4 February 2014

Paul Cottis
HMRC
by email to: pensions.policy@hmrc.gsi.gov.uk

Dear Paul

Finance Bill 2014

Lifetime allowance: individual protection 2014 draft legislation and guidance

Thank you for the opportunity of commenting on the individual protection 2014 draft legislation and guidance published in December 2013.

This is one of two letters from ACA – this letter relates directly to individual protection 2014 (IP14), and the issues we have spotted to date are set out in Appendix 1 (with a rewritten example explained there and then set out in full in Appendix 2).

Our other letter will follow, and relates to an item that is not individual protection but we would very much like to be considered as a change implemented to Finance Act 2004 – we are not sure whether this would be via FA2014 or by regulation.

Yours sincerely

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APPENDIX 1

DESIRABLE CHANGES TO THE LEGISLATION

1. **Disclosure of Amounts A to D on the HMRC certificate**

   We note that in the 2006 LTA changes, the registration approach for Primary Protection required members to apply to HMRC in a form in which they broke down the elements of their protection into some components but these components did not appear on the HMRC certificates.

   For IP14 the legislation again requires an individual to apply to HMRC giving the relevant amount in total and a breakdown by Amounts A, B C and D. It would be extremely useful to all parties if HMRC could replicate this split on the certificate. In particular if a member has only amount B and C, then the scheme administrators who come to process any BCEs for the individual after 5 April 2014 can use Amount B for a full "summary figure" of all BCEs before 6 April 2014, and save a considerable administration cost and risk of inconsistency and error.

   We note this now in case it requires some empowerment in the legislation. We note that it is the member who shows the certificate to the scheme so we would not expect any Data Protection Act issues on this.

2. **Amount A (pensions in payment at 5.4.2006) – should be split A1 and A2**

   At the moment all pension in payment as at 5 April 2006 are included in one Amount A. Where the member has had a BCE before 5 April 2014, there is a fully determined "deemed BCE" value to the pre 2006 pension. It contributes to the IP14 relevant amount at 25 x the rate of pension that was in payment just before that BCE; and in post 2014 BCE processing, the individual's protected LTA is deemed to be used up by [that same value/SLTA at the first BCE event] x personal LTA/£1.5m. When a post 5 April 2014 BCE occurs, the scheme administrator managing the BCE could simply take the value and multiply up by [protected LTA/£1.5m]. (This point is pursued further in relation to Example 6 below.)

   Where the member has had no actual BCE before 5 April 2014, the pre 2006 pension is brought into the relevant amount at 25 x the pension rate at 5 April 2014; but for any post 5 April 2014 BCEs, its use of BCE will reflect its level the instant before the first post 2014 BCE ie a figure to be determined after the IP14 registration.

   We therefore think it would be sensible to identify the first type of pre 2006 as entry Amount A1 and the second as A2, with A1 more akin to Amount B in terms of how it would be used in future. This would be particularly relevant if you agree to our request in (1).

3. **Amount A (pensions in payment at 5.4.2006) if no BCEs before 5 April 2014**

In a type A2 case (See section (2) above, we note that the IP14 relevant amount is fixed as at 5 April 2014, but the usage of the member's (fixed) protected LTA reflects the level of the pension just before the first BCE so some time in the future. This means that this benefit, already in payment and potentially increasing with increases imposed by law, erodes an individual's remaining LTA available for uncrystallised benefits. This seems unfair but the changes required to accommodate a solution would be rather intricate.

4. The calculation of relevant amount in "obvious cases"

In general getting the information to pin down the registerable value involved some work, including work for pension schemes.

The protected Lifetime Allowance for an individual who registers for IP14 is set to £1.5m if their relevant amount is £1.5m or more. We suggest an easement (within FB2014 and the relevant information regulations) that would significantly reduce work for all parties for some cases. If the number is obviously above £1.5m, we would suggest that the individual can simply tell HMRC this fact instead of calculating the exact number.

We acknowledge that if the member later has a divorce debit, this might mean that the individual needs to have enough information to check whether this brings the IP14 adjusted amount below £1.5m and work out the right figure to notify to HMRC. But the member can make arrangements to have enough information on file or get the information then, should s/he need it.

We would be happy to discuss other variations on this if HMRC wanted to offer this with some constraints.

DESIRABLE CHANGES TO THE GUIDANCE

5. Guidance on calculating relevant amount - valuation assumptions

The valuation assumptions (from S.277 FA04) are briefly mentioned in part 3.4 of the draft HMRC guidance. However these are an important and complex concept. We suggest that you include a paragraph "For the purposes of working out the registerable value of uncrystallised benefits, **members**' rights under **defined benefits arrangements** and **cash balance arrangements** are calculated using the **valuation assumptions in a similar way to the first steps in calculating Pension Input Amount for Annual Allowance**. An explanation of what this means in practice is given in RPSM06107060 and there are some examples in RPSM06107100."

6. Guidance on calculating Relevant Amount Scheme Pays

In separate correspondence with you we have noted that by 5 April 2014 a number of individuals may have used Scheme Pays to pay for an Annual Allowance charge.

It would be helpful to clarify in guidance that where the reduction has been implemented by 5 April 2014 it is to be reflected in the relevant amount for IP14; but where the reduction has not yet been implemented there is no impact even if the member election has been given by that date.
(in relation to the latter, we particularly note that a cross reference to RPSM06109050 would be helpful which states that "As the notional negative DC account might not impact the defined benefits until a future event occurs, when applying the valuation assumptions (see RPSM06107060), the calculation of the pension input amount for the pension input period in which the negative DC account is set up, and in subsequent pension input periods, ignores the fact that the negative DC

account has been set up as a result of an amount of annual allowance charge being paid by the scheme administrator". It would be helpful to note in the IP14 guidance on calculating Amount B states that the same principle applies.

7. Examples 4 5 and 6 –IMPORTANT easy approach regarding pre 2014 BCEs (and type A1 Amounts)

We have not reviewed all the examples (we do note a typo in example 6 and then £600 lost somewhere along the way).

However we think that as shown the example suggests an odd mixed approach to the calculation, of Amount B and misses a very important easy approach Given the way the law is being interpreted in the guidance (which in relation to members with Fixed Protection is different from some previous correspondence with HMRC) then:

- The percentage reported to the member at each BCE will, in accordance with legal requirements have been £BCE amount/standard LTA at BCE with this slightly rounded down (noting this will be £1.8m if the BCE was in 12/13 or 13/15 and the member had Fixed Protection at the BCE),
- Amount B is calculated as £BCE amount x £1.5m/standard LTA at BCE (noting ....etc)
- But this formula is also Amount B = the reported % from the scheme(s) x £1.5m.

So a member can simply use the sum of the percentages reported to him x £1.5m.

Example 6 should thus better be written as set out Appendix 2 to this letter (with similar changes to 4 and 5) **Reliance on BCE statement percentages when calculating Amount B of the relevant amount**

8. **Guidance suggesting that the individual asks schemes for extra information on past BCEs**

HMRC suggests on P.21 and P.23 of the draft guidance that scheme members should approach their scheme administrator for the actual £ amount of a crystallised amount rather than relying on the LTA percentage quoted in the BCE statement the member will already have received (and for which they get reminders annually).

In accordance with the requirements in law and HMRC guidance, schemes already provide BCE statements with percentages quoted to 2 decimal places rounded down. The maximum difference to Amount C that using the actual value can make per BCE is 0.009% of the relevant standard LTA so around £135 per BCE. This difference is in the context of a total relevant amount that must be more than £1.25m for an IP14 registration.

There is no obligation for schemes to provide the £amount; and the extra administration burden of revisiting a member's files up to seven years ago at a member's request would be far more costly than the tax the member saves. (We do note that in some rare cases, the impact of another £135 could result in an individual passing the threshold qualification for IP14 –but only so as to acquire a personal LTA only a tiny bit higher than the new standard LTA of £1.25m)

We request that this suggestion in removed from HMRC guidance; or that it is acknowledged that the scheme might charge for providing this information.

You will see from our comments in the section above for Example 6 how little difference is made, and how unnecessary it is to use more than the percentage statement information.

9. PCLS scope

Currently this states
"**What is the maximum tax free lump sum I can have?**
The maximum tax-free lump sum you can take from 6 April 2014 will be 25% of the uncrystallised value of your protected lifetime allowance, subject to what the rules of your pension scheme(s) allow."
This does get across the most important point which is that the available portion is calculated by reference to the protected LTA. But we think this needs changing on several counts.
We suggest that it is changed to:

"**What is the maximum tax free lump sum I can have?**
Under tax law, the maximum tax-free lump sum that you can take from 6 April 2014 when drawing benefits from a scheme is 25% of your protected Lifetime Allowance, less if you have already drawn some benefits before; and not more than 25% of the value of the total benefits you are drawing. The rules of your pension scheme(s) may set further constraints."

The original does give the key point (that the protected LTA is used for the available portion. But our revision shows better that there are extra tax law constraints (not just the available portion, but also the applicable amount). It avoids using an undefined term ("uncrystallised value"); and it also avoids exacerbating the impression that the available portion is 25% of on the same unused LTA as is used for establishing LTA charge - when an adjustment will be needed (as per Schedule 29 para 2 where in the past DC funds have been used to buy scheme pension.

10. Other

We suggest that the guidance uses only one of the two terms "personalised" and "protected" lifetime allowance.

Has any scheme applied to HMRC for an RVF different from 20? (for several years after 2006 HMRC reported not to the industry groups). If not, then the guidance could be simplified by removing reference to RVF.

We have separately discussed the protocol that ABI and HMRC agreed in 2006 to assist individuals understanding and placing a market value on (and before that estimating) their uncrystallised DC investments, for inclusion in their Primary Protection valuations as at 5 April 2006. It would be good if a similar protocol could be agreed in relation to IP14 relevant amounts and publicised within HMRC's Guidance.

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APPENDIX 2

This shows how we think Examples 4 5 and 6 should all be changed – we just provide the new version for Example 6]
Example 6 – valid FP on 5 April 2014, IP14 if FP is subsequently lost

Samina has three personal pensions. On 5 July 2008, Samina was aged 55 and took a pension commencement lump sum of £100,000 (BCE 3) and purchased an annuity (a “lifetime annuity”) for £300,000 (BCE 4) from one of her personal pension schemes. At that time, Samina had no form of protection and had not previously taken any pension benefits. Samina’s BCEs used up £400,000 of her lifetime allowance.

Samina applied for fixed protection so has a lifetime allowance of £1.8 million from 6 April 2012. On 9 September 2012, Samina took a pension commencement lump sum of £150,000 (BCE 6) from another of her personal pension schemes and designated £450,000 as being available for the provision of drawdown pension, and these had total BCE values £150,000 and £450,000 respectively.

On 25 March 2013, Samina loses her fixed protection. Samina has uncrystallised rights valued at £700,000 on 5 April 2014 (see Chapter 3.4**: valuing uncrystallised rights (Amount C)).** She decides to apply for IP14.

Approach one = the easy approach
Just after she had her first two BCEs, the scheme in which they occurred will have given her a statement that she used up **24.24%** of the standard lifetime allowance at the time. The scheme administrator will provide a statement showing this percentage annually until Samina reaches age 75 (in 2028). *See (*) below how this was calculated but Samina does not actually need to know the background.*

Just after second two BCEs occured, the scheme that they occurred in will have provided a statement to her (and repeated the statement annually to her) that these two BCEs used up **33.33%** of her Lifetime Allowance (see *)

[the way the schemes will have calculated these percentages is set out here, **but Samina does not need to know or look into this:***

24.24% *= 100,000/1,650,000 plus 300,000/1,650,000, rounded down to 2 decimal places in the percentage, where £1,650,000 was the standard Lifetime Allowance at the time of the BCE*

33.33% *= £150,000/£1,800,000 plus £450,000/1,800,000) again rounded down, where £1,800,000 was the standard Lifetime Allowance at the time for an individual with valid Fixed Protection.]*

The mathematics underlying the legislation means that Samina can calculate her amount B simply by taking the total of these percentages and multiplying by £1,500,000, so:
(24.24% +33.33%) x £1,500,000 = 863,550.
To this she adds the value of her uncrystallised savings (her “amount C”) of £700,000

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So her total pension savings as at 5 April 2014 for applying for IP14 (her total "relevant amount" is £1,563,550.
This is a very slight underestimate in fact (see next approach) but can be used for the application.

Approach two – the more detailed but harder approach

Samina decides not to use her reportef percentages. She approaches her schemes for the £amount of her BCEs. So she established that her BCEs from the first scheme were of BCE value £100,000 and £300,000 on 5 July 2008; and from the second scheme were £150,000 and £450,000 on 9 September 2012 when she had Fixed Protection.
She identifies from HMRC guidance manuals that the standard LTA when the first pairs of BCEs happened (which was 2008/9) was £1,650,000. She notes that the relevant standard LTA for the second pair of BCEs (which happened in 2012/13) was not the general standard LTA of £1,500,000 then, but was instead £1,800,000 because she then had Fixed Protection.

She calculated her Amount B as follows:
100,000 x 1,500,000/1,650,000 = 90,910 plus
300,000 x 1,500,000/1,650,000 = 272,728 plus
150,000 x 1,500,000/£1,800,000 = 125,000 plus
450,000 x 1,500,000/£1,800,000 = 375,000
So a total of £863,638.

To this she adds her Amount C of £700,000 so her total pension savings on 5 April 2014 (her relevant amount) is £1,563,638
Note this exact calculation gives some £90 more of protection than the easy approach noted above.

Whichever of the two above approaches she used, the result is more than £1.5 million, so Samina's protected LTA for IP14 is £1,500,000.

As she has already used up 57.57% of her lifetime allowance (as can be seen from her statements from her previous two schemes) she still has 42.43% of her protected Lifetime Allowance of £1.5 million available to her before exceeding her lifetime allowance. This means she can take £636,450 in further benefits (BCEs) before having to pay the lifetime allowance charge

NOTE to really help understanding it would be good if you could add:

> (We note that since she no longer had FP12 at 5.4.14, had she had a BCE at 5.4.2014 it would have been free of LTA charge up to 636,450 (42.43% of the standard unprotected LTA at the time of £1.5m) so registering for IP14 has maintained her position. If she did not apply for IP14 at all, at her next BCE after 5 April 2014 she could only draw up to 530,375 BCE without triggering LTA charge.

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The above changes to the draft guidance are proposed to clarify the possibility of a very easy calculation without needing to know much about the details. However, again to help understanding of this complex area where Fixed Protection is involved, it would be very helpful if the guidance could go on to cover two more variations for this same member:

6a where the individual held FP12 and did not lose it before 5.4.2014 (she can still register for IP14)

The calculations above as at 5 April 2014 would all be the same, and hence her protected LTA under IP14 LTA 1.5m.
But in terms of any post 5.4.14 BCEs:
If she still holds FP12, her protected Lifetime Allowance is 1.8m, and she can have a BCE up to 1.8m x (1-.5757) = 763,740 without triggering LTA charge. If she has lost FP12 the BCE could be up to 636,450.

6b where the individual had never held FP12

The change to the calculation s above as at 5 April 2014 would be that for her second pair of BCEs, her scheme would have reported a percentage usage to her of 40% rather than 33.33%.
Her pension savings as at 5 April 2014 would be
(24.24% + 40.00%) x £1,500,000 = 963,600;
plus £700,000
so a total of 1,663,600.

So her protected Lifetime Allowance under IP14 would again be at £1.5m; but she would count as having already used up 64.24%.
She at her next BCE after 6 April 2014 she can draw up to (1-0.6424) x £1,500,000 = 536,400 BCE amount without triggering LTA charge.

If you disagree with our reading on these two addendums we would appreciate an urgent call, as it is likely that not only we but many other readers do not understand the intended operation of IP14.