Defined benefits pension savings and the money purchase annual allowance

The amount of money individuals and their employers can contribute to pension plans, and receive full tax relief, is restricted to the annual allowance of £40,000. For some people – high earners and those who have flexibly accessed their retirement benefits – the limit may be lower (down to a minimum of potentially £4,000).

This factsheet explains how the pension savings are tested against the annual allowance in defined benefit schemes and how the money purchase annual allowance (MPAA) affects defined benefits pension savings.

Testing defined benefits pension savings against the annual allowance

The pension savings (pension input amount) should be worked out for each pension arrangement an individual is a member of. For defined benefit schemes, the pension input amount is based on how much the value of the individual's accrued pension (and any lump sum) has increased over the last year.

Generally, the value of the accrued pension at the end of the tax year is compared to the (inflation adjusted) value at the start of the year, and any difference is treated as pension savings. The value is worked out by multiplying the pension income by a factor, currently 16, and adding on the value of any lump sum.

Example – Dawn

Dawn is contributing to her defined benefit scheme. She also has a flexi-access drawdown plan (Fad).

In December 2018, Dawn takes income from her Fad. This triggers the MPAA. In June 2019, she decides to pay £3,000 into a separate money purchase plan.

The maximum pension input to her defined benefit scheme in 2020/21 (without incurring an annual allowance charge) is:

£40,000 - £3,000 = £37,000

If Dawn decided instead to pay £6,000 to her money purchase plan then she would be liable for an annual allowance charge on the excess of £2,000, which if she were a higher rate taxpayer would be £800 (40% of £2,000).

The MPAA test

If the MPAA has been triggered, then the individual tests any money purchase contributions against the £4,000 MPAA. If the MPAA has been exceeded, then the individual has the alternative annual allowance for any defined benefits pension input.

To make sure the same contributions are not subject to the annual allowance twice, any money purchase contributions tested against the MPAA will not be tested against the alternative annual allowance as well.

Exceeding the MPAA

If the money purchase contributions are over £4,000, then the amount which will be subject to any annual allowance charge is worked out by taking the higher of these two amounts:

Alternative chargeable amount	Excess over MPAA + excess over alternative annual allowance
Default chargeable amount	Excess of total pension contributions over annual allowance (£40,000 or tapered amount)

Example – Ashley

Ashley is taking income from her Fad, as well as paying into both a Sipp and a defined benefits scheme.

Her Sipp contribution is £6,000 and her defined benefit pension input is £35,000, making a total of £41,000.

She has no available carry forward, and is not subject to the tapered annual allowance.

Ashley will pay an annual allowance charge on the greater of these:

Alternative chargeable amount	= excess over MPAA + excess over alternative annual allowance
	= £2,000 + 0
Default chargeable amount	= excess of total input over annual allowance
	= £1,000

So, she pays an annual allowance charge on £2,000.

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If the MPAA is not exceeded

If the individual's money purchase contributions are less than £4,000, then the individual's total pension contributions are tested against the annual allowance (£40,000 or tapered amount).

If you only read one thing...

- Pension saving into a defined benefits scheme is measured by comparing the value of the pension at the end of the tax year with the (inflationary adjusted) value at the start of the tax year.
- Individuals can contribute to a defined benefits scheme once the MPAA has been triggered. The maximum amount that can be paid to a defined benefit scheme – the alternative annual allowance - is the annual allowance less the money purchase contributions paid (up to a maximum of £4,000, the MPAA).
- If the MPAA is exceeded then the annual allowance charge applies on the higher of:
  - the alternative chargeable amount (the excess over the MPAA plus the excess over the alternative annual allowance); or
  - the default chargeable amount (the excess of total input over the annual allowance).
- If the MPAA has not been exceeded, then the individual's total pension contributions are tested against the annual allowance (£40,000 or tapered amount).