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The Money Purchase Annual Allowance

Following the retirement reforms in 2015, the government was concerned that some may seek to exploit the new flexibility to gain tax advantages e.g. by washing funds through retirement contracts or pension plans.

Rules were introduced so when a client flexibly accesses their retirement funds they trigger the money purchase annual allowance (MPAA). Once triggered, all future contributions paid to money purchase pensions are restricted to MPAA – currently £4,000 - rather than the standard annual allowance (currently £40,000). Once triggered, the MPAA cannot be 'un-triggered', even if no further benefits are 'flexibly accessed'.

When pensions freedoms were introduced in April 2015, the MPAA was set at £10,000, but it reduced to £4,000 for contributions paid from 6 April 2017.

How does it work?

Those who flexibly access their benefits trigger the MPAA rules, and will have a specific reduced annual allowance for their money purchase contributions.

When the MPAA rules are first triggered, only money purchase contributions made after the 'trigger date' will be tested against the MPAA for the first tax year. However, the whole pension input amount will be tested against the full annual allowance for the tax year. (There are different rules for cash balance arrangements.)

Case study – Dan

Dan takes income from his flexi-access drawdown (Fad) plan on 5 June 2019. He also contributes £350 a month into his Sipp. The payment date is the 1st of the month. Post trigger date, Dan will contribute £3,500 (10 x £350), which has to be tested against the MPAA of £4,000.

Dan also has to test the full money purchase input for that tax year against the annual allowance. Again, £4,200 (12 x £350) is lower than £40,000, and doesn't give rise to an annual allowance charge.

Triggering the MPAA

The MPAA is triggered if the client:

- Takes income from a Fad.
- Takes an uncrystallised funds pension lump sum (UFPLS) payment.
- Takes income from a capped drawdown plan which is in excess of the maximum government actuary's department (Gad) limit, or the first payment after a capped drawdown plan has been voluntarily converted into a Fad.
- Receives the first payment under a 'flexible annuity contract' (this has a specific definition and is one which is allowed to decrease in payment under the April 2015 rules).
- Has primary protection with £375,000 lump sum protection, and is paid a 'stand-alone lump sum' for the first time. Please see our factsheet on enhanced and primary protections (0325).
- Receives a payment from a scheme pension that was set up after 6 April 2015 from a scheme with fewer than 12 members.

The MPAA is not triggered when the client:

- Designates funds into Fad or receives the pension commencement lump sum (PCLS) from Fad (but takes no income).
- Takes income from a capped drawdown plan that falls within the maximum Gad limit.
- Takes an income from a standard lifetime annuity.
- Takes a small pot lump sum.

Avoiding triggering the MPAA

Clients who intend to continue to make future pension contributions need to take care when deciding when and how to take retirement benefits as this could trigger the reduced MPAA. This has the potential to cause problems for a wide variety of clients – particularly since the MPAA reduced to £4,000.

For example, those who:

- are made redundant, flexibly withdraw benefits, and then return to work;
- need to flexibly withdraw benefits to pay off debt; or
- take partial retirement and continue working on a part-time or self-employed basis.

It could be easy for these clients if they contribute to a pension to exceed a £4,000 cap.

To avoid triggering the MPAA clients may want to consider:

- using up their PCLS from their Fad first, and avoid taking income;
- avoiding taking an UFPLS – and instead take PCLS from a Fad (UFPLS is not available on all FGad contracts);
- continue receiving an income from a capped drawdown plan (if it falls below the Gad maximum); or
- take income from a standard annuity.

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Paying defined benefit contributions

The MPAA only applies to money purchase contributions being made. It's possible to continue to contribute to a defined benefits scheme once the MPAA has been triggered. The amount paid into the defined benefits scheme is not tested against the MPAA, but will be included in the test of total contributions against the annual allowance.

The maximum amount that can be paid to a defined benefits scheme – the alternative annual allowance - is the annual allowance less the money purchase contributions paid.

Reporting requirements

Once the MPAA has been triggered, the pension plan administrator must, within 31 days, tell the plan holder they now fall under the MPAA regime for all future money purchase savings. The plan holder then has 91 days to pass this information on to any other money purchase scheme they are contributing to.

On a transfer, the plan administrator must, within 31 days, tell the receiving pension plan if they believe the individual has ever triggered the MPAA (either in that scheme or in another scheme).

If the MPAA is triggered, then the pension plan needs to monitor the individual's position after each tax year and provide a full annual allowance pension savings statement after any tax year in which the MPAA is exceeded.

Exceeding the MPAA

If the individual pays a contribution that is higher than the MPAA then an annual allowance tax charge will apply to the excess.

It's unlikely the individual can simply ask for a contribution refund. Not knowing what their allowance was - and whether it has been restricted by the tapered annual allowance or by triggering the MPAA – cannot be offered for grounds for a refund.

The plan holder/client is solely liable for the annual allowance charge. This is usually paid through their tax self-assessment. There is a possibility the individual can require the pension plan to pay the charge if certain conditions are met. Alternatively, the pension plan may voluntarily pay the charge (not all schemes or providers offer to do this).

If you only read one thing…

- Advisers and clients need to be aware of the rules and where the MPAA is triggered to avoid paying an unnecessary tax bill.
- If the MPAA is triggered clients have 91 days to get in touch with any other money purchase scheme they are contributing to.
- There may be opportunities for clients to take some retirement income and keep a higher annual allowance of £40,000 by taking
    - PCLS from a Fad plan but no income; or
    - retirement income from a capped drawdown (set up before 6 April 2015) within the maximum Gad limit; or
    - income from a standard annuity.
- Carry forward of unused annual allowance cannot be used to increase the MPAA.

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