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Pension tax changes – what they mean and what to look out for

Yesterday's budget confirmed a 50% increase in the Annual Allowance for pension accrual. However, the biggest surprise was the removal of the £1,073,100 Lifetime Allowance.

These changes are designed to incentivise senior NHS workers and high earners across the board to keep working and continue saving into their pensions.

As always, we'll need to look at the detail but here's our initial view.

What are the changes and what will they mean?

- There'll be no tax penalty for having a large pension pot on retirement. The tax charge for exceeding the Lifetime Allowance (LTA) will be removed from April 2023, with the LTA itself abolished altogether in 2024.
- The only limit that will apply to pension saving will be at the input stage, in the form of the Annual Allowance. This will increase from £40,000 to £60,000 from April 2023.
- However, the unpopular Tapered Annual Allowance remains (the reduced Annual Allowance for very high earners).
- The equally unpopular Money Purchase Annual Allowance will increase from £4,000 to £10,000 (the reduced Annual Allowance for individuals who have flexibly–accessed their money purchase pension savings).
- Members can still take part of their pension pot as tax-free cash. However, the most they can take will now be frozen at £268,275. Anyone with a protected right to a higher amount will keep it (subject to fulfilling the requirements of their protection).
- Those lucky enough to have pension pots in excess of £1,073,100, either now or in the future, will enjoy significant tax savings. This is thanks to the removal of the tax charge for exceeding the LTA and then the removal of the LTA altogether.
- There are some losers. Members who took benefits recently under the current LTA and who already paid tax charges.

Actions and what to look out for

- Members with benefits over the current LTA and who want to retire now should consider waiting until 6 April 2023 (when the LTA tax charge will disappear). We've already seen cases where members could save over £180,000 in tax charges if they wait just 3 weeks to access their benefits.

- Pension Scheme Administrators should also pick out and alert any members nearing retirements where benefits are above the current LTA.

- Administrators will need to update systems and member communications, adding to their already busy workload.

- Trustees should consider when and how to communicate the changes. For many it won't be possible to do this before the new limits apply.

- Employers should look at how their benefits are structured. For higher earners, we expect to see a move from cash reward to pension, which is more tax efficient for both employer and member.

- It won't just impact those close to retirement. Decisions around pension savings are the member's responsibility. All members who think they could be affected, now or in the future, should consider taking advice.

- As with all pensions tax legislation, the devil will be in the detail. For example, once the LTA disappears entirely in 2024, how will the limit of £268,275 on tax-free cash be applied for individuals with multiple pension pots? And what transitional arrangements (if any) will there be for anyone who has already taken some cash?

The abolition of the LTA is viewed by some commentators as highly political. There is always the possibility that a change of government could see some form of LTA reinstated.

Remember 'A' Day on 6 April 2006 when the reform of the pensions tax system was hailed as 'simplification'?

In practice, it just gets more complex, and anyone seeking to navigate their way through this maze may need to seek specialist advice to make sense of it all.

If you'd like to discuss this further, please get in touch with your usual contact at Cartwright.

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Mill Pool House
Mill Lane
Godalming
Surrey GU7 1EY
T: 01483 860201
E: enquiries@cartwright.co.uk

250 Fowler Avenue
Farnborough Business Park
Farnborough
Hampshire GU14 7JP
T: 01252 894883
E: enquiries@cartwright.co.uk

Marlborough House
Victoria Road South
Chelmsford
Essex CM1 1LN
T: 01245 293300
E: enquiries@cartwright.co.uk