Lump Sum Allowance (LSA)

Video transcript

We're going to move onto Lump Sum Allowances, which are the maximum levels of tax-free cash lump sum that can be payable either when you take your pension savings or in the event of your death. Starting with the Lump Sum Allowance (LSA).

The Lump Sum Allowance was introduced with effect from 6 April 2024 and is the maximum tax-free lump sum that you can take from your pension savings.

The former Lifetime Allowance (LTA), which was the maximum value of benefits that could be taken from a registered pension scheme without being subject to the Lifetime Allowance charge, was removed from 6 April 2024.

Before 6 April 2023 the Lifetime Allowance was £1,073,100. Of this Lifetime Allowance, a quarter of it, or 25%, could be taken as tax-free cash. That meant that if you had benefits valued at £1,073,100 or more, then up to £268,275 could be taken as tax-free cash.

In practice, most members have benefits valued below that £1,073,100 mark, so the maximum tax-free cash that you could take would actually be below the £268,275 and based on 25% of your overall benefit value.

But if you had benefits in value of more than the Lifetime Allowance, there was an additional tax charge of 25% in addition to income tax if these benefits were taken as income. Or a 55% charge if the excess was taken as cash.

From 6 April 2023, the Lifetime Allowance was still in place and you could still take up to £268,275 tax-free cash, dependent on the level of your benefits. But the additional tax charge if the value of your benefits was more than the Lifetime Allowance was removed.

Then from 6 April 2024, the Lifetime Allowance was removed altogether, but the maximum tax-free cash amount has been kept in place at £268,275 and is now called the Lump Sum Allowance (LSA).

Where the Lifetime Allowance used to look at the total value of all benefits, the Lump Sum Allowance is the limit on the total amount of certain tax-free lump sums that you'll be able to receive before marginal rate taxation applies.

The calculation for the maximum lump sum that you can take depends on the value of your benefits that you're taking from any of the pension schemes that you have. If taking all of your benefits from USS, for example, it'll be calculated using the value of your Retirement Income Builder (DB) benefits plus any Investment Builder (DC) savings that you have.

You can use the Benefit Calculator on My USS to estimate what the maximum lump sum will be for you based on the value of your benefits. But that's from USS only. The Benefit Calculator does not take into account benefits you may have with other schemes.

Each time you take a lump sum from a pension scheme, you may be able to take up to 25% of the value of your benefits as a tax-free lump sum, as long as the value of all tax-free lump sums you've taken does not exceed the Lump Sum Allowance in total.

So the limit is £268,275, which is 25% of the Lifetime Allowance of £1,073,100 when it was in place at 5 April 2024.

But that limit might be higher if you have a former Lifetime Allowance protection. There are no longer any specific Lifetime Allowance checks, just consideration of how tax-free lump sum amounts add up. And just to note, the Lump Sum Allowance for the current tax year is still £268,275.

Each time you take a tax-free lump sum from your benefits or savings, you'll use up some of your Lump Sum Allowance. If you have not yet taken any benefits from any pension schemes yet, then the limit for you will be £268,275.

However, if you've already accessed benefits, then depending on whether that was before or after April 2024, there's different information that you need to gather to work out how close to the Lump Sum Allowance you are. And we're going to have a look at an example of how to work out how close you are to the Lump Sum Allowance.

First, you need to look at if you've taken any benefits prior to 6 April 2024. And if you have, take 25% of the amount of the Lifetime Allowance that you used up for any benefits taken prior to 6 April 2024, as noted in the relevant paperwork of the scheme where you took those benefits from.

Then work out 25% of the amount of any benefits transferred overseas to a Qualifying Recognised Overseas Pension Scheme (QROPS) before 6 April 2024, if applicable. Also if you turn 75 before 6 April 2024, even if you did not access any benefits at that time, you need to include in any Lump Sum Allowance calculation, 25% of the value of any unclaimed pension benefits at your 75th birthday.

You then need to look at the value of any benefits paid as a tax-free cash sum from 6 April 2024. For example, a Pension Commencement Lump Sum – this is the one-off tax-free lump sum that you may have opted for when you retired or flexibly retired or when buying an annuity; or the tax-free element of an

Uncrystallised Funds Pension Lump Sum, or UFPLS for short. An UFPLS is where you've taken a cash sum from your Investment Builder savings or any other defined contribution (DC) savings.

Also the tax-free element of any drawdown payments, including flexi-access drawdown.

If all these figures come to a total higher than the Lump Sum Allowance of £268,275, you may be subject to a tax charge on any lump sum benefits in excess of your available allowance. This will be taxed at your marginal rate and deducted at source from any taxable lump sum benefits USS pay to you. For example, if you're a 40% taxpayer and your lump sum exceeds your available Lump Sum Allowance, you'll pay 40% tax on the amount in excess of this limit.

Let's take a look at a member who's taking benefits in a few different ways. A member had a pension that they started taking before April 2024 and they used 40% of the Lifetime Allowance, or the LTA, at that time.

Assuming that a quarter of their Lifetime Allowance usage was taken as tax-free cash, that means they took 10% of their Lifetime Allowance as tax-free cash. The Lifetime Allowance at 5 April 2024 was £1,073,100 meaning that the member has used up £107,310 of the Lump Sum Allowance, which is 10% of that £1,073,100.

Then they took a cash lump sum known as an UFPLS in May 2024. The UFPLS was £60,000 and a quarter of this was tax-free, so £15,000. So they've used up another £15,000 of the Lump Sum Allowance.

That leaves our member with a remaining £145,965 of available Lump Sum Allowance. Whilst they have this amount remaining, it will depend on the value of their remaining benefits as to how much they can actually take.