In this Talking Points:

Protect your client's pension savings from a second HMRC bite

Many clients may think once they have started to take benefits from their SIPP, even if in the form of drawdown, they are safe from Lifetime Allowance charges.

This is not the case and this Talking Points explores the issue further.

First bite
For any client entering drawdown, be it capped or flexible, there will always be at least one Lifetime Allowance test. The fund is first tested at the point of entering drawdown and taking the pension commencement lump sum, using up a percentage of the Lifetime Allowance. This leaves a remaining percentage of the Lifetime Allowance unused for a later benefit crystallisation event.

It is not a monetary figure - if 100% of the Lifetime Allowance is used and the allowance subsequently increases, there will still be no remaining entitlement.

Second bite
When the client subsequently buys an annuity or reaches age 75 there will be a further benefit crystallisation event and hence an additional test.

This test looks at the growth on the fund since the last BCE and tests it against the remaining unused percentage of the Lifetime Allowance. The reduction in lifetime allowance next year (from £1.8 million to £1.5 million) will also reduce the discrete value of the remaining allowance.

Fixed protection
For those at or near the Lifetime Allowance when crystallising into drawdown, there is always the chance they may exceed their percentage of unused Lifetime Allowance, exacerbated by the reducing Lifetime Allowance amount.

Fixed protection could be the answer for those eligible to apply.

In order to apply for fixed protection the client must have ceased contributing to, or accruing benefits in, all registered pension schemes. If there is no additional growth fixed protection has no detrimental effect.

If the client wanted to make contributions at a later date, realising they did not need to rely on fixed protection, then following the contribution they must notify HMRC that fixed protection no longer applies.

Our view
With the market volatility that has almost become the norm over the past couple of years some investors could easily be caught out by this. They'll certainly thank the adviser that protected their investment gains from further taxation.