ASSOCIATION OF CONSULTING ACTUARIES

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To: HMRC at policypensions@hmrc.gov.uk
and Catherine Batey at pensions.policy@hmrc.gov.uk

Dear All

Abolishing the pensions lifetime allowance: comments on draft Finance Bill legislation

We are writing on behalf of the **Association of Consulting Actuaries (ACA)** in response to the consultation on Abolishing the pensions lifetime allowance[1] published on 18 July 2023 and the newsletter 152[2] issued on 20 July 2023.

The ACA welcomes the opportunity to provide input. Members of the ACA are all qualified actuaries – mainly Fellows of the Institute and Faculty of Actuaries. All actuarial advice given by our members is subject to the Actuaries' Code. Members provide advice to thousands of employers and pension schemes – with total assets exceeding £1 trillion – including most of the country's largest schemes – and increasingly consulting actuaries are now involved in a wide range of additional areas. We are therefore responding in the capacity of a representative body for professional advisors who provide advice to a range of occupational pension schemes.

We have already written (two letters on 17 August)[3]:

- Letter 1 addressing some of the policy issues raised in HMRC's newsletter, and our strong views on the real problems that could arise given the timing of this project (and suggestion of considering moving to an implementation date of October 2024 to allow for more completely formed holistic policy legislation and for technical consultation on it) and
- Letter 2 with thoughts on transition and disclosure where the intended policy has yet to be published.

In this letter we have attempted a deep dive into the draft legislation so far published to identify remaining issues, either on technical points or areas that appear to demonstrate policy change that has not been highlighted.

[1] https://www.gov.uk/government/publications/abolishing-the-pensions-lifetime-allowance
[2] https://www.gov.uk/government/publications/pension-schemes-newsletter-152-july-2023/newsletter-152-july-2023

[3] ACA responses to consultation: Draft legislation published for Finance Bill 2023-24: Abolishing the LTA

Structure of this letter

Our comments are set out in Appendices corresponding to the parts of the draft legislation which currently would be in the proposed Schedule 1 to the Finance Bill/Act.

Appendix 1 summarises our main concerns with details in Appendices 2 to 5. Appendix 6 addresses some suggestions on terminology.

Where our 'letter 1' suggested different approaches of policy, our comment here on the drafted legislation is relatively limited.

Further comments on timing, and risk (and risk management) from our experience in this deep dive

We refer you again to the comment made in our letter 1 on the extreme challenges of creating sensible policy and robust legislation in the timeframe proposed, and the limited form of consultation. We noted in particular that there are key areas of unknown policy (for example the policy on taxed Pension Commencement Lump Sum but also on other areas); and that the industry urgently needs certainty on these aspects, and revised or replaced draft legislation as a whole, with a further opportunity of consultation to review whether the final whole is coherent. We note again our proposal that the implementation date is delayed by 6 months to October 2024.

These concerns are reinforced with our deep-dive reading of the draft legislation released so far: 41 pages of complex legislation modifying hundreds of pages of legislation with connected regulations. There is material restructure between Finance Act(s) and into Income Tax (Earnings and Pensions) Act 2003 (ITEPA) (where in moving text from one place to another some things have been deliberately dropped); the draft implements some deliberate new policy but also replaces well known old pieces of legislation with new wording so as to avoid references to LTA and (old style) BCEs. This makes it extremely difficult to read and to spot all changes (intentional and not), and of course we are not lawyers. **Our review here has involved a lot of resource and time, but cannot be considered in any way complete.**

Furthermore – given that some of the key policy underlying the draft is expected to change (particularly reining back drafted "excess, taxable" PCLS and given that a key section (called "Transitions provisions" is still outstanding), **all our review to date could change once these items have been released, involving new overall interactions and contexts.**

As well as the primary legislation, there is the **interaction with regulations** that currently exist (and will still apply, albeit referencing potentially-moved legislation) and regulations not yet drafted. This will need careful checking of the cross-references to and from other legislation to ensure that the correct intention is retained – but that can only be done once the gaps/changes in policy are known and further drafts released.

Another issue for understanding, review and practical implementation is **Guidance**: the pensions tax regime currently is extremely complicated. Schemes rely fundamentally on HMRC's guidance (including what is now known as PTM), built up over 20 years, to know HMRC's reading of how this complex legislation applies in common practical situations. With the substantial reshaping of the legislation, we cannot see how sufficient guidance will be available in good time (and in time for a review of what has changed); and the industry's ability to look to extant guidance will be compromised. The need to take legal advice on this still-complex position will rise, adding to costs (and more queries to HMRC); and risks of non-compliance will increase.

Finally a point to avoid immediate unintended outcomes: this legislation interacts with scheme rules, and the impact of changes in legislation will create different changes to options and rights in a scheme depending on particular wording in the scheme documentation – unplanned and not in line with employer or trustee intentions and the good operation of the trust. We think it likely to be important to have a pair of **protective regulations** akin to the two at A-day[4] , to manage this risk. We leave further thoughts on this to the expert lawyers (and in particular the Association of Pension Lawyers).

We would be happy to discuss this matter further. Please contact Jillian Pegrum on 01252 768175 (jillian.pegrum@aon.com) or Karen Goldschmidt on 0207 4326621 (Karen.Goldschmidt@lcp.uk.com).

Yours sincerely

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Vice chair
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Karen Goldschmidt FIA,
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On behalf of the Association of Consulting Actuaries Limited

[4] SI 2006/364 – The Registered Pension Schemes (Modification of the Rules of Existing Schemes) Regulations 2006 and 2006/ 744 The Taxation of Pension Schemes (Consequential Amendments of Occupational and Personal Pension Schemes Legislation) Order 2006

Appendix 1 from the Association of Consulting Actuaries
Abolishing the pensions lifetime allowance consultation: *Summaries*

Note: The draft legislation uses terms individual's "lump sum allowance" and "lump sum and death benefit allowance. In this letter we refer to these as ILSA and ILSADBA. *ILSA = "[individual's lump sum allowance" and ILSADBA = "[individual's lump sum and death benefit allowance"*

We set out below first a summary of some key operational and policy points, and then suggestions of legislation that could be removed. Full details are given later in this document.

A. Some key operational or policy points that are out of line with expectations and may be errors (noting that we have not fully reviewed sections covered in our Letter 1)

Protected Lump sum Rights (5 April 2006 transitional right) See Appendix 4

The provisions give an appropriate uplift to continue the easement for those who had rights to more than 25% lump sums since 5 April 2006; but then have no provision to avoid the situation where the advantage that the protection gives in one scheme is clawed back by reducing scope in another. (We understand from HMRC that such a provision was intended to be included in the legislation, and look forward to seeing the draft.)

Enhanced Protection (EP) See Appendix 4

The law on EP is complicated, the draft provisions even more so. We started by focussing on the PCLS and think we have found important flaws in policy/drafting. NOTE that we have made some general comments on, but have not tried to look in detail at, provisions on EP interacting with: UFPLS, death lump sums (which operate in a different way to retirement lump sums) and SIHLS.

Individual Protections See Appendix 4

The drafted enhancement to the levels of ILSA and ILSADBA for those with IP (in particular for IP2016) need **underpins** of the standard levels.

Cash out of small benefits (TCLS, WULS etc) (see Appendix 3)

Our comment here is particularly limited because we deal with many points in letter 1.
As an aside (subject to changes made in the light of our letter 1), can HMRC make clear that the new provisions are intended to apply to small lump sums and to payment after relevant accretion which we read to be the case because of existing regulation.

The calculation of the tax-free element has changed from a simple 25% of the lump sum paid, to an unintuitive figure.

B. Requests for deletion of draft provisions

Dependants' scheme pensions (see Appendix 2)

Constraints currently apply to these pensions such that some elements may become unauthorised in some situations. These constraints are no longer needed given that they were intended to prevent avoidance of LTA charge and they are nuisance to operate, for both the scheme and the members.

Anti-abuse measures for PCLS (see Appendix 3)

Some current recycling provisions have been retained (although we are unclear on intent where there has been change). It is arguable whether the recycling measures currently deliver policy intent, this is an opportunity to remove them.

Appendix 2 (Part 1 of the draft clauses) Repeals to the provisions of Part 4 of FA 2004 that impose the lifetime allowance charge, and consequential amendments

Calculating AA PIA when entitlement to Cash Balance/DB benefit arises (BCE2/6) in the tax year

(Para 5-6) In the Annual Allowance provisions in s232 and s236 (for cash balance and defined benefit respectively) for calculating AA pension input amount, there is new wording relating to when benefits crystallise during the tax year to create an add back for the uncrystallised benefit so 'removed' from consideration in the calculation. The draft wording due to be inserted (paraphrased to avoid reference to BCEs) intends to leave the detail up to regulations.

Whatever wording is used in regulation, it must be such as to result in unchanged HMRC guidance. In particular, where a lump sum derives from commutation of pension the current HMRC guidance PTM053340 states that "the pension reduction arising from the commutation for lump sum is added back as well" ie that the pension 'added back' is the **pre-commutation** pension (and guidance also indicates that where retirement is early, the relevant early retirement factor is reflected in that benefit; the PTM also includes guidance to reflect the treatment of late retirement additions). We expect that unless there is explicit public consultation/review[5] by HMRC (followed by appropriate communication), practitioners are expecting legislation enabling this long-standing approach to continue.

There is an urgent need for certainty on this area (that is left to regulation), for 2024/25 charges. Members who are considering retirement in 2024/25 will want to know ahead of time the impact on their AA position and potential charge for 2024/25 in advance of retirement to help their decision making. (They may also need to know the full position in time to apply for mandatory scheme pays).

Rights to Scheme Pays

(Para 7) We note (and welcome) that (by the deletion of references to certain BCEs) there is no longer an age 75 cut-off for making a notice for "mandatory rights" to scheme pays.

Request to HMRC to simplify some provisions re dependants' scheme pensions

We ask that HMRC delete the extensive provisions in FA04 Schedule 28, paragraphs 16-16C that have been preserved in the released draft. This would remove significant administrative complexities that arise in practice in a material number of cases (not just at member death but in the setting up of benefits and limiting options at member retirement). We explain this further below:

Essentially, in the year following the member's death the dependant's pension must not exceed the sum of the annual rate of the member's pension in the year before death, plus 5% of any tax free lump sums taken in connection with the member's pension (uprated for inflation). However the working of the requirement and the exemptions is very complex.

The spirit of the new regime is to leave pension fully subject to income tax (with no Lifetime Allowance charge or similar consideration); and introduce special measures to manage how much of the various lump sums are taxed or are also subject to income tax. We welcome the consequent removal from legislation of all [pension-type] BCEs (this means more members will be able to take full 25% tax-free PCLS, removes special consideration of the size of pensions increases ("BCE3") etc, and thus simplifies admin).

But currently (as shown above) there are complicated provisions on dependants' scheme pensions that create unauthorised payments in certain circumstances. The draft legislation leaves these in place. They were designed to deal with HMRC's concern of a LTA charge avoidance opportunity: that individuals with large pensions coming into payment might give up part towards dependants' pension specifically to avoid LTA charge. This is no longer a concern. So we cannot understand why the provisions are still in place.

Appendix 3 (Part 2 of the draft clauses) Amendments to Part 4 of FA 2004, Part 9 of ITEPA 2003, and subordinate legislation, relating to the taxation of lump sums

Impact of certain taxed lump sums on the taper formula for AA

Para 21 removes any lump sum death benefit (that is chargeable to income tax) from the definition of both "adjusted income" and "threshold income". This is welcome, to avoid anomalous and unexpected impacts for beneficiaries. However, if the intention is for money purchase pension death benefits to be more widely taxed (despite comments in our letter 1 of 17 August) we suggest that pension death benefits should also specifically be carved out.

The explanatory notes (although not the policy note) suggest that the same removal would apply to drawing taxed retirement lump sums but this has not been put in the draft. Unless that is also changed, this needs to be highlighted in guidance, and members will need to take careful advice on the Annual Allowance implications from taking the option.

Unlimited PCLS scope with a limit just on the tax-free element

(Para 24) The draft legislation amends the restrictions on PCLS in Schedule 29.

S637A introduces the new "permitted maximum" for PCLS (being the lowest of the applicable amount, remaining ILSA and remaining ILSADBA) . And subsection 2 confirms that if a PCLS "exceeds the permitted maximum, section 579A (pensions) applies to the excess as it applies to any pension under a registered pension scheme." These changes in tax law would allow unlimited PCLS and apply limits only to how much is tax-free – but HMRC has stated in its newsletter that "it is not the government's intention to significantly expand pension freedoms". So clearly the drafting goes further than intended. We have already commented on this fully in our Letter 1: in Appendix 1, and in Appendix 4 where we suggest alternative approaches to the policy issue HMRC raises in its Newsletter. This could involve a range of structural changes, so our comments here are limited.

Incorrect Lifetime Allowance charge could have been paid and this situation could still occur in historic adjustments (for example adjustments due to the McCloud ruling) and so legislation regarding how to remedy such overpayments needs to be retained (and possibly with power for further regulatory amendment to this).

We note that the present MP-DB arbitrage prevention provisions are retained - but would operate in the context of the new-style limits; we have not had time to consider the implications in full.

Some current recycling provisions have been retained here (although we are unclear on intent where there has been change). It is arguable whether the recycling measures currently deliver policy intent, this is an opportunity to remove them.

Valuation of benefits for £30K trivial commutation test

Para 28 discusses how to value benefits for the £30K test for trivial commutation, and introduces a regulation-making power. We cover proposals for trivial commutation in detail in our letter 1 of 17 August and so do not comment further here on the wording initially suggested by HMRC[6].

Tax free part of small benefit cash out for uncrystallised rights - flawed

The new s637F changes the calculation of the tax-free part of trivial commutation lump sum TCLS and Winding up Lump Sum WULS (and thereby for small lump sums too) inappropriately.
In short, currently the tax-free part is, in all practical cases of uncrystallised benefits, simply 25% of the lump sum paid. The draft legislation would change this to something unintuitive, complicated and in our view inappropriate – more details are given below.

The present legislation 636B for TCLS and WULS provides that if the member has uncrystallised rights under the pension scheme, the amount of the taxable pension income—

(a) if all his rights under the pension scheme are uncrystallised rights, is 75% of the lump sum, and

(b) otherwise, is reduced by 25% of the value of any uncrystallised rights extinguished by the lump sum.

In practice nearly all cases of the rights being cashed out in a scheme are EITHER all crystallised (so all taxable) OR all uncrystallised, not a mixture. So the usual scenario here would be a) above where 75% of the sum paid is taxed ie the tax free element is simply 25% of the sum paid.

Under the new legislation (s**637F)** the tax-free element (if any) is 25% of the "value" of any uncrystallised rights extinguished by the lump sum (ignoring the other limitations in relation to the ILSA and ILSADBA here). Both the "uncrystallised rights" and their value are defined to have the same meaning as the terms in section 212 of FA 2004.

There is no simple "75%" any more. Every case with uncrystallised benefit would involve a potentially complicated identification of a deemed notional of pension level and a fixed 20x valuation. So say £12K is paid out for an uncrystallised benefit under the scheme's rules, the member will expect £3K to be tax free, but the draft would mean it could be very different.

A simple solution to this is that the new 637F 3(a) or (4) define the tax-free element as 25% of so much of the lump sum amount as [the scheme identifies as] represent the uncrystallised benefits.

Taxation of death lump sums
In the new s637G the various scenarios for payment of Defined Benefit Lump Sum Death Benefit DBLSDB are set out sequentially (perhaps more clearly than the present ITEPA legislation). Essentially as expected, the DBLSDB paid to a qualifying person and within 2 years of death (similar rules as currently) where the member died under age 75 will be taxed (as income) only on the excess over the permitted maximum. In other circumstances (eg over 75, outside the 2 year limit, or paid to a non-qualifying person) tax will, as now, apply to the whole lump sum (just at different rates depending on whether it is paid to a qualifying or non-qualifying person). A similar pattern broadly runs through for Uncrystallised Funds Lump Sum Death Benefit in new s637I, Drawdown Pension

[6] DWP will need to review contracting-out legislation on scope for cash out to consider appropriate consistency with the new provisions. We hope we can be involved to take the opportunity to clarify areas that do not appear to operate as intended.

Fund Lump Sum Death Benefit in s637K and Flexi-access Drawdown Lump Sum Death Benefit in 637L. HMRC has chosen to change the operation of three lump sums materially – the Pension Protection Lump Sum Death Benefit and the two Drawdown-related Lump Sums. *We refer you to our Letter 1 concerning policy points.*

We were surprised that, for the two Drawdown-related Lump Sums, if the member dies after reaching age 75, income tax applies to just the excess over ILSADBA rather than the whole sum as applies for the other Lump Sum Death benefits, we were not sure of the logic for this.

Note that under new 637H re Pension Protection Lump Sum Death Benefits, presumably as a policy decision, income tax now applies on the excess of the PPLSDB over the permitted maximum, whereas currently PPLSDB is tax-free. *We do not comment on the policy point but see our comment later on Transition.*

As an aside, and perhaps a matter impacting regulation rather than primary legislation, we would strongly request that the management of tax due on a death lump sum continues in line with the pre 2023 regime, that is, that the scheme pays lump sums gross and it is the Legal Personal Representative that manages the identification of whether any of the lump sum is taxable, and provides HMRC with information to arrange its collection. (If there is to be any move away from the process, it would require careful discussion to identify potential timing or other issues in this sensitive situation.) Please see our letter 2 of 17 August for further details.

Tax-free PCLS: minor amendments

S637Q-S aim to replicate the present provisions for the 'applicable amount' in a PCLS We note that the current legislation uses words requiring the deduction of rights which are attributable to a disqualifying pension credit in calculating the applicable amount. This approach has been retained for most benefit types under ITEPA, with the exception of the scheme pension in S637Q (2), where an attempt has been made to incorporate this deduction in the formula by deduction "D" .

We suggest reverting to the current approach i.e. removing D from the formula and adding: substituting the text in item D with

"Any part of what would otherwise be A or C which represents rights attributable to a disqualifying pension credit is to be disregarded."

As it stands, D could be read as meaning (correctly) that the £ amount of any lump sum relating to the disqualifying pension credit should be deducted, but also that (incorrectly) the £ pa amount of pension relating to the disqualifying pension credit should be deducted, rather than that amount multiplied by the relevant valuation factor.

In the new 637Q definition of "the applicable amount" for the purposes of the PCLS, there is a typo in the definition of B: "relevant revaluation factor" should be "relevant valuation factor".

Taxed PCLS or other retirement lump sum – date for assessing tax

We note that the legislation still has (from FA04 sched 29) the present provisions for the 18-months window of payment of the PCLS around entitlement date. We also note that the operation of ILSA and ILSADBA testing is carried out based on the "entitlement date" to the lump sum. In the case of PCLS this continues to be defined in the law to (broadly) the instant before entitlement to the related pension. Setting aside the PAYE practical process for collection of tax, it is not clear to us whether the amount of income tax due on the taxable element of the PCLS is assessable according to entitlement date or payment date. To the extent that the final legislation permits any taxed PCLS, this point will need to be made very clear in law and guidance. (In any case, schemes continue to have to consider very carefully what constitutes “entitlement date” for pension – an area in which HMRC to date has given important guidance which will need to be updated.)

(And we would reiterate a point in one of our other two letters, it is not clear what are the corresponding impacts on Trustees and members if the Trustees deduct the wrong income tax for the new benefits being paid through PAYE. We propose that HMRC would seek to reclaim/refund the tax via the usual methods for under/overpayment of income tax rather than require the pension scheme to do so.)

Para 38 introduces consequent amendments to the 2009 Authorised Payments regulations (as amended). *As noted above, on the assumption that it is not the intention to allow an uncapped PCLS, we would question why HMRC is proposing to remove the facility to allow lump sums previously calculated on the basis of incorrect pension amounts – this will still be required so that any overpaid PCLS will still be an authorised benefit (the facility may also be necessary to deal with the position where entitlement to the pension arose in 2023/24 but the PCLS is paid in 2024/25, depending on how the transitional arrangements would apply here).*

Appendix 4 (Part 3 of the draft clauses) Amendments to provisions that confer transitional protections in relation to the introduction of the lifetime allowance charge or reductions in the amount of the lifetime allowance

Primary Protection - error for death lump sum?

For Primary protection an increase to the member's ILSA is introduced being the primary protection factor of

(A – £1,500,000)/£1,500,000

where A is the amount of the individual's relevant pre-commencement (6 April 2006) pension rights (ie the figure on the member's PP certificate)

But this same calculation also features in the calculation of the increased ILSADBA. Under current legislation the revised primary protection factor for death lump sum uses the value of the individual's pre-commencement rights to **death benefits**.

There are later provisions relating to members with £>375K lump sum rights, this is a particularly complex area that we have not reviewed.

Enhanced Protection

We understand that the context here is currently that EP members can have higher tax-free lump sums than the standard (in two "flavours"); but HMRC wants to limit these in line with general policy and also in the light of the members' new potential for adding more funds without losing EP.

EP - Error in Finance (No 2) Act 2023

Our work on the draft legislation has identified a possible flaw in the 2023 change to Enhanced Protection. The new limitation in para 27 of FA04 Schedule 36, inserted by s23 Finance (No 2) Act 2023 says:

> 3)In paragraph 27 (enhanced protection: modifications of paragraph 2 of Schedule 29), in sub-paragraph (3), in the substituted sub-paragraph (5) of paragraph 2, for the words after "the permitted maximum is" substitute "the lower of—
>
> (a)the applicable amount calculated in accordance with paragraph 3, and
>
> (b)the amount that would have been the applicable amount calculated in accordance with paragraph 3 if the lump sum had been paid on 5 April 2023."

So, (b) sets the maximum at 5 April 2023.

The issue is that (b) never changes, irrespective of any post-5 April 2023 PCLS taken.

What would this mean in the following (DC) situation, that a member with x% protected lump rights on their certificate could draw [most of] those funds including an x% tax-free lump sum part (capped as per the amended paragraph 27(3) including provision (b)); and then had additional growth or put in extra funds, and then aimed to draw out another tax free PCLS of x% of those new funds? How would that be capped? As drafted, would the 2023 cap in paragraph 27(3 (b) apply at the same amount again to this PCLS?

EP - PCLS provisions in draft legislation
The legislation overwrites the proposed new approach to the standard tax-free PCLS limit (in ITEPA S637A 3(b) in the following ways:

For **those without "£>375K protected lump sum** rights"

the permitted maximum is the lowest of

(a) the "applicable amount" (broadly 25% of the package),

(b)~~ the amount remaining available of the ILSA at entitlement~~ ^The maximum amount of PCLS that could have been paid to the individual on 5 April 2023 ^*[via para 45(2) which inserts the modification in subpara (3B) to FA04 Schedule 36 para 12)]*
(c) the amount remaining available of the ILSADBA at entitlement, *[where ILSADBA is an amount equal to the value of the individual's uncrystallised pension rights on 5 April 2024] [via para 45(2) which* inserts the modification in subpara (3D) to FA04 Schedule 12)*]*

ILSA is overwritten to £375K (modification in subpara (3C)) – but is not then used in the calculation of scope for tax-free PCLS here because (b) above is overwritten.
ILSADBA is overwritten as noted above

For **those with ">£375K protected lump sum** rights"
Here there is a further overwrite by paras 55 and 56, which inserts para 29A to FA04 Schedule 12 and changes the EP provisions above (ie those that arose from para 45) to give the following difference from the "basic" position.

The permitted maximum is the lowest of

(a) the "applicable amount" (broadly ~~25%~~ [certificate percentage] of the package),

~~(b) the amount remaining available of the ILSA at entitlement~~ ^The maximum amount of PCLS that could have been paid to the individual on 5 April 2023^ [still via 45 (2) above, with no further modification by para 56]
(c) the amount remaining available of the ILSADBA at entitlement, [where ILSADBA is an amount equal to the value of the individual's uncrystallised pension rights on 5 April 2024 via 3D]

ILSA is set to "the maximum PCLS… 5 April 2023" but is not then used in the calculation of maximum scope for tax free PCLS because it is already eliminated by the para 45 changes.
ILSADBA is as above.

We do not understand why you have chosen these approaches, nor think they operate practically, given the context being reflected, as follows.

For the first group above, the **context** is that the current provisions are that

(i) the PCLS is subject to a cap of the available portion like any basic PCLS, but using an LTA for this purpose underpinned by £1.5m (this is done in FA04 Schedule 29 para 2 (10) and 2 (11) for PCLS which are being deleted)

(ii) No change was made by Finance (No 2) Act 2023
(iii) these members can now make DC contributions etc without losing EP.

Comment: on this basis, we would expect their (a) and (b) provisions to operate identically to a member with FP14. So in particular (b) would revert to referencing ILSA albeit to an ILSA that has been overwritten to £375K. We discuss (c) ILSADBA later.

For the second group above, in present law, Schedule 29 is currently modified by way of FA04 Schedule 36 para 24, 27 and 29 (and then by way of Finance (No 2) Act 2023 adding an extra cap within para 27). The PCLS for these members is calculated scheme by scheme. Compared to the standard PCLS case,

(i) the scheme uses the protected % on the member's certificate instead of 25%, in the applicable amount;
(ii) there is no "available portion" cap reflecting the LTA.

The % simply applied to the value of benefits (if EP survived) and hence a certificate showing 10% could still give a PCLS more than the standard of "25% with an available portion cap".

(iii) As from 6 April 2023 because EP members can add contributions etc, Finance (No 2) Act 2023 added a cap clearly operating on an in-scheme basis – but that may be flawed as noted above.

Comment: on this basis the (a) and (b) above seem to work appropriately for this group, and sensibly on a scheme by scheme basis, subject to the potential flaw identified above in Finance (No 2) Act 2023 being appropriately dealt with – that might be by way of amending (b) so that it reverts to referencing ILSA (which is again duly redefined to the 5 April 2023 scheme limit) but with the only offsets applying to the operation of ILSA being those relevant lump sums arising from the scheme.

Thoughts on ILSADBA in this context:
ILSADBA's amount is overwritten (to the value of **uncrystallised** benefits at 5 April 2024) but there is no proposed change to its basic operation ie that it applies across all schemes and so past lump sums from any scheme are offset. That would suggest that (c) has to operate somehow at a cross-scheme aggregate basis. We do not think that is possible eg because of the information exchange required to establish the value of uncrystallised benefits across all schemes at 5 April 2024. So maybe the clauses on the operation of ILSADBA need to be modified– to operating on a per scheme basis?

We note that ILSADBA only reflects uncrystallised benefits. This is rather different from ILSADBA elsewhere where members have a "clean slate" full-LTA equivalent. So when the missing section on "Transitions" is drafted, it will have to take a different approach to past BCEs [from this scheme or from others] as to how past lump sums/BCEs are offset.

EP - lump sums other than PCLS
The above suggested enough complex issues on PCLS to be untangled that we could not go into depth considering UFPLS, SIHLS or death lump sums – which have very different structures. We would be happy to discuss these further once we know HMRC's thoughts on the PCLS case.
(We do note the limitation on the tax- free element of lump sums paid on serious Ill health or death:

for Serious Ill Health Lump Sums, Section 637B of FA04 is to be modified to protect “the maximum amount of a serious ill-health lump sum that could have been paid to the individual on 5 April 2024”. We think there is a real challenge to a DB scheme working out what such a limit might have been – often issues such as this are only explored when (rare) cases crop up, perhaps taking actuarial and legal advice. A simpler approach albeit slightly more generous could be to reference the “appropriate limit” as at 5 April 2024 under FA04 Schedule 36 Para 15e.

The administrative difficulties for members who need to use that protection at the 5 April 2023 level have previously been pointed out. We note that *this is a provision where HMRC has r*egulation-making powers about how the value of the individual's uncrystallised pension rights on 5 April 2024 will be valued. There might still be an advantage in creating regulation making powers on how to value a member’s cash rights on 5 April 2023.

We note that para 39 removes the restriction that currently prevents an UFPLS being available to someone with Enhanced Protection who also has >£375K protected lump sum. As noted above, further thought might be needed here as we are not sure that ILSA and ILSADBA can work across schemes.

Protected lump sum rights (PPCLS)

In relation to Para 58-59,we would make comments in relation to the protected pension commencement lump sum (PPCLS) provisions (not the >£375K provisions with PP or EP).

(a) interaction with ILSA

We note that If someone has PPCLS from some of their schemes under Para 31 of Schedule 36 of the present FA 04, under para 59 of the draft Bill clauses there is provision for this protection to be retained broadly unchanged (with some simplifications) within the paying scheme .

We had expected two additional modifications compared to the new standard PCLS approach:

- Individual lump sum allowance (ILSA) would not cap the protected PCLS; and
- ILSA and ILSADBA would be used up only at 25% - or something along similar lines, so as to avoid clawing back the advantage that the protection was delivering in one scheme by reducing scope in another.

Eg if a member had 2x £400K pots in schemes A and B ,
they might be able to take £300K tax free PCLS from A (because of protected LS rights and even though it is more than £286K); and if they did, that £300K would only eat into their ILSA as 400K/4 = £100K. £186K of ILSA would remain.
So the next scheme B (say it is unprotected) could still offer tax free PCLS of £400K/4 = £100K.

The importance of the second bullet above is how it influences timing of drawing. Without it:

If the member takes the £300K first, from A, they cannot take anything tax free from B as they have used up all ILSA.

If the member takes the £100K first from B, they can still take the full £300K tax free afterwards from A as the test for protected cases ignores past cash.

We hope that HMRC will introduce a provision of this form, or one with equivalent impact.

(b) The formula

for calculating the scope for PCLS for these cases has largely been preserved with some sensible simplifications on the whole. We note an error in that in Para 59(2) - ALSA replacement ('B') is no longer subject to an explicit minimum of zero in the calculation of scheme-level protected lump sum. (under the present legislation "ALSA = greater of the [defined] additional lump sum amount and nil." This seems a clear (and worsening) error. (Negative ALSA could occur in practice without the floor.)

(c) impact of transfers out

There is currently a regulation that reduces the scope of PPCLS where there has been a partial transfer out, by an offset of [-TV amount/4]. There is no specific mention of this in the draft. We think this regulation currently has some very flawed outcomes of double penalty and would happily see this removed. Does it still come through because the current regulations still apply?

If that regulatory provision is maintained, we would ask HMRC to put into the law an explicit provision that where a member has PPCLS rights, the scope for [tax-free] PCLS can always be at least the standard formula without protection.

Aside on Stand Alone Lump sums

We note that the new provision in s23 of Finance (No 2) Act 2023 in relation to standalone lump sums is not being disturbed – ie the legislation permitting payment of the standalone lump sum remains but tax under ITEPA is charged on any amount in excess of that available at 5 April 2023. There is a similar point to that made above for scheme specific lump sums about additional provisions such that the larger than 25% scope for tax free PCLS is not clawed back.

Fixed and Individual Protection

1 Adjustment to ILSA and ILSADBA needs to be an underpin

The legislation overwrites ILSA and ILSADBA with figures relevant to the FP or IP that the member has applied for. We believe there is an error in that the overwrite should be changed to an underpin so that ILSA and ILSADBA are never below £268,275 and £1.7031m (this is implied in the explanatory note but seems not to have been implemented). In particular a member could have registered for IP16 with a figure between £1m and £1.0731m, and under current legislation would be tested using the (now higher) standard LTA.

2 **Closing date for Fixed Protection 2016 and Individual Protection 2016**

Our letter 1 of 17 August discussed the possible difficulties of closing the application window particularly for those who have not yet sought Individual Protection; and suggested an extension to the deadline. But if the proposed deadline for Fixed Protection is introduced as proposed in the draft clauses, we would point out that 5 April 2025 is a Saturday.

Appendix 5 (Part 4 of the draft clauses) Commencement and transitional provisions.

Commencement

We addressed commencement at the start of this letter and in Letter 1

"Transitional provision",

There is no suggested legislation yet on this potentially very challenging area that may need to cover a range of issues. Our comments here are limited because of input in our other letters, but among other things, this section will need to cover the following

- How benefits crystallised before 6 April 2024 should eat into the ILSA and ILSADBA

  Our letter 2 of 17 August suggests various points that would no doubt feature in the transitional provisions viz how to record and take account of previous benefits taken before the effective date of this legislation (including benefits that were taken when Lifetime Allowances were higher but 'ate into' the previous levels of the LTA because usage was noted by reference to the percentage taken).
  This could need variation for a range of special cases (eg see the section on EP)

- Special implications for benefits that were crystallised before 6 April 2024

  For example, if drawdown funds already incurred LTA charge, should tax on death lump sums be modified?

  And we noted earlier that under new 637H re Pension Protection Lump Sum Death Benefits, as a policy decision income tax now applies on the excess of the PPLSDB over the permitted maximum, whereas currently PPLSDB is tax-free. T*ransitional cases need consideration if the PPLSDB represented a payment in respect of a pension on which a LTA charge has already been assessed at retirement.*

Appendix 6 Suggested changes to terminology / Some overall points

Names for the Allowances

The draft legislation uses the terms "lump sum allowance" and "lump sum and death benefit allowance" (and then uses the terms with "individual's" in front of them).
However both of these only apply to tax-free elements, not the total lump sum. In addition, ILSADBA only applies to death before age 75, but many deaths occur after age 75 (this is subject to one query we raise within the main Appendices).

For both these reasons, the names for the allowances in draft legislation are potentially confusing.

Most people will interact with neither limit, some will plan around ILSA and very few will worry about ILSADBA. As such, we suggest the important point is to give ILSA an intuitive name and not worry too much about ILSADBA. For example, ILSA could be known as the "Tax-free allowance" / "TFA" and ILSADBA as "Overall tax-free allowance / "OTFA".

Name for "Relevant BCEs"

The term 'Benefit Crystallisation event' (BCE) is being removed from the FA04 legislation (although the concept of the event or calculation relating to the event will be retained for various purposes). A new term proposed is "relevant benefit crystallisation event" (which is defined differently for ILSA and ILSADBA, and includes some old BCE items but adds in some new items). This could be confusing given the entrenched used of Benefit Crystallisation Event for the last 17 years – and potential use in the section on "Transition Provisions".
We suggest a new term "relevant lump sum event".