HM Treasury

Reducing the money purchase annual allowance:

consultation response

March 2017

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1 Introduction

1.1 Contributions to pension schemes are tax free, provided that the amount paid in a tax year does not exceed the annual allowance (AA). The standard AA is £40,000, but once a person has accessed pension savings flexibly, if they wish to make any further contributions to a defined contribution (DC) pension, tax-relieved contributions are restricted to a special money purchase annual allowance (MPAA).

1.2 At Autumn Statement 2016, the government launched a consultation on proposals to reduce the MPAA to £4,000, with effect from April 2017.

1.3 It has been possible to draw DC pension savings as a lump sum since 2011. However, until the pension freedom reforms in 2015, there were tighter controls on this and anyone using the facility was unable to make any further DC contributions. This ensured that people could not recycle their pension savings for a further round of tax relief.

1.4 The government did not (and does not) believe that this supports the pension freedoms and, instead, introduced the MPAA.

1.5 This was initially set at £10,000, which helped to deliver a smooth introduction of the pension flexibilities. However, the government does not believe that a £10,000 MPAA is appropriate on an ongoing basis.

1.6 The government set out in the consultation that it believes that a £4,000 MPAA is fair and reasonable, and will only affect up to 3% of individuals over age 55. It allows people who need to access their pension savings to rebuild them if they subsequently have opportunity to do so, while limiting the extent to which pension savings can be recycled to take advantage of tax relief, which is not within the spirit of the pension tax system.

1.7 The government thanks all those who submitted responses to the consultation and a summary of these follows in the next Chapter.

1.8 The consultation ended on 15 February 2017 and 111 responses were received, 64 from individuals and 47 from institutions. A list of institutional respondents is at Annex A.

1.9 The government did not receive evidence that a reduction in the MPAA to £4,000 would impact on the successful roll out of automatic enrolment or that such a reduction would impact disproportionately on different groups. The reduction will go ahead, from 6 April 2017.

1.10 Chapter 3 explains how government will take this forward.

2 Summary of responses

Question 1: Do you agree that a £4,000 MPAA would minimise re-cycling pension savings and that, coupled with ongoing monitoring, the new MPAA will allow the continued successful roll-out of automatic enrolment?

Minimising recycling

2.1 A majority of respondents agreed that it is appropriate that government should seek to minimise recycling. However, many – particularly amongst individual respondents – considered that any restriction should apply to personal contributions only, arguing that employer contributions could not constitute recycling.

Treatment of employer contributions

2.2 The MPAA applies to aggregate employer/employee contributions. It is common for employers to allow employees to sacrifice salary for an employer pension contribution and a person who accesses their pension savings flexibly is likely to have greater scope for salary sacrifice than would otherwise have been the case. In such circumstances, rather than using their salary to meet everyday expenses and then recycling pension savings, they are able to live off their pension and request larger employer pension contributions. This is, in effect, indirect recycling.

2.3 The MPAA will continue to apply to aggregate pension savings.

Alternative approach to minimise recycling

2.4 Some suggested that recycling should be controlled through an alternative mechanism to the MPAA. When the government was originally considering how to guard against this risk in 2014, other approaches were considered, such as not allowing a pension commencement lump sum in relation to funds attributable to contributions made after benefits had been accessed flexibly. Although some respondents have suggested this, it is clear from the government's prior discussions with stakeholders that this is not an attractive option.

2.5 To abandon the MPAA now and consider a new approach would require new processes, new communications and new disclosures. Government believes that refining the MPAA is a simpler and more appropriate way forward. Alternatives approaches to limiting the amount of tax relief a member who has accessed their pension flexibly can enjoy would continue to rely on members notifying pension providers that they had accessed some of their savings and so the same risks as noted in paragraph 2.27 would persist.

2.6 The MPAA will remain the primary control to minimise recycling.

Automatic enrolment

2.7 Many respondents agreed that an MPAA of £4,000 would have little impact on the rollout of automatic enrolment. However, respondents also noted that the government would need to keep this under regular review. The maximum legally-required savings under automatic enrolment are currently £743, rising to £2,974 from 2019.[1] As stated in the consultation, it is

[1] The 2019 maximum is based on the ceiling of earnings required to be pensioned in 2016. This is aligned with the higher-rate tax threshold in 2016. No uprating through to 2019 has been assumed, as this figure is set annually. The Conservative party manifesto included a commitment to raise this to £50,000 and, even at that level, required contributions under automatic enrolment would be less than £4,000.

the government's intention to ensure that the MPAA remains at a level that does not impact on the future development of automatic enrolment.

2.8 The MPAA level will be kept under regular review, as are all aspects of the tax system.

2.9 Some respondents expressed concern that individuals automatically enrolled into more generous employer schemes may face an MPAA charge, even if they are only on modest incomes. The latest available data identifies the current average rate of combined employer/employee contribution to private sector DC schemes as 4%.[2] However, this is only an average and the rising number of individuals being pensioned under automatic enrolment, combined with contribution rates initially being set low is likely to have depressed this percentage; the previous year's combined average was 4.7%. By 2019, the required contribution will have risen to 8% and where contributions are made at this rate, only individuals with pensionable earnings greater than £50,000 (actual earnings may be higher) would be impacted by the reduced MPAA. Average earnings are currently around £28,000.[3]

2.10 There are, however, schemes that receive higher contributions than the statutory minimum and the government is keen to encourage this. Schemes that have achieved the Pensions Quality Mark (PQM) receive contributions of at least 10% (although pensionable pay may be 85% of total pay). Where such a scheme received a 10% contribution, individuals with incomes of £40,000 would be able to remain in full membership, without an MPAA charge. The "PQM Plus" standard requires a higher minimum aggregate contribution – 15% (again, pensionable pay may be 85% of total pay). Individuals who are in such a scheme **and who have accessed benefits flexibly** would be affected at lower levels of income. Currently, however, there are only around 100 schemes who hold PQM Plus and around another 100 who hold PQM, while the total number of registered active schemes (this includes defined benefit) is around 700,000.

2.11 Some respondents referenced the simplified approaches for employers to certify their compliance with the automatic enrolment requirements, including one where a 9% contribution is required. Under this approach, pensionable pay needs to match basic pay only and other elements such as overtime, commission bonus etc. may be disregarded. A 9% contribution would invoke the MPAA (where benefits have also been accessed flexibly) for a person with pensionable pay of £44,500. However, such a person may have total earnings considerably higher than this and the tax charge relating to such a contribution would be £2[4] (as the person would be a higher-rate taxpayer).

2.12 To avoid significant and disproportionate complexity, the MPAA is set at a single level, which applies once benefits have been accessed flexibly. The government will keep the MPAA level under review, but does not believe that resetting it to a level higher than £4,000 is currently necessary.

Question 2: Is there any evidence that setting the MPAA at £4,000 would impact disproportionately on particular groups?

2.13 Individual responses often detailed the personal circumstances behind a decision to draw benefits flexibly, most relating to those mentioned in the consultation e.g. divorce, redundancy, bankruptcy. There was no evidence of a disproportionate impact on any particular group. Some

[2] Occupational Pension Schemes Survey 2015 - https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/pensionssavingsandinvestments/bulletins/occupationalpensionschemessurvey/2015#contribution-rates-in-private-sector-occupational-pension-schemes

[3] Annual Survey of Hours and Earnings 2016 (provisional results) - April 2016 figures. https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/bulletins/annualsurveyofhoursandearnings/2016provisionalresults#average-earnings

[4] A 9% contribution on earnings of £44,500 would deliver a contribution of £4005. This would exceed the £4,000 MPAA by £5. The MPAA charge on a £5 excess would be (for a 40% taxpayer) £2.

of the responses also stated that the purpose underpinning a decision to access savings flexibly was to gift money to family members, for example to assist in property purchase. Although this is a legitimate decision for an individual to make, flexible access to pension saving was not intended to allow tax-advantaged intergenerational transfers of wealth.

2.14 Responses suggested that groups where earnings may be volatile would be affected and, for them, the ability to catch up on contributions is valuable. There is an existing facility, available before a pension has been accessed flexibly, whereby individuals can "carry forward" unused allowance to subsequent years to cater for this. However, this carry forward does not extend into any period when benefits have been accessed flexibly, as this would increase the scope for recycling, which is contrary to the government's aims to reduce the scope for recycling. The reduced ability to continue making contributions should be a factor in any decision whether to access savings flexibly and is already covered by the guidance offered by Pension Wise.

2.15 Another group that respondents suggested might be disproportionately affected are those who access their savings flexibly. The government accepts that such individuals are affected – this is the only group who can be affected as flexible access is the trigger for application of the MPAA. However, government believes that a £4,000 MPAA is an appropriate compromise between the competing interests of preventing recycling, while allowing scope to rebuild some pension savings.

People who have already accessed savings flexibly

2.16 A number of responses suggested that rights to an MPAA of £10,000 a year should be protected and that, where a person accessed benefits flexibly before 23 November 2016 (the date on which the MPAA consultation was launched), the current MPAA of £10,000 should continue to apply until further benefits are accessed flexibly on or after that date. This is not the government's intention.

2.17 The government accepts that some individuals may have planned to contribute up to £10,000 a year, but the number in this group is small. Median DC contributions are less than £3,000 for men aged 55+ and less than £2,000 for women in the same age group. To apply different MPAAs, dependent upon when a benefit was last flexibly accessed would be disproportionately complex, both operationally and in relation to disclosure requirements. There would also be a need for transitional requirements for the year in which a person subject to the £10,000 MPAA became subject to the £4,000 MPAA.

2.18 Others suggested that there should be a short transitional period, during which individuals who accessed savings flexibly before Autumn Statement 2016 should retain their £10,000 MPAA. This too would require separate MPAAs depending on when benefits had been flexibly accessed and would add further costs and complexity, requiring a new set of disclosure rules and operational processes, which would then be used for a short period only.

2.19 The £4,000 MPAA will apply to anyone who has accessed benefits flexibly, regardless of when they made the decision to access that pension.

Treatment of defined benefit (DB) pension savings

2.20 Some respondents made the point that individuals who access DB entitlements do not become subject to the MPAA and that this creates inequality across different groups. However, there is no flexible access – the trigger for the MPAA – in relation to DB rights. While it may be possible to phase the drawing of DB rights, any DB rights accessed will deliver an income for life (and possibly a tax free lump sum). This is not flexible access. Similarly, making a comparable choice in relation to DC rights e.g. purchasing a non-reducing lifetime annuity (and tax free lump sum) is not considered to be flexible access and does not trigger the MPAA.

2.21 The government has no intention to extend the application of the MPAA to circumstances other than when savings have been flexibly accessed.

2.22 A concern was also raised about fairness across DB and DC. An individual who is being pensioned through a DC scheme and has accessed some savings flexibly is constrained by the MPAA on future DC savings. An individual who is being pensioned through DB and also has some DC savings which have been accessed flexibly is not constrained by the MPAA in relation to future DB accrual. Instead, the DB provision becomes subject to the "alternative annual allowance" (broadly, £30,000 for an MPAA of £10,000).

2.23 Entitlement under a DB scheme comprises (usually a tax-free lump sum and) a secure income for life. There is no opportunity to access benefits flexibly from a DB scheme and the scope to recycle savings into a DB arrangement is limited. To facilitate recycling the DB arrangement would have to allow either additional voluntary contributions (AVCs) to purchase further DB rights – this is unusual as most DB plans (such as in the public sector) deliver DC rights from AVCs – or allow salary sacrifice to provide additional DB rights. This would be similarly unusual, at a time when employers are looking to reduce their exposure to (and quantum of) DB risks, for which they remain responsible.

2.24 DB accrual will remain subject to the alternative AA, not the MPAA, when DC savings have been accessed flexibly.

Scale of impact

2.25 The evidence underpinning the change was questioned. Some believed that the government's estimate that only around 3% of individuals aged 55+ make contributions (including from employers) of more than £4,000 indicates that those who have actually accessed benefits flexibly will be far smaller and will not deliver the revenue savings suggested.

2.26 The government agrees that the number actually impacted is likely to be smaller. An estimate of the degree of recycling – and the government's forecast cost saving from a reduction in the MPAA to £4,000 – was derived from the Survey of Personal Incomes and other HMRC administrative data, and the ONS Annual Survey of Hours and Earnings. This was independently certified by the Office for Budget Responsibility.

2.27 Concern was raised that some individuals who access savings flexibly may not notify the pension scheme(s) to which they are contributing, as is required. Government will consider this issue in conjunction with the pensions industry, including those developing the pensions dashboard and, if appropriate, investigate ways in which the process may be improved.

Level of MPAA

2.28 Many respondents suggested that £4,000 is too low, arguing that individuals on modest earnings could be affected. However, there were others who considered £4,000 reasonable or even too high.

2.29 The MPAA seeks to balance the competing interests of preventing recycling, while allowing scope to rebuild some pension savings. An MPAA of £10,000 offers scope for a higher-rate taxpayer to reduce their tax bill by £1,000 a year. A £4,000 MPAA does not prevent higher-rate taxpayers from recycling, but does reduce the incentive for doing so and is unlikely to affect many basic-rate taxpayers.

The MPAA will reduce from £10,000 to £4,000.

3 Next steps

3.1 The Government does not believe that a £10,000 MPAA is appropriate and consultation responses have not provided evidence that changes this view. From 6 April 2017, the MPAA will apply at the level of £4,000. This will apply to anyone who has already accessed savings flexibly, or does so in the future, irrespective of when that occurred.

3.2 These changes will be effected through Finance Bill 2017.

A Respondent organisations

Aegon

AJ Bell

Aon Hewitt

Association of Accounting Technicians

Association of British Insurers

Association of Consulting Actuaries

Association of Member-Directed Pension Schemes

Association of Pension Lawyers

Barnett Waddingham LLP

BPH Wealth

Capita Employee Benefits

Castlegate Capital

Cranbourne Financial

Equity

Eversheds Sutherland LLP

Fidelity

Hargreaves Lansdown

Hymans Robertson

ILAG

Institute and Faculty of Actuaries

JLT

Kingfisher

LEBC

Low Incomes Tax Reform Group

LV=

Mattioli Woods

Mercer

Musicians Union

Norton Rose Fulbright

Now:Pensions

Nucleus

Old Mutual Wealth

PLSA

PMI

Prospect

Punter Southall

Resolution

Retirement Advantage

Royal London

Scottish Widows

Society of Pension Professionals

Standard Life

TISA

TPAS

Unite

Willis Towers Watson

Zurich

HM Treasury contacts

This document can be downloaded from www.gov.uk

If you require this information in an alternative format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

Email: public.enquiries@hmtreasury.gsi.gov.uk