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Could the Lifetime Allowance come back?

November 2023

Contents

Executive Summary

In his March 2023 Budget, the Chancellor announced plans to abolish the Lifetime Allowance (LTA), a lifetime limit on the cumulative amount of pension savings which can be drawn without incurring an additional tax charge. In simple terms, implementation was to be in two stages:

- From 6 April 2023, the rate of additional tax charges arising from the LTA will be set to zero.

- From 6 April 2024, the LTA will be fully abolished, though the exact details of this are still being worked out.

In addition, a lifetime cap on tax-free lump sums would remain and be frozen, set at 25% of the old LTA of £1,073,100, namely £268,275.

Within hours of the announcement, the Labour Party said that it opposed this measure and would reverse it if it were to win the next General Election. Labour also said that it would introduce separate measures to ensure that senior NHS doctors were not encouraged to retire early as a result of the reintroduction of the LTA.

Leaving aside the merits or otherwise of reinstating the LTA, this paper examines how this might be done in practice and identifies a number of challenges which a potential incoming government might face, including how individual pension savers might act in anticipation of the reinstatement of the LTA.

Our key findings are:

- Reintroducing the LTA is not as simple as pasting back into legislation every line which has been taken out; careful consideration would need to be given to transitional arrangements, including for those who had made savings decisions during the period in which the LTA had been abolished.

- This is not just an issue for 'the top 1%'; we find that 4-6% of those in the run-up to retirement with pension savings are potentially affected, perhaps around a quarter of a million people.

Key issues for a new government to consider on reintroducing the LTA include:

- Would 'transitional protection' be needed for those who had, in good faith, taken advantage of the LTA changes from April 2023 to build up their pension savings beyond this level but could now face a tax charge if the LTA was reintroduced before they accessed their savings?

- More generally, would everyone start under a reintroduced LTA regime with the 'LTA used up clock' reset to zero? Or would the government – as seems likely – try to estimate how much of the LTA people might previously have used up and use this as a baseline for how much remaining LTA was available to them?

- Given how long it might take from an Election to pass detailed legislation in this space, would it be necessary to pass urgent 'anti-forestalling' legislation to avoid a rush of people crystallising their pensions to avoid a potential LTA charge?

If it became widely expected that a change of government was imminent, we could see this driving a lot of financial advice and individual pension decisions. Possible behavioural impacts could include:

- Those with large DB pensions retiring early; in the specific case of NHS doctors, the potential Labour government might need to specify with some degree of certainty, and before the General Election, how these doctors will be protected from LTA charges in the new regime; otherwise, senior doctors might prefer the more certain option of retiring when there is no LTA charge.

- Those with higher incomes and unused annual allowances from previous years might choose to 'pile' money into their DC savings and then crystallise them before the LTA was reintroduced (or before a General Election); similarly, those who had already built up large DC pots might bring forward the point at which they crystallise them, to avoid potential LTA charges; this would reduce the amount of tax revenue a future government could expect to gain by bringing back the LTA.

There is no doubt that reintroducing the LTA would be far from straightforward and would require difficult judgments of the kinds set out above. Implementation in time for the first financial year after a General Election (almost certainly starting in April 2025) might be exceptionally difficult, and this could increase the need for interim legislation to avoid large scale post-election pension withdrawals purely designed to avoid LTA charges. A new government might also find that unless it had made its plans very clear before the Election, it would need to deal with the consequences of an exodus of senior NHS doctors.

Whilst reinstating the LTA is no doubt attractive from the perspective of political messaging, the practicalities and risks associated with doing so would appear to be daunting.

01 Introduction

The March 2023 Budget included a range of measures designed to relax the various limits on tax-relieved pension saving.

One of these measures was to abolish the Lifetime Allowance (LTA), a limit on the cumulative amount of pension savings which can be put into payment without incurring an additional tax charge. One of the main motivations for the change was a concern that senior doctors had been choosing to retire early or reduce hours to avoid triggering pension tax charges. The announcement was welcomed on the day by the British Medical Association[1].

However, the Labour Party was immediately critical of this decision and, the next day, announced that it would reverse the Chancellor's measures and instead would design a specific regime to deal with concerns about senior doctors.

The government's abolition of the LTA is itself a phased process, with an interim solution applied from 6 April 2023 prior to full abolition currently scheduled for 6 April 2024. But, in the event of a change of government, we could then potentially see some form of LTA reintroduced, possibly with (at a push) some measures as soon as 6 April 2025.

This naturally creates considerable confusion and uncertainty for pension savers and raises important questions about what might actually happen.

The purpose of this paper is to address some of those issues.

We begin with a description of the LTA regime as it existed prior to 6 April 2023 and then describe the two-stage abolition of the LTA, which the Chancellor announced at the March 2023 Budget[2]. We then look at how a future government might think about reintroducing the LTA and what issues they may face. Finally, we consider the position of individual savers and how they may be affected by these various changes.

[1] See, for example: Chancellor listens to BMA with pension taxation reform to help keep senior doctors in the NHS - BMA media centre - BMA Similar complaints arose about the Annual Allowance – for which there were also announced measures.

[2] Although the central focus of this paper is on the Lifetime Allowance, the 2023 Budget also included changes to the Annual Allowance and the Money Purchase Annual Allowance. We refer to these where relevant.

02 What just happened?

We begin this section with a description of the LTA system[3] as it existed up to 5 April 2023 and briefly consider some of the reasons why there had been growing pressure for reform. We then set out what the Chancellor announced in his March 2023 Budget and look at how his plans will be implemented in 2023-24 and 2024-25[4].

The Lifetime Allowance (LTA) up to 5 April 2023

The LTA was introduced on 6 April 2006 and was designed to provide a lifetime limit on the extent to which individuals can benefit from pension tax relief (effectively clawing back some of the relief – both income tax and national insurance - when savings were made and invested)[5].

In simple terms, whenever people start to draw[6] retirement benefits, they use up some of their LTA. For Defined Contribution (DC) pensions, lump sum withdrawals (or the use of a DC pot to buy an annuity) the funds used are generally scored against the LTA, usually at the face value of the fund value used. For Defined Benefit (DB) pensions, the score is 20x the annual start rate of pension at retirement[7] plus any lump sum. Where this total cumulative 'score' on retirement benefits started to be drawn exceeds the LTA, an LTA charge is payable on the excess[8].

[3] Note that what follows is intended as a 'Plain English' guide and is inevitably, therefore, a simplified description of the system. It should, of course, not be relied on to make personal financial decisions, where expert advice should be sought.
[4] At the time of writing, there are however many unanswered questions about exactly how the regime will work from April 2024 onwards.
[5] For more detail on the basis on which the LTA charge rates were set, see: https://webarchive.nationalarchives.gov.uk/ukgwa/20140109143644/http://www.hmrc.gov.uk/pbr2003/simplifying-pensions.pdf
[6] This is called "crystallising" and includes arranging a pension to start, funds being designated into a drawdown wrapper, or payment of certain lump sums. For a full list of 'Benefit Crystallisation Events' see: PTM088100 - The lifetime allowance and the lifetime allowance charge: benefit crystallisation events: benefit crystallisation events overview - HMRC internal manual - GOV.UK (www.gov.uk)
[7] One consequence of scoring LTA use based on the start rate of the pension is that those who retire early on a lower pension use up less of their LTA. This could potentially encourage some of those with larger pension entitlements to retire earlier than they would otherwise have done.
[8] In practice, what happens is that at each setting up of benefits in a way ready for payment (crystallised), the value of the whole tranche of benefits involved is tested against the LTA in force at the time and a percentage use of the LTA is scored. This percentage use is added to every time another pension is crystallised, and it is when that percentage goes over 100% that an LTA charge will arise.

This is calculated as follows:

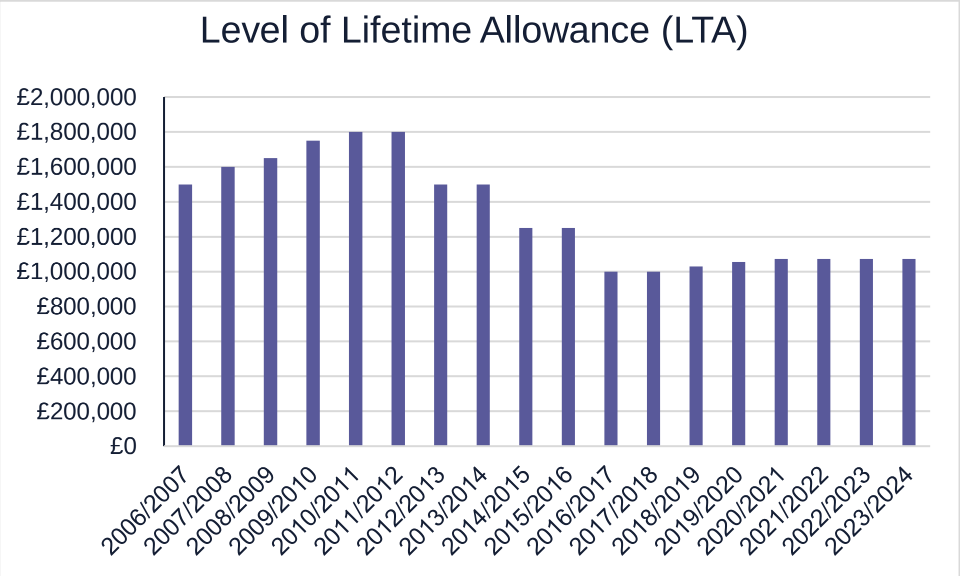
- For lump sum withdrawals in excess of the LTA, the rate of charge is 55% on the excess; no further income tax is then due.

- For withdrawals taken as income, the rate of charge is 25% on the excess, in addition to the individual's normal income tax liability on that income as it is received.

When first introduced, the LTA stood at £1.5m and was gradually increased to a peak of £1.8m in 2010-11 and 2011-12. After this, there was a series of stepped cuts to £1.5m, £1.25m and then £1m before a short period of indexation up to £1,073,100 followed by a multi-year freeze. Such a freeze, particularly at a time of high inflation, has meant that the LTA has affected steadily more people in recent years[9]. Since the LTA was set at £1,073,100 in April 2020, the policy of freezing the LTA means that it will already have fallen by about £300,000 in real terms by April 2024.

Figure 1 shows the changing value of the LTA and illustrates the lack of policy consistency towards this important element of the pension tax relief system.

Figure 1. Level of Lifetime Allowance 2006-07 to 2023-24



Source: HMRC

[9] Unfortunately, HMRC data on the number of people facing LTA charges is published several years after the event, with the latest data at the time of writing only covering the period up to 2021-22. However, this does show that the number of people facing LTA charges has risen almost every year since the LTA was introduced. See: Table 8 [Private pension statistics - GOV.UK (www.gov.uk)]

One issue when the LTA was first introduced, and on each occasion where it was cut, is what to do with people whose total pension wealth (including pensions not yet drawn) on an LTA basis is:

a) already over the old LTA;

b) under the old LTA but over the new LTA; or

c) currently under both old and new LTA but with the expectation that, with no additional contribution/accrual it would grow to be over the new LTA.

Without special measures, such savers may feel that there is an element of retrospection, as pension saving decisions made in good faith on the basis of existing limits suddenly became potentially subject to penal taxation.

In response to this, various ‘protection’ regimes have been introduced so that those who might otherwise face tax penalties when the LTA was introduced, and also when it was cut, are protected, in some cases with the proviso that they do no further pension saving. A detailed description of the different protection regimes is beyond the scope of this paper, but the fact that such protection has always been introduced when the LTA has been cut in the past is relevant to our discussion later about how a future government might potentially reintroduce the LTA.

How much does the LTA raise for the government?

There is some official data on the amount of tax revenue which the government derives from LTA charges, and this is shown in Table 1. This is drawn from information supplied by pension schemes and providers who are responsible for collecting and paying LTA charges.

At face value, Table 1 would suggest that in the latest year for which data is available (2020-21), LTA charges raised a little over a third of a billion pounds. However, this is likely to be a significant underestimation of the fiscal impact of the LTA.

This is because those who are potentially impacted by the LTA may respond by diverting savings which would otherwise have gone into pensions into other forms of saving. To the extent that this other saving is not as tax privileged as pension saving, this ‘behavioural impact’ also generates additional tax revenue not reflected in the LTA charge revenue shown in Table 1. Notably, when the Chancellor announced the abolition of the LTA, HM Treasury estimated[10] that the effect on government revenues when the measure was fully implemented in 2025-26 would be a loss of £770m and in following years. The Policy Costings document confirms the costing includes allowing for the potential for more contributions, so this is a more realistic estimate of the impact of the LTA regime than simply adding up the LTA charges which are actually paid.

[10] Source: Budget 2023 ‘Red Book’, Table 4.1 Spring Budget 2023 (publishing.service.gov.uk) and Costing_Document_-_Spring_Budget_2023.pdf (publishing.service.gov.uk)

Table 1. HMRC estimates of revenue from LTA charges 2017-18 to 2020-21

Tax Year	No. of lump sum LTA charges (55%)	Total value (£m) of lump sum LTA charges (55%)	No. of non-lump sum LTA charges (25%)	Total value (£m) of non-lump sum LTA charges (25%)	No. of all LTA charges	Total value (£m) of all LTA charges
2017-18	1,850	94	5,210	176	7,060	270
2018-19	1,460	78	5,810	207	7,270	285
2019-20	1,830	82	6,860	264	8,620	346
2020-21	1,930	102	6,890	290	8,820	391
2021-22	2,650	125	9,010	372	11,660	497

Source: Table 8, HMRC Private Pension Statistics

Problems with the existing system

There is no doubt that the LTA system is both a core part of and one of the most complex features of the overall pension tax relief regime. When considered in the round, the system could also result in triple taxation: Annual Allowance charge when savings are made, LTA charge on retirement and income tax in payment – versus just one set of relief, granted mostly at the contribution stage. The constant changes in policy have also made it hard for savers to plan, and every time the LTA is cut, a new and complex system of 'protections' has had to be introduced to help those who might otherwise be unfairly treated. The cuts and freezes have also brought more and more individuals into scope of this tax.

However, pressure for reform came to a head in recent years because of concerns over the impact of the LTA (and other tax limits) on the decisions of senior doctors around retirement. High earners with long service in the NHS can easily build up a Defined Benefit pension, which generates an LTA tax charge when it is drawn. A combination of sensitive political issues, such as problems with NHS recruitment and retention, lengthening NHS waiting lists and the particular pressures caused by the Covid-19 pandemic, has led to a growing demand for action.

One suggestion, favoured in the past by the British Medical Association, would be for senior doctors to be moved into a wholly different regime, similar to that for judges. Under this approach, doctors would build up pensions in a scheme which was 'unregistered' by

HMRC. Whilst this would mean that they would not benefit from tax relief on personal contributions, it would also mean that they were not subject to LTA tax charges.

The Government has rejected this approach, giving as one of its reasons[11] the fact that most members of the NHS pension scheme are not high earners and are not at risk of LTA charges.

The 2023 Budget announcement

In response to this growing pressure, the Chancellor decided that rather than simply raise the LTA to ameliorate the problem, he would abolish it altogether. This measure was accompanied by other changes, such as a big increase in the Annual Allowance for pension tax relief, designed to ensure that doctors would no longer feel the need to base their retirement and other work decisions around concerns about pension tax charges.

In his 2023 Budget speech, the Chancellor explicitly linked the abolition of the LTA to concerns about NHS retention, saying:

> *"I have listened to the concerns of many senior NHS clinicians who say unpredictable pension tax charges are making them leave the NHS just when they are needed most... [but] I do not want any doctor to retire early because of the way pension taxes work. As Chancellor, I have realised the issue goes wider than doctors. No one should be pushed out of the workforce for tax reasons.*
>
> *So today, I will increase the pensions annual tax-free allowance by 50% from £40,000 to £60,000. Some have also asked me to increase the Lifetime Allowance from its £1 million limit. But I have decided not to do that. Instead, I will go further and abolish the Lifetime Allowance altogether. It's a pension tax reform that will... stop over 80% of NHS doctors from receiving a tax charge... incentivise our most experienced and productive workers to stay in work for longer.... and simplify our tax system, taking thousands of people out of the complexity of pension tax."*

Source: Spring Budget 2023 speech - GOV.UK (www.gov.uk)

Given that the March Budget came just a matter of weeks before the end of the financial year, it would have been impossible to entirely re-write the pension tax regime between the Budget and the start of the new tax year. But the Chancellor was keen for his measures to have more-or-less immediate effect. So, the government set out a two-stage route to abolition:

[11] See: Make the NHS Pension scheme tax-unregistered - Petitions (parliament.uk)

- From 6 April 2023, whilst the LTA structure would remain, there would be no LTA tax charges. Pension withdrawals, including those in excess of LTA limits, would simply be subject to income tax in the normal way. Section 18 of the Finance (No. 2) Act 2023 starts off with a simple statement that "No lifetime allowance charge arises for the tax year 2023-24 or any subsequent tax year". Lump sums would have a tax-free element but beyond a cap would again be subject to income tax.

- From 6 April 2024, the LTA would be abolished. Some details on how this might be achieved were published for consultation by HMRC on 'L Day' in July 2023[12], but much further work is needed before abolition can proceed.

One very attractive feature of the pension tax regime is the ability to draw a tax-free 'pension commencement' lump sum (PCLS), typically up to 25% of the total value of the pension package per scheme. With the abolition of the LTA, and changes to how pensions fit in, this could lead to larger amounts being drawn as tax-free lump sums in some cases.

So, despite the abolition of the LTA, there will continue to be an overall cap on tax-free "pension commencement lump sums", frozen at the 2022-23 level of £268,275[13]. However, where individuals already benefited from a higher 'protected' level of LTA (secured before the March 2023 Budget) and so had a higher scope for a tax-free lump sum, they would continue to be able to draw 25% of that higher level of LTA in the form of a tax-free pension commencement lump sum. This would apply even in the case where the individual made additional pension contributions after 5 April 2023, which might otherwise have invalidated their protected LTA figure[14].

The Labour Party's reaction

In response to the Budget, the leader of the Opposition, Sir Keir Starmer, was immediately critical of these measures, saying:

> *"On pensions, the Chancellor made a big spending commitment that will benefit those with the broadest shoulders when many people are struggling to save into their pensions. We needed a fix for doctors, but the announcement today is a huge giveaway to some of the very wealthiest. The only permanent tax cut in the Budget is for the richest 1%. How can that possibly be a priority for this Government?"*

[12] See: Abolition of the Lifetime Allowance - GOV.UK (www.gov.uk)

[13] Other forms of lump sum payment such as the LTA excess lump sum, serious ill-health lump sum (SIHLS), defined benefits lump sum death benefit (DBLSDB), and uncrystallised funds lump sum death benefit (UFLSDB), where they are currently subject to a 55% tax charge above the LTA, are, broadly, since 6 April 2023 and currently to the extent that they are in excess of the LTA subject to taxation at an individual's marginal rate.

[14] HMRC have produced a 'plain English' guide to some of these issues, which can be found at: Taking higher tax-free lump sums with lifetime allowance protection - GOV.UK (www.gov.uk)

This was followed the next day by a statement by the Shadow Chancellor, Rachel Reeves, who confirmed Labour's intention to reverse the measures. She said:

> *"Labour believes that the tax burden must be shared fairly. That is why I have announced today that Labour will reverse the changes to tax-free pension allowances. It is the wrong priority, at the wrong time, for the wrong people. Instead, we would create a targeted scheme to encourage doctors to work overtime and not to retire early."*

When the Budget measures for 2023-24 were subsequently tabled in the form of Finance Act legislation, the Labour opposition followed through on its statements by tabling amendments (which were not carried) which were designed to prevent the abolition of the LTA charge. This suggests that the Labour Party is serious about its intention to reintroduce the LTA if it were to win power.

03 How could the LTA be reintroduced?

Based on current opinion polls, it seems quite possible that the next General Election could lead to the election of a Labour Government, which could be expected to implement its stated policy of reversing the abolition of the LTA. In this section, we consider what this might mean in practice and what challenges a new government might face in this regard. We assume, for now, that a new government would literally reintroduce the LTA regime as previously in force and would not make any refinements or other changes to the LTA regime.

Challenges in reintroducing the Lifetime Allowance

At first sight, it might be assumed that reintroducing something that previously existed would be a straightforward matter – presumably simply a matter of reinstating previously existing legislation.

However, in practice, matters will be more complex than this and an incoming government would need to make decisions on a number of issues.

Will all individuals start with a 'clean slate' under the new regime (ie with full LTA available), or will account be taken for pensions which have already been crystallised?

This is a fundamental question for a new Chancellor who wishes to reintroduce the LTA.

If the new regime effectively 're-sets the clock' so that everyone starts again with a full unused LTA of say £1.073m, the tax revenue from reintroducing the LTA will be very low for many years.

For example, suppose someone has already taken a large DB pension but has some remaining uncrystallised DC pension. If the crystallised benefits 'clock' is re-set to zero, then unless the remaining DC pension is – on its own - in excess of the reinstated LTA, there would be no LTA charge. This would be true even if the combined value of the two pensions on an LTA basis were well in excess of the new LTA. This could be a particular issue for the Treasury if savers with higher levels of pension wealth anticipated a change of government by crystallising all or most of their pensions before the LTA was reinstated[15]. There would be a risk that the government would have to deal with any

[15] We come back to the issue of how savers might respond to all of this uncertainty later in this paper.

political flak for reinstating the LTA, but without generating significant revenue from the measure.

If re-setting the clock is seen as undesirable on both fiscal grounds and fairness grounds, the new Government could attempt to give everyone a ‘starting score’ of LTA used up based on previous crystallisations.

However, there are some profound practical problems with this approach. The present system is based on a process whereby information is given by schemes to members (eg how much of their LTA was used up when they drew their pension), which in turn has to be passed by members to other schemes (from which subsequent benefits are being taken) who have to rely on this information being given correctly and in good faith. This is quite a shaky foundation on which to base a reinstated LTA score.

In addition, this whole process needs to be considered in two tranches - events pre-6 April 2024 (from when the current Government propose to abolish the LTA), and - in particular – events between 6 April 2024 and whenever Labour can implement new provisions – a date we will refer to as ‘I’ day.

At first glance, it might seem easy to look back at past LTA usage under the existing regime. For events pre-2024, someone who has drawn pension benefits under the LTA regime will have been notified of the percentage of the LTA they used up (and get reminders – which may continue past 2024). However, from April 2024, with the abolition of the LTA, pension schemes will no longer provide this information for new retirements/crystallisations and some individuals might seek to argue it was reasonable to discard any records that have no obvious need under the tax law in force then.

Despite a lack of records for crystallisations between April 2024 and I day, in some cases, such as DB pensions in payment, it might still be relatively straightforward to give a starting score. HMRC could specify that the approach will be that the information to look to will be, for DB, the amount of pension paid at retirement (or even just use the current pension figure) - the member undeniably knows this - and multiply it up to impute an amount of LTA used up by this pension. The normal LTA calculation would be 20x pension at retirement plus any lump sum, but in this, HMRC could simply assess the amount of LTA used up as 25x the current annual DB pension as a proxy. We are not suggesting HMRC would then charge tax on this retrospectively - but it would eat into future available allowance. The 25x approach is the exact approach which was used for pensions already in payment when the LTA was first introduced in 2006.

For Defined Contribution pensions, which had been crystallised, things might be more difficult. Where all the pension pot had been used to buy an annuity (and perhaps a tax-free lump sum) then an approach similar to that used for DB pensions could be applied (or the annuity provider might still have a record of the funds used for purchase). But if someone had simply fully cashed out a DC pension before the General Election, and the member has no clear record, and no records are practically available for the now unengaged provider, it is hard to see a straightforward way in which an amount can even be guessed at for the amount of LTA which would be deemed to have been used up.

An intermediate case would be where people have crystallised their DC pensions by taking a lump sum and moving the rest into a drawdown wrapper and have not yet taken all the funds from that. HMRC could potentially count the individual's remaining drawdown balance (uplifted by 100%/75% as a provision for tax-free cash that might have been taken) as the amount of LTA 'deemed' to have been used up at the point of reintroduction of the LTA – but this is likely to be pretty crude. In 2006, there was much less scope for using DC funds flexibly, so the approaches taken for how pre-2006 DC crystallised benefit used up LTA do not work that well now.

There is, however, one avenue open to the government, which is the fact that even under the present government's proposals, there is still a lifetime cap on 'pension commencement lump sums.' As a result, individuals are likely to have a duty to record amounts they have taken in the form of tax-free cash, and it is possible that HMRC could work back from that data to impute information about pensions already drawn. For example, HMRC could assume that the total value of the pension plus lump sum taken was four times the tax-free lump sum figure. But this would be unfair or overgenerous in lots of situations, for example, where people had taken less than the maximum amount of tax-free cash.

Therefore, it seems most likely that a new government would want to make sure that the crystallised benefits 'clock' did not start again at zero on 'Implementation Day' but would probably have to come up with some pretty rough-and-ready rules to allocate a broadly fair amount to each individual for LTA already used up, particularly by events after 6 April 2023.

It is important to stress that this process would almost certainly only be relevant to those who had further pension benefits to crystallise. It seems exceptionally unlikely that a new government would, for example, calculate that someone with a large DB pension drawn just before the Election had used up more than the new LTA and apply some sort of LTA charge tax bill. This would be likely to be seen as retrospective taxation and would almost certainly face a legal challenge.

What about people who have (as yet) uncrystallised pensions as a result of contributions made since 6 April 2023, which are likely to take them over the new LTA?

One 'transitional' issue, which a new government would have to deal with, would be fair treatment of those who may be sitting on uncrystallised pensions which would take them over a reinstated LTA.

The issue here is that people may have acted 'in good faith' by adding to their pension pot after 6 April 2023 (or indeed after the March Budget announcement) when the LTA charge was abolished, and it might be regarded as retrospective taxation to now apply a tax penalty for having done so.

In many ways, this is a similar issue to the one which the Government faced when the LTA was first introduced back in 2006. At that point, some people already held uncrystallised pensions above the newly-created LTA, and it might have been controversial to penalise them for this. As a result, two highly complex forms of 'protection' were introduced –

‘Primary Protection’ and ‘Enhanced Protection’ – each of which sought to avoid unfair taxation of those who had made savings decisions under previous pensions tax law but now faced the creation of an LTA. This was done again at each LTA drop, using the simpler format protections, Individual and Fixed Protections. It seems highly likely that a new government would have to introduce similar protections.

Other issues to consider

With any change of this nature, there is always a range of potential wider issues which need to be considered. Although reducing the LTA charge to zero was achieved in just a few weeks between the March 2023 Budget and the start of the new tax year in April 2023, the full abolition of the LTA is a much bigger job, with large amounts of tax legislation needing to be re-written. Even the current timetable of completing that process by April 2024 is looking challenging, given the number of issues outstanding at time of writing in September 2024. It may equally be the case that a new government elected in, say, Autumn 2024 would struggle to reintroduce the LTA by April 2025 once it had considered the full impact of reintroduction.

To give just one example, millions of public sector workers are affected by the McCloud remedy process, which requires a choice at retirement by members of public service schemes as to whether they wish to be treated as having been a member of their pre-reform or post-reform public service pension scheme for the period between 2015 and 2022. In some cases, a decision to be treated as having been in the reformed scheme rather than the pre-reform scheme for the period in question could lead to a larger pension at retirement and a bigger LTA score. For some higher earners, such as senior doctors, this could generate an LTA charge which they had not anticipated, and the interaction between the reintroduced LTA and the McCloud issue would have to be thought through carefully.

Another issue might be whether anti-forestalling legislation might be needed early in a new Parliament. As we discuss later, if a General Election leads to a change of government and pension savers decide to try to avoid a potential LTA charge either by retiring early (primarily DB) or crystallising their pensions (DC), then this could severely undermine the revenue-raising potential of the new measure.

If full implementation were not possible until April 2025 or even 2026, the new government might well have to try to design urgent legislation to avoid the risk of potential tax revenues haemorrhaging from the system.

A new government might also have to act very quickly to prevent damage to the NHS from a large-scale exodus of senior doctors who had delayed retirement following the abolition of the LTA. Unless doctors were convinced that the new government’s replacement regime avoided the risk of large tax charges, they may ‘vote with their feet’ by taking retirement. Indeed, given how quickly such decisions could be taken, it may be that a potential government needs to do more before the General Election to set out its plans in order to offer the necessary reassurance.

In the next two sections, we consider the potential impact of the prospect of the reintroduction of the LTA on not just the NHS but also the wider UK workforce.

04 Who might be affected?

We have so far focussed mainly on the policy (and politics) of reinstating the LTA, but it is worth also looking at which groups of individuals might be most affected and how they may change their behaviour over this period of uncertainty.

Who might be affected by the reintroduction of the LTA?

One way to think about the impact of the pre–April 2023 LTA regime (and therefore of its potential reinstatement) is to consider Defined Contribution (DC) and Defined Benefit (DB) pensions separately.

For someone who has purely DC arrangements, unless the crystallised lifetime value of those pensions uses up the full LTA, then the LTA will not affect them. And, given the typical level of DC pot sizes at present, that will be the vast majority of DC-only savers.

For DB-only savers, the calculation is more complex but the basic idea is the same. When you take your DB pension you use up your LTA based on 20x the start rate of your annual pension at retirement plus the amount of any lump sum. If, to keep the maths simple, we assumed that the LTA was £1m, then a combination of (say) a £200,000 lump sum and a £40,000 per year pension would use up the LTA. As this example shows, the size of pension needed to have LTA issues from a DB scheme would be far in excess of that which most people can expect to receive from their DB scheme[16].

Increasingly, however, we are seeing people coming up to retirement with a mix of DB and DC entitlements. They may, for example, have spent some period of their working life building up DB rights but in a DB scheme which has since closed to new accruals and has since then been revalued on an inflation proofed basis. More recent pension saving is more likely to have been in a DC arrangement.

In principle, the same basic arguments apply. Where someone has both types of pension, setting up a pension ready to start triggers a test against the LTA in the way described above and the saver only has an issue if the combined value of those drawings across all of their pensions exceeds the LTA.

[16] For some years, there has been an argument that DB pensions are treated more favourably than DC pensions when it comes to testing against the LTA. In the era of ultra low interest rates, someone with a given level of DB pension used up far less of their LTA than someone whose DC pot could have bought them an annuity of equivalent value. However, the recent rise in annuity rates means that this argument now has considerably less force.

In terms of the number of people who have an LTA issue or might be expected to, reliable estimates are hard to find. The best source of data is the Wealth and Assets Survey (WAS) which attempts to capture the amount of pension wealth (and other sorts of wealth) held by a representative sample of the population.

We present some results from the latest round of WAS surveying, which was undertaken between 2018 and 2020. However, it should be noted that some of the results of the survey do not seem to match very well some of the information we know at an aggregate level about the numbers of people with different types of pension. In particular, there is reason to think that respondents to the WAS who work in the private sector may have over-reported active DB accrual whereas public sector respondents seem, if anything, to have under-reported active DB membership. We have not attempted to adjust the WAS data for this, but it should be borne in mind when interpreting the results.

Given that our primary focus is on those who have not yet retired but who may have built up enough pension to be thinking about LTA issues in the foreseeable future, we restrict our analysis to those in the 55-64 age group.

The survey data gives us separate estimates for DB and DC pension wealth of:

- The value to date of pensions of which the respondent is still an active member.
- The value to date of 'deferred' pensions from previous jobs which have not yet been taken.
- The value of pensions already taken.

To give us a rough idea of how many people (and what sorts of people) may have LTA issues, we start by deducting the value of pensions already taken from the current maximum LTA figure, giving each person an 'unused' LTA figure. We then look at how many people have pension rights built up to date which will be over this figure when taken[17], or are within 20% of that figure.

Table 2 shows our initial results.

[17] As the survey data is for 2018-20 we have updated the figures in the survey for inflation between then and now, but have not otherwise adjusted the data for things such as market movements in recent years.

Table 2. Estimated numbers of people (in millions) aged 55-64 with uncrystallised pension wealth which would take them a) Over 100% of the 2022-23 LTA and b) Between 80 and 99% of the 2022-23 LTA

	All	Of which	
		Over 100% LTA	80-99%
DB Pensions Only	1.61	0.10	0.05
DC Pensions Only	2.33	0.07	0.02
DB & DC	1.06	0.06	0.05
All aged 55-64 with undrawn pension wealth	**5.00**	**0.23**	**0.12**

Our analysis suggests that, as a rough order of magnitude, there are around 5m people in the 55-64 age group who have some sort of pension wealth which they have not yet accessed.

Nearly half (46%) have only DC wealth. Many of these are likely to be people who started pension saving as a result of automatic enrolment and who therefore only have very small pension pots to date. Around a third (32%) have only DB wealth, and in many cases, these will be people whose working career has been wholly or largely in the public sector. The remaining group have a mix of both types of pension wealth. Amongst those with both kinds of pension, further analysis suggests that the DB wealth on average accounts for around 80% of the total pension wealth for this group.

Looking at those who, taking account of any pensions they have already accessed, would exceed the LTA purely based on their remaining pension wealth accrued to date, we estimate around 230,000 are in this position. Notably, the majority (70%) have some DB pension as part of this total and this fact may be particularly relevant to the policy discussion around the reintroduction of the LTA as we discuss later.

We also look at those who are within 20% of using up their remaining LTA, on the basis that many of these may still be active contributors to pensions and may have the prospect of having to think about the LTA even if they have not already gone over the LTA. This group numbers around 110,000 and they are heavily skewed towards those with DB pensions, either alone or alongside DC rights.

In summary therefore, we estimate that roughly one third of a million people (340,000) aged 55-64 may have pension wealth yet to be drawn which puts them potentially above or close to the LTA as it existed up to 5 April 2023.

Broadly speaking, this suggests a little over 4% of those aged 55-64 with pension savings may already be over the LTA and a combined total of around 6% may be at or near the LTA. This seems broadly consistent with the Treasury's own statement[18] that "…95% of savers approaching retirement are currently unaffected by [the LTA]".

[18] Setting the standard Lifetime Allowance from 2021 to 2022 to 2025 to 2026 - GOV.UK (www.gov.uk)

It is interesting to note that much of the commentary[19] around abolishing the LTA has suggested that this was a tax change which benefited the 'top 1%', whereas in terms of those who are coming up to retirement – and presumably most engaged in this issue – the impact of LTA abolition and/or reinstatement may be of somewhat wider interest.

One rather large caveat to all of this is that we know that some people who are already over the LTA (or expect to be so) may have locked in some form of 'protection' of a previously higher LTA. For example, those who already had pension wealth of £1.1m when the LTA was cut in 2016 from £1.25m to £1.0m may have secured 'fixed protection' or 'individual protection' which would protect them against LTA charges, subject to certain conditions. To the extent that such people feature in Table 2, we would be overstating the potential impact of the LTA. Unfortunately, the survey does not ask if people have such protection.

The total group of 340,000 people aged 55-64 who are at or near the LTA is the group who might be most affected by any potential reintroduction of the LTA. In the next section we consider how they might respond to the abolition and potential reintroduction of the LTA.

What behavioural response might we see if reintroduction of the LTA is on the cards?

Depending on the type of pension wealth held by different individuals, there are a range of reactions we might expect to see[20].

Bringing forward drawing a DB pension to before the General Election

One of the primary objectives of the Chancellor's Budget 2023 changes was to encourage top doctors to go on working rather than retiring. By allowing them to draw (and add to) a large DB pension entitlement without any LTA penalty, this should have removed one motivation for retirement. Indeed, following the Budget there were anecdotal reports of senior doctors who were planning to retire imminently putting their retirement plans on hold.

However, the converse of this effect is that doctors (and others) who might face a large tax charge on a DB pension if the LTA were to be reintroduced might be tempted to retire as soon as it seemed likely that an LTA was set to return. It is quite possible therefore that any respite we have seen since March 2023 in numbers of senior doctors retiring could prove to be temporary.

It would only be fair to say that the Labour Party has said that it would come up with an alternative mechanism to protect senior doctors from tax penalties if they work on, and therefore there would be no need for them to retire early. However, unless the Labour Party has specified in some detail how this might work, it seems likely that doctors may prefer the certainty of retirement and a penalty-free pension rather than the risk of carrying on.

[19] See, for example: Hunt's 'budget for growth' gives top 1% a pension bonus but ignores public services | Budget | The Guardian and UK's Labour attacks planned pension changes as giveaway to the rich | Reuters
[20] Note that nothing in this paper constitutes financial advice. We express no opinion as to whether the potential behavioural responses which we describe would necessarily be the best strategy for the individuals concerned.

Broadening the debate beyond senior doctors, our previous analysis showed that for most people with LTA issues it is the relatively large value of their DB pension which is pushing them up towards the LTA. Where retirement before the potential reintroduction of the LTA is a viable option, we could well see significant numbers of people taking their DB pension for LTA reasons. This would, of course, move things in the opposite direction to the current government's drive to get people enjoying 'fuller working lives' and being economically active for longer.

One potential mitigation would be if the Labour Party were to make it clear that existing pension savings at the date of re-introducing the LTA would be protected, including growth on those funds in future.

Accelerated DC saving followed by 'early' crystallisation

A combination of much higher annual limits on tax-privileged saving plus the abolition of the LTA may lead to much higher levels of DC pension saving amongst higher earners in 2023/24 and 2024/25. Some who had stopped saving into a pension because they would be above the LTA when they drew their pension might now feel encouraged to save more. In particular, those who had not saved into a pension for some years could carry forward substantial amounts of unused Annual Allowance from previous years and could – provided they had the savings and current earnings to do so – put six figure sums into their DC pension.

Again, there would be a big question as to whether such people would then look to access their pensions prior to a potential change of government. With a potential LTA charge of 55% on lump sum withdrawals and 25% plus income tax on regular income (assuming the LTA rules from 2022/23 were simply recreated), the financial incentive could be very considerable.

One option would be to move accumulated pension savings into a (flexi-access) drawdown account. The act of doing this is a 'benefit crystallisation event' and would previously have potentially triggered an LTA charge. But savers who move into drawdown before the LTA is reintroduced would (depending on the approach taken to the new LTA) avoid such a charge.

It is, of course, possible that a future government could look at funds in drawdown and 'work back' to how much LTA would have been used up had the LTA been in existence at the time the account was opened. But it seems very unlikely that there would be any attempt to impose a retrospective tax charge; the most that might reasonably happen, as with DB pensions in payment when the LTA was brought back, is that DC balances in drawdown (and any imputed tax-free lump sum taken out alongside) could be added to the citizen's running total of (notional) LTA used to date, which would limit the scope for further contributions within the new LTA.

Reviewing the sequencing of pension withdrawals

One unfortunate ‘quirk’ of the 2023/24 regime (currently in place) is that the sequence in which different pensions are taken can affect an individual’s ability to enjoy a tax-free lump sum. This is because there is still a cap on tax-free cash even though the LTA charge has been abolished.

To give an example, consider an individual who has benefits in two schemes – DB in scheme A worth £1.0731m and DC in Scheme B worth £200,000. If the individual starts to draw benefits from A first and chooses not to take any tax-free lump sum from there, then, with no LTA left, there will be no scope to draw a tax-free lump sum from B. (There is also the tax rule that, within this overall cap, places a maximum allowed from each scheme of broadly 25% of the package being drawn.)

In light of this, those with multiple pension pots, and particularly those with both DB and DC pots, may choose to think very carefully about the order in which they take their pensions and the options they take with each pot.

The post-April 2024 regime is likely to lessen this state of affairs as only lump sum and not pension eat into the proposed regime’s lump sum allowances. But in the meantime, those with multiple pension pots, and particularly those with both DB and DC pots, should think very carefully about the order in which they take their pensions and the options they take with each pot.

05 Conclusion

As we have shown in this report, whilst the process of abolishing the LTA is complex and ongoing, its reintroduction would be no more straightforward. It is not simply a matter of reinstating all previous legislation. A new government would need to consider complex issues such as how to treat pension wealth, which had already been drawn, some subject to the LTA historically others not, as well as the position of people who had saved heavily during the period when there was no LTA.

They will also have much work to do to come up with an alternative arrangement for senior doctors, which would help to retain their services in the NHS and justify why similar arrangements should not apply to other key workers. It could also be argued that rather than simply reintroduce the old LTA with all its flaws and complexity, a new government would be an opportunity to rethink these issues more fundamentally and potentially design a simpler system.

The big risk for an incoming government is that older savers with larger pension pots will simply ‘vote with their feet’ in all of this. For many of those with LTA issues, we have found that this is being driven largely by DB pension entitlements. For this group, early retirement in the run-up (or immediate aftermath) of a General Election may look very attractive if considering the LTA alone.

Likewise for DC savers, with pensions still accessible from age 55, the scope for high levels of tax-privileged accumulation in the run-up to a General Election followed by crystallising those pots before or shortly after an Election may look very tempting.

We have also found that this issue is rather broader than headlines about ‘the top 1%’ being affected would suggest. For those in the run-up to retirement, we find – in line with Treasury estimates – that around 5% may have enough pension wealth to be concerned about the LTA.

A new Labour government would face complex technical challenges both in designing a restored LTA and a separate regime for doctors and may struggle to implement a new regime much before the 2026/27 tax year. But even if and when it does so, it seems quite likely that a restored LTA may actually generate remarkably little revenue if pension savers choose to use the window of LTA abolition to maximum advantage.

There is also a material risk that older workers make life-changing decisions having second-guessed potential future changes in the pensions tax regime without understanding the wider impact on their tax position, finances and death provision to name but a few.

Whilst challenging, the Labour Party might find that publishing detailed plans (or confirming that the LTA will not be reintroduced[21]) ahead of the election could reduce the number of people retiring early and so both boost economic activity and tax revenues.

[21] Such an announcement would certainly be welcomed by those who work in the pensions industry. In particular, if the Government felt able to take more time to implement the abolition of the LTA then it would hopefully have more time to get things right.

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