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RETIREMENT INCOME

MONEY PURCHASE ANNUAL ALLOWANCE (MPAA) GUIDE

Summary box

There's currently no limit on the amount of money that you can contribute into a pension each tax year and you can normally receive tax relief on contributions up to 100% of your earnings.

But if your contributions are more than £40,000* a year (known as the **Annual Allowance**), tax charges apply that effectively recoup the tax relief you receive on contributions over this amount. This includes all contributions made by other people, such as your employer.

- If you access your pension savings flexibly, then the amount you can contribute each tax year to a money purchase or certain hybrid pension scheme(s) without incurring tax charges reduces to £4,000**. **This is called your Money Purchase Annual Allowance.**
- MPAA was introduced to stop excessive recycling of pension monies for tax relief purposes. This could have a hidden residual impact for many retirees who've accessed their pensions flexibly, but who haven't 'retired'.
- The contribution restrictions may mean that someone who's taken taxable lump sums (or income) from their drawdown plan to fund a short term need, could struggle to accumulate a big enough future pension pot to provide for their longer term retirement income requirements.

*A tapered annual allowance will apply to those with income over certain levels. To find out more, visit: gov.uk/guidance/pension-schemes-work-out-your-tapered-annual-allowance.

**Up until 6 April 2017 the MPAA was £10,000. The legislation to reduce it to £4,000 was delayed because of the general election in June 2017. The Government has since confirmed they still plan for this change to go ahead (from 6 April 2017). For this to happen, the legislation still needs to be passed in Parliament. This is likely to take place later this year.

What triggers the MPAA?

There are several ways it can be triggered, such as:

- Accessing income through a Flexi-Access drawdown plan.
- Exceeding the GAD limit (150%) on income for capped drawdown plans.
- Converting a capped drawdown to a flexi-access drawdown, and taking income.
- One-off or regular cash withdrawals from a pension (also known as Uncrystallised Fund Pension Lump Sum, or UFPLS).
- Where an individual had received a flexible drawdown payment prior to 6 April 2015 from their pre-6 April 2015 flexible drawdown arrangement (it automatically becomes flexi-access drawdown).
- Receiving income from a scheme pension, where entitlement occurs on or after 6 April 2015, with fewer than 12 members.
- Taking a stand-alone lump sum payment from a pension pot, where primary protection applies, and the lump sum protection exceeds £375,000.
- Payments from certain overseas pension schemes.
- Taking an income from a lifetime annuity after 6th April 2015 where reductions to income levels are possible. This can happen where an initial taxable lump sum payment (over and above the 25% tax free cash lump sum) is taken from an annuity. Where the facility exists the initial taxable lump sum is treated as an income payment, where the subsequent income level then reduces.

What doesn't trigger the MPAA?

There are a few situations where the MPAA doesn't come into effect:

- Taking an annuity, including where tax free cash is paid, where the income level does not reduce. (No initial taxable lump sum taken).
- Taking a tax free cash lump sum from a flexi-access drawdown plan, but no income.
- Taking an income from a beneficiary's flexi-access drawdown plan.
- Taking a lump sum under the 'small pots' rules.

These lists aren't exhaustive, but will cover many circumstances your clients face when using pension freedoms.

Carry Forward

You may be able to carry forward any unused annual allowance from the previous three tax years, if you've exceeded the annual allowance, to reduce the applicable tax charge. If the MPAA is triggered however, carry forward can't be used to increase the money purchase annual allowance.

Carry forward, however, can still be used to increase the alternative annual allowance for any defined benefit accrual.

Alternative Annual Allowance

If the MPAA is triggered, and future DC contributions are reduced to £4,000 per tax year, then the balance of the Annual Allowance can be used through a DB scheme, if your client has the opportunity.

This means they'll still have £36,000 of DB 'contributions' that can be made in the tax year without incurring a tax charge. This is called the 'alternative annual allowance'. Be aware that the input for DB 'contributions' is based on a specific calculation, rather than the actual contributions paid.

This is a complex area, with much of the detail outside of the remit of this document, and will require individual investigation with each of your clients where necessary.

What does this all mean for my clients?

The MPAA was introduced to stop excessive recycling of pension monies for tax relief purposes. This could have a hidden residual impact for many retirees who've accessed their pensions flexibly, but who haven't 'retired'.

The contribution restrictions may mean that someone who's taken lump sums (or income) from their drawdown plan to fund a short term need, could struggle to accumulate a big enough future pension pot to provide for their longer term retirement income requirements.

It's important to keep a close eye on MPAA triggers, to ensure that clients don't find themselves unintentionally subject to this.

FOR MORE INFORMATION

Call: **0345 302 2287**
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