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UK

Volume 2017 | Issue 19 | 30 March 2017

Money Purchase Annual Allowance Reduces to £4,000

The government recently published its consultation response on reducing the money purchase annual allowance (MPAA) with effect from April 2017. Trustees of pension schemes that provide money purchase savings (which would include the majority of Additional Voluntary Contribution (AVC) funds within defined benefit pension schemes) should make their members aware of the reduced £4,000 MPAA.

Communicating the change will reduce both the risk of members making decisions without understanding the tax implications and the potential reputational damage where members receive unexpected tax bills. This is particularly important where members have received communications based on a £10,000 MPAA in the past. Your usual Conduent contact can help you prepare an appropriate communication.

Background

Contributions to pension schemes are tax free, provided the amount paid in any tax year does not exceed the annual allowance. The standard annual allowance is £40,000 (reduced on a tapered basis for individuals whose taxable income, including pension savings, exceeds £150,000 a tax year).

Following the introduction of pensions freedoms on 6 April 2015, individuals over age 55 have been able to access their money purchase savings flexibly. The government were concerned that these pension savings might be recycled for a further round of tax relief.

The government, therefore, introduced a money purchase annual allowance (MPAA) of £10,000. The MPAA is triggered when an individual first flexibly accesses money purchase benefits, and acts as a tax relief limit for future contributions to money purchase arrangements.

If the MPAA limit is exceeded, as well as the possible tax charge, individuals will have a reduced annual allowance for the remainder of their pension savings for that tax year. Where money purchase pension savings do not exceed the MPAA, the individual still receives the full balance of the annual allowance (after any adjustment for tapering).

Events Triggering the MPAA

The MPAA applies for the tax year in which an individual first flexibly accesses money purchase benefits, and for all subsequent tax years. Events which trigger the MPAA include flexibly accessing money purchase savings:

- as a one-off payment by taking an uncrystallised funds pension lump sum.
- through a flexi-access drawdown fund, where the first income drawdown from the arrangement occurs on or after 6 April 2015.

Money purchase savings include both defined contribution arrangements and the majority of additional voluntary contribution (AVC) facilities operated by defined benefit pension schemes.

Receipt of a tax-free lump sum (pension commencement lump sum) is not a trigger event, neither is the designation of the funds into a flexi-access drawdown fund.

The MPAA Reduces to £4,000 from 6 April 2017

The government, following consultation, announced in the Spring Budget 2017 that it is reducing the MPAA to £4,000 with effect from 6 April 2017. This will affect all individuals who have flexibly accessed money purchase savings since 6 April 2015 (including those that did so before 6 April 2017).

The facility which exists for individuals to carry forward any unused annual allowance to subsequent years does not apply to the MPAA as the government believe this would increase the scope for recycling. Thus anyone not making use of the full MPAA this tax year will still only have an MPAA of £4,000 after 6 April 2017.

Member Communication

It is critical that members understand the impact of the MPAA when deciding how to access their benefits, as the implication on their future pension savings may not be immediately apparent. Members that have previously flexibly accessed benefits on the understanding that the MPAA was £10,000 will also need to be communicated with, to avoid unexpected tax bills from the reduction in the MPAA.

Comment

The claim in the government’s consultation response that the MPAA of £4,000 allows individuals who need access to their pension savings to rebuild them if they subsequently have the opportunity to do so, appears a pretty hollow one. Anyone accessing money purchase savings flexibly has to be over age 55, and therefore at £4,000 a year, has a limited number of years to continue to make payments into a money purchase pension scheme. The limit of £4,000 a year effectively removes the option of any meaningful “rebuilding”.

It is also particularly unfortunate for individuals who have started to draw benefits flexibly, perhaps as a phased retirement whilst they continue to work part time, and now find the government is moving the goal posts. It also applies to individuals who are members of defined benefit pension schemes with a money purchase AVC fund, who choose to take their AVC fund as a one-off lump sum (an uncrystallised funds pension lump sum).

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