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WEALTH SOLUTIONS

THE NEW LANDSCAPE OF UK RETIREMENT SAVINGS

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Pension policy in the UK has undergone significant shifts recently, reflecting a change in government and differing priorities. The first Labour budget in 14 years expanded taxation on pensions, moving away from the Conservative approach of encouraging pension savings and longer workforce participation.

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Let's look at what has changed over the past two years and examine the impact on pension savers in the UK and beyond.

FINANCE ACT 2024: ENCOURAGING PENSION SAVINGS

The Conservatives made significant legislative changes affecting pensions in their last year of government. They aimed to encourage pension saving while retaining limits on tax-free pension benefits through the following measures:

Lifetime Allowance (LTA) Removed

The cap on an individual's tax-relieved pension savings, previously £1,073,100, was removed. The LTA was seen as a disincentive for high earners to continue working, as many individuals approaching the LTA would opt for early retirement to avoid punitive tax on their pension fund. Removing the LTA aimed to encourage workers to remain in the workforce longer, addressing labour shortages in key sectors such as the NHS.

Although the cap on tax-relieved pension savings was removed, the amount of tax-free cash that can be taken from a pension remains, facilitated by three new allowances:

- **Lump Sum Allowance (LSA)**: £268,275 (25% of £1,073,100). This caps the Pension Commencement Lump Sum (PCLS) and/or tax-free portion of an uncrystallised funds pension lump sum (UFPLS).
- **Lump Sum and Death Benefit Allowance (LSDBA)**: £1,073,100. This is the maximum amount that can be taken from pension arrangements tax-free over life and at death.
- **Overseas Transfer Allowance (OTA)**: £1,073,100 – the same level as the LSDBA, £1,073,100.

Pre-April 2024, a transfer to a QROPS would have been tested against the LTA as it was a benefit crystallisation event. Therefore, if no other pension benefits had been crystallised, it would have been possible to transfer £1,073,100 to a QROPS without any UK tax, with the excess (if applicable) being subject to the LTA Charge of 25%.

Removing the LTA without any further measures would have resulted in pensions of unlimited value being able to transfer to a QROPS free of UK tax. To combat this, all transfers to an overseas pension are tested against the OTA. The excess is subject to an overseas transfer charge of 25%.

The OTA does not interact with the other allowances, so when a lump sum is paid from a QROPS, it is tested against the lump sum allowance for that QROPS only. This meant that, for a short period of time, a UK resident could transfer their pension to a QROPS established in the EEA or Gibraltar and benefit from two or more tax-free allowances. The path to doing this has been restricted due to changes to the exemptions to the overseas transfer charge, which were brought about in the Autumn Budget 2024 and described below.

Lifetime Allowance Protections

Existing LTA protections can be applied to the calculation of LSA and LSDBA.

For example, if a member has LTA protection giving a previous lifetime allowance of £1.5m, the LSA would be £375k (25% of £1.5m), and the LSDBA would be £1.5m.

Increase in the Annual Allowance

The amount an individual can pay into a pension each year increased from £40,000 to £60,000.

Taxation of Death Benefits

The taxation of death benefits received from a pension scheme on death after age 75 remains the same under the new rules, i.e., taxed at the beneficiary's marginal rate. However, if death occurs before age 75, the taxation of death benefits has changed:

DEATH BENEFIT (PRE-75 DEATH)	OLD REGIME	POST 5 APRIL 2024
Uncrystallised Funds – Lump Sum Death Benefit	Excess over LTA taxed at 55%	Excess over LSDBA taxed at beneficiaries' marginal rate
Uncrystallised Funds – dependent/ nominee drawdown or annuity	Excess over LTA taxed at 25%, Income tax-free	No tax on crystallisation event, Income tax-free
Lump Sum Death Benefits from drawdown designated pre-6 April 2024	Tax-free	Tax-free
Lump Sum Death Benefits from drawdown designated post-5 April 2025	N/A	Excess over LSDBA taxed at beneficiaries' marginal rate

Transitional Rules

For individuals who crystallised benefits pre-April 2024 and may not have taken any tax-free cash, reduced tax-free cash, or crystallised benefits when the LTA was lower, there are transitional rules to ensure they are no worse off in terms of the tax-free cash they are entitled to. There are two ways of calculating the tax-free allowances:

› **Standard Method**:
The LSA and LSDBA are reduced by a percentage of the LTA used.

Example

› Member crystallised benefits in June 2023 utilising 50% of their LTA.

› The LSA post April 2024 will be reduced by £1,073,100 x 50% x 25% = £134,137.50

› LSA = (£268,275 - £134,137.50) £134,137.50

› LSDBA = £1,073,100 - £134,137.50 = £938,962.50

› **Alternative Method**:
The LSA and LSDBA are reduced by the monetary amount of benefits taken as tax-free cash.

Example

› If the LTA was £1,073,100 when the benefits were taken, but the individual took 20% of the crystallised benefits as tax-free cash, as opposed to the maximum available which is 25%, the alternative calculation would provide the following allowances:

› £1,073,100 x 50% = £536,550 (crystallised benefits) £536,550 x 20% = £107,310 (tax free cash)

› LSA = (£268,275 - £107,310) £160,965.

› LSDBA = (£1,073,100 - £107,310) £965,790

Where beneficial, individuals can apply for a transitional tax-free amount certificate to benefit from higher allowances.

Examples of when the alternative method of calculation may be beneficial for clients:

› Benefits taken pre-April 2024 with no tax-free cash taken.

› Benefits taken pre-April 2024 with less than 25% tax-free cash taken.

› Benefits taken when the LTA was less than £1,073,100.

› Individual was 75 pre-April 2024 and the BCE test at age 75 used up some or all of the LTA.

› Benefits transferred to a QROPS pre-April 2024 (the QROPS transfer is a benefit crystallisation event and tested against the LTA, but no tax-free cash is taken).

LABOUR REFORMS: EXPANDING TAXATION ON PENSIONS

The Labour Government's 2024 budget introduced key measures impacting pension provision, aiming to address pension-related inequalities by expanding tax on higher-end pensions. Many predicted the LTA would be reinstated, but Labour instead looked at other ways to generate tax on large pension pots.

Inheritance Tax on Pension Funds

From April 2027, unused pension funds and death benefits will be included in the calculation of Inheritance Tax (IHT) on an individual's estate. This applies to all UK registered pension schemes and Qualifying Non-UK Pension Schemes (QNUPS), including QROPS.

The inclusion of pension benefits in an individual's estate, with a potential 40% IHT charge, sits alongside the existing tax on pension death benefits. The government is currently holding an open consultation on the processes required to implement these changes.

Pensions – Overseas Transfer Charge

The Chancellor announced changes to the exclusions from the overseas transfer charge, a 25% tax charge on the excess over the OTA of any transfer to a QROPS and non-excluded transfers from UK relieved pension schemes to QROPS requested after 8 March 2017. The exclusion no longer applies to transfers to a QROPS established within the EEA or Gibraltar, where the member was UK resident or resident in a country within the EEA or Gibraltar. The exclusion still applies if:

› The member resides in the same country or territory as the QROPS is established.

› The QROPS is an occupational scheme or an overseas public service pension scheme, with the member joining as an employee.

› The QROPS is set up by an international organisation to provide benefits for current or former employees of that organisation.

The Impact on Pension Savers in the UK and Abroad

Removing the lifetime allowance incentivised some highly paid employees to continue working and saving into a pension scheme later in life. However, introducing IHT on unused pensions will promote different behaviour in the market. There is no longer a benefit to retaining wealth in a pension for succession planning and tax-efficient wealth transfer. Instead, the government wants to ensure the tax reliefs on pensions, costing over £70bn, are being used for their intended purpose of encouraging saving to generate an income in retirement.

For many individuals who hold significant value in UK pensions, QNUPS, and QROPS, it will be time to reassess their financial plans. The IHT benefits of a pension usually meant the pension pot was one of the last sources of wealth to be used for retirement provision. As this has now changed, we may see more wealth being withdrawn from pensions earlier, benefiting the treasury as they collect income tax on the pension as it is drawn down.

For the UK expat living abroad who has UK Pension or QROPS savings, these measures present new opportunities. With the IHT incentive of the pension removed, there will be scenarios where individuals living abroad in low-tax countries, such as the UAE, will find it more efficient to access the pension in full to avoid any income tax liabilities and then utilise an alternative product to provide tax-efficient withdrawal options in a future country of residence.

Even in a jurisdiction like France, it could be possible to access the UK pension in full under the flat tax regime, with a total tax liability, including social taxes, of around 20%, and utilise Assurance Vie for tax deferral and lower tax on wealth transfer.

For those same individuals who have no intention of becoming long-term residents in the UK, they may benefit from moving the pension fund into a non-UK asset to avoid it being assessed for IHT in the UK. In the right circumstances, an offshore bond can provide a ready-made alternative to the pension, offering gross roll-up, succession planning options, and tax-efficient access.

Introducing an OTC charge on transfers to EEA and Gibraltar QROPS (if the member is not resident there) may have closed a loophole on accessing tax-free cash twice for UK residents. However, it will create difficulties for many people who want to retire in an EEA country where there are no registered QROPS.

If there is no QROPS in their new country of residence, they will have to leave the pension in the UK and deal with currency fluctuations and potential difficulties in accessing pension payments through non-UK bank accounts or lose 25% of their pension value on transfer.

This measure may encourage residency in jurisdictions where there are registered QROPS. Countries like Malta and Ireland could become attractive retirement destinations for the British. Ireland has a resident non-dom regime that only taxes foreign income when remitted. Locally available QROPS are also available, which will avoid the 25% overseas transfer charge, and once the pension is held in the QROPS and the individual loses their long-term residency status in the UK, there will be no UK IHT to pay on the QROPS pension.

With change comes opportunity. In particular, the introduction of IHT on unused pension funds will drive a change in behaviour in how pensions are utilised. This will undoubtedly lead to increased opportunities to restructure retirement provision to make sure it is more efficient and aligned with the new pension environment.

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