

How accessing your pension could reduce your annual allowance

If you are close to, at or over 55 and you have, or are considering, withdrawing taxable income directly from your pension savings, you should know about the 'money purchase annual allowance' (MPAA).

The MPAA restricts how much you can tax-efficiently pay into your money purchase pension each year.

Therefore, it's important to be aware of how this might impact you before making decisions about how to access your pension savings. Especially if you wish to continue making further pension contributions..

In this guide we cover:

- What the MPAA is and how it works
- What happens if you exceed the MPAA
- What to consider if you are impacted by the MPAA

The money purchase annual allowance and how it works

The money purchase annual allowance (MPAA) limits how much can be paid into your money purchase pensions in any one tax-year while still benefiting from tax relief. It applies once you take taxable income from your pension pot using pension freedoms (i.e. more than the tax-free part). You can normally do this from the age of 55.

In the tax year 2020/21 the MPAA is £4,000 compared with the full annual allowance of £40,000 for most people.

It limits the amount of contributions that can be paid into your pension tax efficiently and applies to money put in by you, your employer or anybody else (transfers are ignored for this purpose).

Keep within the limits and all the contributions made to your pension will either benefit from tax relief (those made by individuals) or will simply not be taxed when they are paid in (those made by an employer).

Exceed the limits and all the contributions made to your pension that are above the allowance (regardless of who made them) will be liable to a tax charge which effectively claws back any tax relief that was given at source. The value of tax benefits from a pension depends on your circumstances and all tax rules may change in the future.

When does it apply from?

It will apply from the date you first take taxable income from your pension pot to the end of the tax year and in every tax year thereafter.

For instance, if you took taxable income on the 10 June 2019, contributions of up to £4,000 could have been paid in between 10 June 2019 and 5 April 2020 before a tax charge was potentially payable.

Contributions made before you trigger the MPAA are ignored for MPAA purposes – though the overall annual allowance of £40,000 in 2019/20 still limited your overall contributions for that tax year.

What is a money purchase pension?

This is a type of pension which builds up a pension pot to provide you with a retirement income based on contributions from you and/or your employer. Your pot is put into various types of investments, including shares (a stake in a company). The amount in your pension pot at retirement is based on how much has been paid in and how well the investments have performed, less any charges. A money purchase pension is often known as a 'defined contribution' pension and should not be confused with a final salary (defined benefit) pension.

What happens if I exceed the MPAA?

If you exceed your allowance you will normally face an annual allowance tax charge. The charge is broadly equivalent to the amount of tax relief you would have benefited from. The charge is declared to HMRC either through the income tax self-assessment process or by writing to them. There are situations where the charge could be paid by the pension scheme but specific conditions apply. For details of whether it is possible for the scheme to pay the charge you should contact your pension scheme administrator.

Note: you are personally responsible for monitoring if the MPAA is exceeded and for notifying HMRC, if applicable, that a money purchase annual allowance charge is due.

In addition, you must also notify any other money purchase pension schemes you are a member of, that you have triggered the MPAA. You could face a fine from HMRC if you fail to do this. Your pension administrator will provide details of what you need to do if this applies.

What counts as taxable income?

YES

- ✓ Withdrawals through flexi-access drawdown
- ✓ Taking one or a number of lump sums (known as Uncrystallised Funds Pension Lump Sum, UFPLS)
- ✓ Income from a short-term annuity
- ✓ Income above the maximum limit from a 'capped drawdown' plan

NO

- ✗ Taking tax-free cash only (even if the remainder is set aside for drawdown)
- ✗ Income from a lifetime annuity
- ✗ Remaining in capped drawdown – as long as your income payments don't exceed the limit
- ✗ Small pot withdrawals (on accounts worth less than £10,000)

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This is not an exhaustive list and there are a number of other events which could trigger the MPAA. Your pension provider is required to notify you if you have triggered the MPAA.

This is a complicated topic so please speak to your adviser if you need help or further information.

What if I have a defined benefit pension too?

If you also have a defined benefit (which includes 'final salary' and 'career average') pension scheme that is actively building up benefits (i.e. you are still working for the company you hold the pension with), the MPAA may have an impact. As all your pensions are subject to the standard overall annual allowance of £40,000 for this tax year, contributions of more than £4,000 to any money purchase pensions could reduce the amount available for your defined benefit scheme. You can however, still build up benefits using the 'alternative annual allowance'. This is £36,000 in the 2020/21 tax year.

The MPAA only impacts your money purchase contributions. If this affects you, please speak to your adviser.

How do I maximise the tax relief I receive in this tax year?

If you are subject to the MPAA and want to make further tax-efficient contributions to a money purchase pension in this tax year, you will need to act by 5 April 2021. If you do not use your full allowance under the MPAA during a tax year it is lost forever, as unlike the standard annual allowance, you cannot 'carry forward' any unused MPAA to future tax years. Before personally making any further contributions it's important to remember tax-relief is restricted to 100% of earnings or £3,600 if this is higher.

This is a very complicated area and we recommend you speak with your adviser to establish whether the MPAA could impact any action you may be considering.

What to consider and how it might impact you (if you're affected)

If you have not started taking taxable income from a pension pot yet

Nothing changes for you immediately, though it could be a good idea to plan ahead if you're thinking about taking taxable income in the coming years. If you're in a workplace scheme, you might want to talk with your employer at some point, to see if there are any options for reducing your pension contributions in future.

If you are thinking about starting to take taxable income

You may want to consider making any planned pension contributions for the 2020/21 tax year before you take any taxable income which will then trigger the MPAA with immediate effect. This would then allow you to make tax-efficient pension contributions up to this year's full annual allowance of £40,000 before any reduction comes into effect.

If you're currently contributing more than £4,000 a year, you will need to think about future contributions once you've started taking any taxable income, as you will have to bring them below this level after you trigger the MPAA or face a tax charge. One option could be through workplace schemes.

If you are already taking taxable income from a pension pot

If the total contributions to your pension pots each year are £4,000 or less: Good news! Nothing has to change for you, as you're already below the MPAA.

If the total contributions to your pension pots each year are more than £4,000: You could already be facing a tax charge. This will depend on the date you first took taxable income and how much your contributions have been since that date. If this is more than £4,000 you may want to stop any further contributions until 6th April (when the new tax year starts). If it is less than £4,000 you should think about reducing your contributions in the rest of the tax year to help ensure you remain under the limit. In both cases, you could benefit from exploring how to reduce contributions for the current and future tax years so you stay below the £4,000 limit. This might include talking to your employer if you're in a workplace scheme.

The information in this factsheet is correct as at 6 April 2020.

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