Tech Talk

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Lifetime allowance enhancement factors

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Introduction

For individuals who have diligently planned for their retirement, losing pension funds to the lifetime allowance charge can be frustrating. There are many different types of lifetime allowance protection that can mitigate this loss and, in this Tech Talk, consideration is given to the situations where individuals are entitled to one or more lifetime allowance enhancement factor.

Where an individual qualifies for such a factor, their lifetime allowance (LTA) is increased by the factor at every benefit crystallisation event (BCE) that occurs, in relation to them, from the point they become entitled to the factor.

The four LTA enhancement factors that will be considered in this Tech Talk are as follows:

- Pension credit factor
- Recognised overseas scheme transfer factor
- Non-residence factor
- Pre-commencement pension credit factor

Primary protection operates by way of an LTA enhancement factor, and has been covered in part in previous Tech Talks so will not be covered here. The intention is to cover primary protection in more detail in a later Tech Talk.

Pension credit factor

For an individual to qualify for this factor the following conditions must be met:

- The pension credit is held in a registered pension scheme and was acquired on or after 6 April 2006.
- It’s derived from a pension benefit from the same or another registered pension scheme that was already in payment to the other party (ex-spouse/civil partner) at the time of the pension sharing order.
- The other party became entitled to that pension in payment on or after 6 April 2006.

A pension in payment described in the bullet points above is referred to as a ‘post-commencement pension in payment’.

At some point in the future the pension credit rights derived from a post-commencement pension in payment will be tested against the individual’s LTA. However, these rights have already been tested against the other party’s LTA, and therefore the rationale behind this factor is to remove these rights from future LTA tests in respect of the individual.

The pension credit factor is calculated using the formula:

\[ \frac{\text{APC}}{\text{SLA}} \]

Where:

APC is the appropriate amount of the pension credit rights attributable to a post-commencement pension in payment calculated in accordance with the relevant legislation.

SLA is the standard lifetime allowance at the time when the rights are acquired, unless the individual holds a form of fixed or individual protection at that time, in which case the individual’s LTA under that form of protection is used if greater.

Form APSS 201 (see below) asks the applicant for the date they became legally entitled to the pension credit rights, which is the ‘transfer day’ set out in section 29 of the Welfare Reform and Pensions Act 1999. This date/day is when the pension credit rights are acquired (the effective date of the pension sharing order).

The factor is rounded up to 2 decimal places.
EXAMPLE 1
Morag, aged 64, acquired pension credit rights on 1 July 2012. These rights were derived solely from a pension that came into payment in 2008. The appropriate amount of the pension credit rights was £540,000.

Scenario 1: Morag has no form of lifetime allowance protection
Enhancement factor (EF) = £540,000/£1.5m = 0.36

Scenario 2: Morag has fixed protection 2012
EF = £540,000/£1.8m = 0.3

Note that in Scenario 2 the LTA applicable to Morag in the 2012/13 tax year was £1.8m, because of her entitlement to fixed protection 2012, not the standard lifetime allowance of £1.5m, and it is this figure that is used when calculating the EF.

The individual is responsible for notifying HMRC of their entitlement to this factor and the application is made on form APSS 201 no later than 5 years after the 31 January following the tax year in which the pension sharing order or provision took effect e.g. if an order took effect in the 2018/19 tax year the application must be made by 31 January 2025.

HMRC will issue a certificate confirming the factor the individual is entitled to. The certificate is valid until such time as it is revoked or amended by HMRC.

The individual may rely on this factor beginning on the day on which the pension sharing order or provision takes effect until such time as the certificate is revoked or amended.

Recognised overseas transfer factor

Where post 5 April 2006 an individual transfers rights held under a recognised overseas pension scheme (ROPS) to a registered pension scheme, then the individual’s LTA may be enhanced by a recognised overseas transfer factor. A ROPS is defined in UK pension tax legislation and some overseas pension schemes may not fall within this definition.

The factor is calculated using the following formula:

\[
\frac{TV - \text{relevant relievable amount}}{\text{SLA}}
\]

TV is the amount transferred from the ROPS post 5 April 2006.

The way the relevant relievable amount is calculated depends on the type of arrangement(s) held by the individual under the ROPS and further guidance can be found at [https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm095400](https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm095400). In broad terms the relevant relievable amount covers any contributions made by or in respect of the individual to, or their accrual of benefits under, the ROPS after 5 April 2006 that received UK tax relief.

SLA is the standard lifetime allowance at the time of transfer, unless the individual holds a form of fixed or individual protection at that time in which case the individual’s LTA under that form of protection is used if greater.

All of the rights attributable to such a transfer will be tested against the individual’s LTA at some point in future. Therefore this factor attempts to exclude the part of the transfer that has not benefited from UK tax relief from the LTA test.

The factor is rounded up to 2 decimal places.
EXAMPLE 2
Fidel, aged 64, transferred £250,000 from a ROPS to a SIPP he has in the UK on the 9 October 2017. There is no relevant relievable amount to be taken into account for him.

Scenario 1: Fidel has no form of lifetime allowance protection
EF = £250,000/£1m = 0.25

Scenario 2: Fidel has fixed protection 2016
EF = £250,000/£1.25m = 0.2

Note in Scenario 2 the LTA applicable to Fidel in the 2017/18 tax year was £1.25m because of his entitlement to fixed protection 2016, not the standard lifetime allowance of £1m, and it is this figure that is used when calculating the EF.

The application process for this factor is similar to that for a pension credit factor, except that form APSS 202 is used and the deadline for applying for it is determined by reference to the date the transfer took place.

This factor can be used by the individual in respect of any BCE occurring after the transfer is made.
Non-residence factor

Where an individual is working abroad, in some circumstances they will not receive UK tax relief on contributions to, or the accrual of benefits under, a registered pension scheme. However, the benefits that derive from such pension funding are likely to be tested against the individual’s LTA at a future BCE. It seems harsh that benefits generated from contributions or accrual that received no UK tax relief should be tested against the individual’s LTA. Therefore this factor provides redress in such circumstances.

The factor covers periods of overseas service after 5 April 2006, and to qualify for it the individual during any part of an active membership period under a registered pension scheme is a relevant overseas individual.

A relevant overseas individual is someone who is either:

- not a relevant UK individual under section 189 Finance Act 2004 or
- they are only a relevant UK individual because of the five-year rule in section 189(1)(c) Finance Act 2004 and they are not employed by a UK tax resident employer

A relevant overseas individual does not enjoy UK tax relief on their funding under a registered pension scheme unless they come under the second bullet point, in which case they would qualify for UK tax relief on personal contributions of up to £3,600.

An active membership period under a registered pension scheme is one that begins on the later of the following dates:

- the date when benefits first began to accrue to or in respect of an individual under the registered pension scheme, and
- 6 April 2006.

It ends on the earlier of the following dates:

- immediately before the BCE, and
- the date when benefits ceased to accrue to or in respect of the individual under the registered pension scheme.

The way the factor is calculated depends on the type of arrangement(s) held by the individual under the registered pension scheme e.g. money purchase (not cash balance). In general terms it is calculated by dividing the amount of contributions to, or accrual under, the individual’s arrangement during that part of the active membership period where the individual is a relevant overseas individual by the SLA for the tax year in which that part of the active membership period ends (or if the individual is holding a form of fixed or individual protection as at that date their personalised LTA, if greater).

Where the arrangement in question is money purchase (not cash balance) e.g. a SIPP, the factor is calculated by first establishing the total amount of contributions made by, or in respect of, the individual under the arrangement between the dates determined as follows:

- the latest of the following dates:
  - the date when the individual became a relevant overseas individual
  - the date when benefits first began to accrue to or in respect of the individual under the arrangement, and
  - 6 April 2006.
- the earliest of the following dates:
  - immediately before the benefit crystallisation event,
  - the date when the individual ceased to be a relevant overseas individual, and
  - the date when benefits ceased to accrue to or in respect of the individual under the arrangement.

The total found is then divided by the SLA as at the date under the second set of bullet points above (or if the individual is holding a form of fixed or individual protection as at that date their personalised LTA, if greater) with the result rounded up to 2 decimal places.
EXAMPLE 3
Lauren has a SIPP under which contributions commenced prior to April 2006. In February 2008 she went to work for an overseas employer (not resident in the UK) and from 6 April 2008 became a relevant overseas individual. She returned to work in the UK on 1 July 2014 and therefore ceased to be a relevant overseas individual on 5 April 2014. Throughout the time she worked abroad she and her overseas employer contributed to her SIPP. The SIPP is uncrystallised and she plans to continue to contribute to it.

Total contributions made by her and her overseas employer to the SIPP during the period 6 April 2008 to 5 April 2014 was £150,000. She has never had any form of lifetime allowance protection.

The standard lifetime allowance in the 2013/14 tax year was £1.5m.

EF = £150,000/£1.5m = 0.1

The application process for this factor is again similar to that for a pension credit factor, except that form APSS 202 is used and the deadline for applying is determined by reference to the day that part of the active membership period ends.

Note that, in Example 3, the deadline for applying for the non-residence factor is 31 January 2020. Assuming the application is successful, and the certificate is neither revoked nor amended, Lauren will be able to rely on the factor when determining her LTA at future BCEs (strictly speaking, the factor has been available since 5 April 2014).

Pre-commencement pension credit factor

Where an individual acquired pension credit rights before 6 April 2006, then this factor was available to them provided they gave HMRC the appropriate notification prior to 6 April 2009.

The factor is defined by the following formula:

\[ \text{IAPC / SLA} \]

IAPC is the amount of the pension credit determined, in accordance with the relevant legislation, increased by the percentage increase in the retail price index (RPI) from the month in which the rights were acquired to April 2006.

SLA is the standard lifetime allowance applicable in the 2006/07 tax year i.e. £1.5m.

An individual who made a successful application for this factor will have a certificate from HMRC confirming this. It can be relied upon from 6 April 2006 up until such time as the certificate is revoked or amended by HMRC.

It is not possible for an individual to have this factor while also having primary protection. This is because the benefits the individual has protected under primary protection should include the value of the pension rights from the pension credit. So the primary protection factor the individual has received will incorporate the pre-commencement pension credit element.
How an enhancement factor is applied at a BCE

Where an individual becomes entitled to an enhancement factor, their LTA is enhanced at every BCE that occurs in relation to that individual from that point on. How their LTA is calculated at a BCE depends on the following:

- the date of the BCE
- the type of enhancement factor
- the date of the event giving rise to the enhancement factor
- whether or not the individual has some form of fixed or individual protection

The calculation of the LTA is complicated and for the purpose of simplification in this Tech Talk the following will not be considered:

- BCEs occurring prior to 6 April 2016
- individuals who have primary protection

If an individual is entitled to more than one enhancement factor then all the relevant factors are aggregated and applied as a single enhancement factor.

Where an individual is entitled to any one of the following:

- Pension credit factor
- Recognised overseas scheme transfer factor
- Non-residence factor

then, where multiple factors apply, the corresponding single factor is treated as having arisen when the event giving rise to the first factor occurred.

The following definitions are used in the calculation of the LTA applicable to the individual:

SLA is the standard lifetime allowance at the BCE, unless the individual holds a form of fixed or individual protection at the time of the BCE, in which case the individual’s LTA under that form of protection is used if greater.

EF is the enhancement factor

Event date is the date the individual becomes entitled to the enhancement factor e.g. the date of transfer in the case of a recognised overseas transfer factor.

**Individual has a pre-commencement pension credit factor only**

\[
LTA = SLA + (SLA \times EF)
\]

**Individual is entitled to other factor(s)**

1. Event date is before 6 April 2012:

   \[
   LTA = SLA + (£1.8m \times EF)
   \]

   If SLA is greater than £1.8m, then it replaces £1.8m in this formula.

2. Event date is after 5 April 2012 and before 6 April 2014:

   \[
   LTA = SLA + (£1.5m \times EF)
   \]

   If SLA is greater than £1.5m, then it replaces £1.5m in this formula.

3. Event date is after 5 April 2014 and before 6 April 2016

   \[
   LTA = SLA + (£1.25m \times EF)
   \]

   If SLA is greater than £1.25m, then it replaces £1.25m in the formula.

4. Event date is on or after 6 April 2016

   \[
   LTA = SLA + (SLA \times EF)
   \]

Referring back to the earlier examples to illustrate:
EXAMPLE 2 (CONT’D)
Fidel has no crystallised rights and is about to take benefits from his SIPP. What is his LTA?

The event date is 9 October 2017.

Scenario 1: Fidel has no form of lifetime allowance protection
EF = 0.25
BCE 2019/20: LTA = £1.055m + (£1.055m x 0.25) = £1,318,750

Scenario 2: Fidel has fixed protection 2016
EF = 0.2
BCE 2019/20: LTA = £1.25m + (£1.25m x 0.2) = £1.5m

EXAMPLE 1 (CONT’D)
On 1 March 2018, Morag’s SIPP received a transfer in from a ROPS of £180,000 with no relevant relievable amount. She has no crystallised rights and is about to take benefits from her SIPP. What is her LTA?

The event date is 1 July 2012.

Scenario 1: Morag has no form of lifetime allowance protection
Pension credit EF = 0.36
Recognised overseas scheme transfer EF = 0.18 (£180,000/£1m)
BCE 2019/20: LTA = £1.055m + (£1.5m x 0.54) = £1.865m

Scenario 2: Morag has fixed protection 2012
Pension credit EF = 0.3
Recognised overseas scheme transfer EF = 0.1 (£180,000/£1.8m)
BCE 2019/20: LTA = £1.8m + (£1.8m x 0.4) = £2.52m

In this example Morag is entitled to multiple enhancement factors that are aggregated to produce a single factor and the event date is the one relevant to the first or earliest factor, the pension credit factor.
EXAMPLE 3 (CONT’D)

Lauren is considering taking benefits from the SIPP on 1 February 2020, the date she attains 55. She has no crystallised rights and has made an application for individual protection 2016 (IP16) with a relevant amount of £1.2m. What LTA will she have available on 1 February 2020?

The event date is 5 April 2014.

Assuming her IP16 application is successful:

EF = 0.1

BCE 2019/20: LTA = £1.2m + (£1.5m x 0.1) = £1.35m

Note that if the IP16 application is unsuccessful and Lauren has no form of lifetime allowance protection, her LTA would be:

LTA = £1.055m + (£1.5m x 0.1) = £1.205m

As mentioned above the guidance in this Tech Talk does not cover situations where the BCE in respect of the individual occurs before 6 April 2016. This may not seem important; however given the timescale for a successful enhancement factor application it is possible that a BCE prior 6 April 2016 may need to be revisited because the individual has recently acquired an enhancement factor certificate from HMRC.

Guidance and examples for scenarios not covered in this Tech Talk can be found in the relevant pages of HMRC’s Pensions Tax Manual:

https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm095500

https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm095600
Comment

Given the changes to the SLA in recent years, having access to a greater lifetime allowance is advantageous. The availability of lifetime allowance enhancement factors will therefore be of interest to many individuals. However, due to numerous changes in pension tax legislation since April 2006 understanding the operation of such factors, like many other aspects of the legislation, has become complicated.

Hopefully this Tech Talk offers useful insight into the entitlement conditions of the factors available, their calculation and impact on the lifetime allowance.

Further information

Visit the Technical Hub for further information:

www.jameshay.co.uk/technicalhub