legislation works as intended.

What was the previous policy, how is this different?

5.7 The lifetime allowance was introduced in 2006 to limit the amount of tax-relieved pension savings an individual could benefit from over their lifetime. Individuals could contribute to their pension over this limit, but they were subject to a tax charge to broadly recover any tax relief given on any amounts over this limit.

5.8 The Finance Act 2024 removed the lifetime allowance limit and the associated tax charge. It introduced two new allowances that were needed, as a consequence of removing the lifetime allowance, to restrict tax-free elements of lump sums and lump sum death benefits. Most lump sums that do not exceed these allowances will be

[3] S.I. 2024/356

exempt from tax. The element of lump sums that exceed these allowances will be taxable at the individual's marginal rate.

5.9 The Finance Act 2024 introduced an overseas transfer allowance. This restricts the tax-free element of transfers to qualifying recognised overseas pension schemes.

5.10 Finance Act 2024 contains approximately 100 pages of legislation required to abolish the lifetime allowance. This instrument remedies errors in that legislation and makes consequential changes to ensure the pensions tax regime operates as intended.

5.11 This instrument amends Schedule 29 to the Finance Act 2004, to correct the calculation for the 'applicable amount', and to provide that all rights connected to a disqualifying pension are ignored when calculating the applicable amount in relation to a pension. It also inserts a new calculation in respect of a trivial commutation lump sum and the value of a member's relevant crystallised pension rights.

5.12 This instrument amends Schedule 36 to the Finance Act 2004, in respect of the availability of a member's overseas transfer allowance, where the member had pre-commencement pension rights but had not crystallised pension funds between 5 April 2006 and 5 April 2024.

5.13 This instrument also amends Schedule 36 to the Finance Act 2004, so that the calculation of the pension credit factor is dependent on the standard lifetime allowance at the time the rights were acquired. This ensures the formula continues to operate in the way that it did before the removal of the lifetime allowance.

5.14 This instrument also amends Schedule 36 to the Finance Act 2004, to introduce a condition restricting entitlement to one pension commencement lump sum where an individual has scheme-specific lump sum protection.

5.15 This instrument also amends Schedule 36 to the Finance Act 2004, to correct the calculation of the additional lump sum amount. This ensures that individuals with either individual protection or fixed protection remain in the position they were in before the removal of the lifetime allowance.

5.16 This instrument amends Schedule 36 to the Finance Act 2004, inserting new paragraph 34A, (insofar as that paragraph relates to pension commencement lump sums), into Chapter 15A of Part 9 of the Income Tax (Earnings and Pensions) Act 2003[4], so that the excess of certain scheme-specific lump sums above the lump sum and death benefit allowance will be subject to the individual's marginal rate. The instrument also amends how scheme-specific lump sums are treated in respect of the lump sum allowance. These correct an oversight in the Finance Act 2024, but the circumstances in which this will occur are rare.

5.17 This instrument amends The Taxation of Pension Schemes (Transitional Provisions) Order 2006[5], dealing with the tax treatment of stand-alone lump sums, to ensure that any enhancement of the lump sum and death benefit allowance is disregarded. This ensures that the tax treatment is consistent with the treatment that existed under the lifetime allowance. It provides for determining the amount of the additional lump sum following a member's death. It also makes consequential amendments to this Order.

5.18 This instrument amends The Registered Pension Schemes (Authorised Payments) Regulation 2009[6] so that the overpaid portion of a pension commencement lump sum,

[4] ITEPA 2003
[5] S.I 2006/572
[6] S.I. 2009/1171

paid in reliance on an incorrect transitional tax-free amount certificate, shall form the liability of the recipient in the year it was paid. The payment of a trivial commutation lump sum or a winding-up lump sum, paid in reliance on an incorrect transitional tax-free amount certificate, shall also form the liability of the recipient in the year it was paid.

5.19 Finally, this instrument introduces a transitional arrangement for the payment of a trivial commutation lump sum in certain circumstances. This will mean that these Regulations will not disadvantage a member who received a trivial commutation lump sum between 6 April 2024 and the day before the day on which these Regulations come into force.

6. Legislative and Legal Context

How has the law changed?

6.1 In the United Kingdom, before 6 April 2024, there was no limit on the amount of pension savings that an individual could have, but there were limits on the amount of tax relief available, provided for in Part 4 of the Finance Act 2004.

6.2 The lifetime allowance set the maximum value of tax relieved pension savings that an individual could benefit from over their lifetime. Where an individual exceeded this limit, a tax charge arose on the excess. Sections 214 to 226 of the Finance Act 2004 provided for the lifetime allowance.

6.3 Finance (No.2) Act 2023 reduced the lifetime allowance tax charge to nil.

6.4 Finance Act 2024 removed the lifetime allowance from Finance Act 2004 and updated the pensions tax regime to operate after its removal, including providing for the new allowances. Section 14 and Schedule 9 amend Part 9, including introducing Chapter 15A, to Part 9 of the Income Tax (Earnings and Pensions) Act 2003[7] in relation to the taxation of lump sums under registered pension schemes and certain non-UK unregistered pension schemes.

6.5 Paragraph 134(2) of Schedule 9 to the Finance Act 2024 provides a regulation-making power that permits the amendment of primary legislation. This instrument uses this power to amend Schedule 29 and Schedule 36 to the Finance Act 2004.

6.6 This instrument will have effect from 6 April 2024.

Why was this approach taken to change the law?

6.7 Finance Act 2024 contained 100 pages of legislation to abolish the lifetime allowance. Further changes are required to correct that legislation and allow the pensions tax regime to operate as intended from 6 April 2024. This instrument is made under the power provided in the Finance Act 2024 to make the necessary changes.

7. Consultation

Summary of consultation outcome and methodology

7.1 Since the abolition of the lifetime allowance was announced, HMRC has worked with pension industry representatives to develop and test the legislation needed for the abolition to work as intended, across all aspects of the pensions tax regime. As with previous related legislation, a draft of the instrument has been shared with those

[7] ITEPA 2003

industry representatives for a short informal consultation. HMRC received 27 responses. The responses highlighted a few necessary minor amendments, which have been addressed in the regulations. HMRC has not consulted directly with pension scheme members. That contact was made indirectly through these industry representatives.

7.2 HMRC continues to work with pension industry representatives to help them fully understand their obligations for a smooth transition following the abolition of the lifetime allowance and the introduction of the new lump sum and lump sum death benefit allowances, and international related aspects.

8. Applicable Guidance

8.1 Existing guidance in the HMRC Pensions Tax Manual[8] and the GOV.UK[9] website will be updated to reflect the changes provided for by this instrument. Guidance will be published as soon as possible after the instrument is laid.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A Tax Information and Impact Note[10] covering the key impacts of the abolition of the lifetime allowance was published on the GOV.UK website on 22 November 2023.

Impact on businesses, charities and voluntary bodies

9.2 HMRC do not expect a significant, impact on business, charities or voluntary bodies. Any impact will be from the changes provided for in the Finance Act 2024 rather than this instrument.

9.3 This instrument does not impact small or micro businesses.

9.4 HMRC do not expect a significant impact on the public sector. Any impact will be from the changes provided for in the Finance Act 2024 rather than this instrument.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 This legislation will be monitored through communications with pension industry representatives. This will include the Pension Stakeholder Forum and regular Pension Scheme Newsletters.

10.2 The instrument does not include a statutory review clause.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 This legislation is connected to the lifetime allowance abolition provisions in section 14 of, and Schedule 9 to, Finance Act 2024. This instrument is further to The Pensions (Abolition of Lifetime Allowance Charge etc) Regulations 2024[11].

[8] HMRC Pensions Tax Manual: www.gov.uk/hmrc-internal-manuals/pensions-tax-manual
[9] GOV.UK Pension Scheme Guidance: www.gov.uk/money/pension-scheme-administration
[10] Tax Information and Impact Note: www.gov.uk/government/publications/abolition-of-the-lifetime-allowance-from-6-april-2024.

11.2 This legislation is also connected to The Pensions (Abolition of Lifetime Allowance Charge etc) (No.2) Regulations 2024. The No.2 instrument, and this one, provide for technical changes to legislation following the abolition of the lifetime allowance.

11.3 This instrument is made under paragraph 134(3) of Schedule 9 to the Finance Act 2024, which requires regulations which increase a person's liability to tax to be subject to the affirmative procedure. The amendments made by these regulations may, in some cases, increase a person's liability to income tax. The changes to the scheme-specific lump sum protection provisions in Schedule 36 to the Finance Act 2004 made by regulations 3 and 4, for example, could result in a person's entitlement to an additional lump sum being reduced from that which is currently available and, therefore, that person being liable to more tax than they would have been had these amendments not been made. The amendments made to the calculation of the relevant capital amount and trivial commutation lump sum (by regulations 2 and 6) and as to the availability of the overseas transfer allowance and the calculation of pension credit factors(by regulation 3) may result in certain individuals having a higher liability to tax. The amendments relating to an inaccurate transitional tax-free certificate (by regulation 5) may result in certain individuals have a reduced amount of allowance available and, therefore, a higher liability to tax.

12. European Convention on Human Rights

12.1 The Economic Secretary to the Treasury has made the following statement regarding Human Rights:

"In my view the provisions of The Pensions (Abolition of Lifetime Allowance Charge etc) (No.3) Regulations 2024 are compatible with the Convention rights.".

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").

[11] S.I. 2024/356