**Core Unit 3 – Running a Workplace Pension Scheme**

**Assignment 3 Notes**

(Part 4 – Allowances)

Recommended Time: *2 hours 30 minutes*

1. **Outline the key features of a Pensions Savings Statement.**

**(5 marks)**

Answer should cover:

* must be issued automatically if member exceeds standard AA;
* must be issued within 6 months of tax year end;
* unused AA carried forward and pension input in other schemes not included;
* statement shows pension input amount in the pension input period for current and previous 3 tax years;
* members who don’t exceed AA can request a statement;
* DC schemes – must issue if individual flexibly accessed DC scheme after 6 April 2015 and pension input amount exceeds Money Purchase AA.

Relevant section of the manual is Part 4 Chapter 1.4.

1. **Briefly describe Fixed Protection, Fixed Protection 2014 and Fixed Protection 2016.**

**List the circumstances that may give rise to an individual losing those protections and the information they must provide to HMRC when fixed protection is lost.**

**(20 marks)**

Answer should cover:

*Fixed Protection – any 4 of the following (4 marks)*:

* Introduced due to reduction in LTA to £1.5m from 6 April 2012
* Available to members if value of their benefits likely to exceed £1.5m by the time benefits drawn;
* Applications for fixed protection had to be received by HMRC by 5 April 2012;
* Benefits up to £1.8m in value protected from Lifetime Allowance charge;
* Future contributions (DC) and future accrual (DB) not permitted.

*Fixed Protection 2014 – any 4 of the following (4 marks)*:

* Introduced as a result of the further reduction in the standard LTA to £1.25m from 6 April 2014;
* Members can protect benefits up to a value of £1.25m;
* Members had to apply for to HMRC before 6 April 2014;
* Future contributions (DC) and future accrual (DB) not permitted;
* Not available to members with primary protection, enhanced protection or fixed protection.

*Fixed Protection 2016 – any 4 of the following (4 marks)*:

* Introduced as a result of the further reduction in the standard LTA to £1m from 6 April 2014;
* Members can protect benefits up to a value of £1m;
* No deadline for applying to HMRC;
* Future contributions (DC) and future accrual (DB) not permitted;
* Not available to members with primary protection, enhanced protection, fixed protection or fixed protection 2014.

*Losing Protection (8 marks)*:

* Protection lost if:
  + Benefit accrual has occurred;
  + A transfer that is not permitted has occurred;
  + There has been a transfer of sums and assets in an arrangement they have under a registered pension scheme that is not a permitted transfer;
  + They have made a new arrangement under a registered pension scheme other than in permitted circumstances;
* Must provide HMRC with:
  + full name, address, and National Insurance number;
  + the exact date that they lost protection;
  + the reason why they lost protection (for example benefit accrual, auto enrolment);
  + the type of pension arrangement (defined contribution or defined benefit);
  + their original certificate (if they still have it.

Relevant section of the manual is Part 4 Chapters 3.2, 3.3, 3.5 and 3.7.

1. **In relation to the Annual Allowance tax charge, briefly describe what is meant by “Scheme Pays”.**

**(5 marks)**

Answer should cover:

* member has the right to require the scheme to pay the charge on their behalf;
* scheme makes appropriate reduction to members’ benefit in return;
* member has right to require scheme to pay if certain conditions met:
  + member’s AA charge liability for the tax year must exceed £2,000;
  + pension input amount for scheme must exceed the standard AA;
  + member must request scheme pays via irrevocable election made in a prescribed form;
  + deadline for scheme pays request is 31 July after the end of the following tax year.
* scheme can voluntarily pay member’s charge if all conditions not met.

Relevant section of the manual is Part 4 Chapter 1.3.

1. **Describe the Lumps Sum Allowance (LSA), Lump Sum and Death Benefit Allowance (LSDBA) and the Relevant Benefit Crystallisation Events (RBCES).**

**(20 marks)**

Answer should cover:

*LSA (7 marks)*:

* The amount of tax-free lump sums that can be paid in a member’s lifetime is limited by the LSA. The LSA is equal to £268,275 for most members, but can be higher for members with LTA protections. £268,275 is equal to 25% of the standard LTA at the point it was abolished (i.e. 25% of £1,073,100 = £268,275).
* Broadly speaking, the LSA is used up when a lump sum is paid in the member’s lifetime that is tax-free (either wholly or in part). Any lump sum paid in excess of the LSA will be subject to income tax at the member’s margin rate.

*LSDBA (6 marks)*:

* The amount of tax-free lump sums that can be paid both in the member’s lifetime and on death is limited by the LSDBA. The LSDBA is equal to £1,073,100 for most members, but can be higher for members with LTA protections.
* Broadly speaking, the LSDBA is used up whenever the member uses up any part of their LSA during their lifetime or a lump sum is paid tax-free (either wholly or in part) on the member’s death. On death, anything paid as a lump sum above the remaining LSDBA will be taxed at the beneficiary’s marginal rate.

*RBCES (7 marks)*:

* RBCEs replaced BCEs with effect from 6 April 2024. These are split into “relevant lump sums”, which are lump sums made in the individual’s lifetime, and “relevant lump sum death benefits”, which are lump sums paid after the individual has died. Post the abolition of the LTA, only lump sum payments will be tested against the LSA and LSDBA limits. No test is triggered when pension benefits are taken as income such as annuities.
* Relevant lump sums which are tested against the LSA include pension commencement lump sums, standalone lump sums, and uncrystallised funds pension lump sums. Small lump sums and trivial commutation lump sums are not RBCEs. Serious ill health lump sums are tested against the LSDBA but not the LSA. Where multiple RBCEs happen on the same day the member can decide the order in which they are deemed to have occurred.

Relevant section of the manual is Part 4 Chapters 2 (introduction) and 2.2.

# Explain the Tapered Annual Allowance and provide an example of a tapered AA calculation.

**(10 marks)**

Answer should cover:

* Key features of the Tapered AA (6 marks):
  + Effective from 6 April 2016 for high earners;
  + Range of tapered AA between £10,000 and standard AA of £60,000;
  + Threshold income – broadly total taxable income;
  + Adjusted income – broadly taxable income plus pensions savings;
  + 2 income tests apply:
    - whether threshold income exceeds £200,000;
    - whether adjusted income exceeds £260,000;
  + where both tests passed, AA reduces by £1 for every £2 of adjusted income above £260,000;
* A worked example showing the tapered AA for a high earner (4 marks).

Relevant section of the manual is Part 4 Chapter 3.9.2.

1. **The initial level of the Annual Allowance (AA) was £215,000, effective from 6 April 2006 (A-day).**

**Explain how the amount of the AA has changed since A-day.**

**(10 marks)**

Answer should cover:

* AA increased by £10,000 every tax year until 2010/11 when it was £255,000;
* Finance Act 2011;
  + reduced AA to £50,000 effective 2011/12 tax year, due to:
    - state of the public finances and the consequent need to raise revenue;
    - fear that the 50% additional rate of Income Tax introduced in 2010/11 would prompt

high earners to put excessive amounts into pension schemes to avoid (or defer) tax;

* Calculation of AA charge of 40% abolished and replaced with new calculation;
* Excess pension input amount over AA deemed as earnings, taxed at individual’s marginal rate:
  + PIA over higher rate tax limit taxed at 45%;
  + PIA over basic rate limit but below higher rate tax limit taxed at 40%;
  + PIA below lower rate tax limit taxed at 20%;
* removal of exemption for members with Enhanced Protection and for those who draw all their benefits from the scheme;
* introduction of” carry forward” – unused AA can be carried forward from the previous three tax years to cover excess pension savings over the AA in the current tax year;
* special rules introduced relating to the calculation of PIPs for the period 14 October 2010 to 5 April 2011.
* Finance Act 2013 – AA reduced to £40,000 6 April 2014;
* Budget 2023 – AA increased to £60,000 6 April 2023. It remains at this rate in 2024.

Relevant section of the manual is Part 4 Chapter 1.1.

1. **Briefly outline how an individual’s pension rights are valued in order to determine whether they exceed the Lifetime Allowance, and provide a worked example.**

**(10 marks)**

Answer should cover:

* HMRC laid down a set of criteria for valuing pension rights when they are crystallised;
* DC scheme – value generally taken as the fund value at the time of crystallisation;
* DB scheme - value is the amount of any cash sum taken plus 20 x the starting pension;
* The value for a money purchase pot used to provide a scheme pension is also 20 x the starting pension;
* a pension that was put into payment prior to 6 April 2006 is also tested - at the time of the first post 6 April 2006 BCE;
* value of pre 6 April 2006 pension is the pension in payment at the time of the first BCE x 25;
* total value of the pension rights is then deducted from the member’s Lifetime Allowance;
* worked example showing value of pension rights and tes t against LTA.

Relevant section of the manual is Part 4 Chapter 2.3.

1. **Describe the purpose and key features of the Pension Input Amount, in relation to the Annual Allowance.**

**(15 marks)**

Answer should cover:

*DC Scheme (5 marks)*:

* pension input amount is the total ‘relievable contribution’ paid by or on behalf of the member in the pension input period;
* includes AVCs paid by the member but excludes transfers into the scheme from other arrangements;
* Taxation of Pensions Act 2014 introduced a Money Purchase Annual Allowance from 2015/16 tax year;
* MPAA limit £10,000, reduced to £4,000 from 6 April 2017, increased back to £10,000 6 April 2023;
* MPAA only applies to pension input amounts in DC arrangements when individual has flexibly accessed a DC arrangement;
* MPAA does not apply if individual has not flexibly accessed a DC arrangement.

*DB Scheme (7 marks)*:

* pension input amount is difference between value of a person’s benefits at the end of the pension input period is compared with the value of their benefits at the end of the previous pension input period;
* inputs relating to the 2010/11 and earlier tax years:
  + a factor of ten is used to value the benefits;
  + adjustments made to the figures to take account of transfers in or out of the scheme and pension debits or credits;
  + further adjustment for deferred DB member - ensures that the normal annual revaluation not included in pension input amount;
* inputs relating to the 2011/12 and later tax years:
  + valuation factor of 10 replaced by 16;
  + inflation protection extended to active members;
  + deferred members whose benefits’ revaluation does not exceed the increase in the CPI deemed as having no pension input amount;
* individual subject to MPAA still entitled to the alternative Annual Allowance for ‘other inputs’;

*Short worked example of pension input amount calculation and comparison to AA (3 marks)*

Relevant section of the manual is Part 4 Chapters 1.1 and 1.2.

1. **Outline the tax relief available to individuals in relation to pension scheme contributions and how the Annual Allowance tax charge impacts on the tax relief granted to an individual who exceeds the tax relief limits.**

**(5 marks)**

Answer should cover:

* Individual may pay an unlimited amount into a registered pension scheme in any tax year but will enjoy only up to the greater of 100% of their UK taxable earnings and £3,600 (for a scheme operating on a ‘relief at source basis’);
* Contributions in excess of the Annual Allowance will have received tax relief when paid, provided the individual has sufficient earnings, but the individual will then be subject to a tax charge (assuming they do not have sufficient carry forward to offset the excess contributions);
* The tax charge effectively claws back, in a broadbrush manner, tax relief granted on the contributions in excess of the Annual Allowance;
* Contributions to a money purchase arrangement that exceeded both earnings and the Annual Allowance, the tranche of contributions in excess of the greater of (i) the Annual Allowance and (ii) their earnings would not have received tax relief when paid;
* No Annual Allowance charge is therefore due on this tranche of contributions because no tax relief has been granted in the first place and so there is no relief to claw back.

Relevant section of the manual is Part 4 Chapter 1.3.