HM Treasury

Reducing the money purchase annual allowance:

consultation

November 2016

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1 Introduction and summary

1.1 The pension flexibilities introduced in April 2015 gave savers the ability to access their pension savings flexibly, as best suits their needs.

1.2 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). This consultation is seeking views on government proposals to reduce the MPAA, with effect from April 2017.

1.3 The government believes that an allowance of £4,000 is fair and reasonable and should allow people who need to access their pension savings to rebuild them if they subsequently have opportunity to do so. Importantly, however, it limits 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. The government does not consider that earners aged 55+ should be able to enjoy double pension tax relief i.e. relief on recycled pension savings.

1.4 This consultation seeks views on whether respondents agree that this level of MPAA would neither impact on the roll out of automatic enrolment nor disproportionately affect particular groups.

1.5 Responses to this consultation will help to inform any legislative changes.

2 The money purchase annual allowance

2.1 This section explains the background to the MPAA and how it operates.

Why have an MPAA?

2.2 Before April 2015, a limited form of pension flexibility was available and people who used this were prohibited from making further DC pension contributions. This prevented people gaining a second round of tax relief by withdrawing savings and reinvesting them into their pension and so acting against the spirit of the pensions tax system; or, similarly, diverting their salary into pension, gaining tax relief, and then immediately withdrawing 25% tax-free.

2.3 However, with the introduction of widespread flexible access to pensions, the government saw the need to strike a balance. Some individuals may need to draw on their pension, but then find that their circumstances change, and the government felt it was right for these people to be able to rebuild their pension savings.

2.4 Since April 2015, on reaching normal minimum pension age, currently 55, a person can access their pension flexibly and continue to save into a pension. However, the risk of acting against the spirit of the system remains and the MPAA was introduced and set at £10,000.

2.5 While the MPAA reduces this risk, it does not eliminate it. An individual still in work can invest up to £10,000 of their earnings, tax-free, into a pension whilst also drawing out their existing DC pension savings. Although against the spirit of the tax system, acting in this way reduces an individual's tax bill by 25% and, at the level of £10,000, this means £1,125 for an additional rate taxpayer[1].

What does accessing a pension flexibly mean?

2.6 Accessing a pension flexibly means taking benefits from a money purchase (cash balance or DC) pension pot through

- a flexi-access drawdown fund (whether or not having also taken a tax-free lump sum), which can be either
    - income withdrawal, as and when required
    - a short-term annuity
- a lifetime annuity that allows actual or possible decreases in the amount of annuity payable
- a one off payment, known as an "uncrystallised funds pension lump sum" is paid for the first time – one quarter of which is tax free

2.7 There are other less-common circumstances where DC pension savings are also considered to have been accessed flexibly, which are where

1 Pension contributions can only offset tax on earned income – those without earnings cannot normally "recycle" pension withdrawals by putting money withdrawn from a pension back into a pension. However, contributions of up to £3,600 can be made, unsupported by earnings.

- a stand-alone lump sum payment is made where the person has primary protection and a protected tax-free lump sum right which is greater than £375,000
- a pension scheme delivers the DC pension directly - a "scheme pension"- and there are fewer than 12 individuals receiving a scheme pension
- payment of one of the types of benefits listed above is from an overseas pension scheme that has benefited from UK tax relief

2.8 Other types of pension options do not constitute accessing benefits flexibly, for example

- payment of funds from a money purchase arrangement as a 'small lump sum' (a pension pot of up to £10,000 can be exchanged for a lump sum, 25% of which is tax-free)[2]
- where a member was drawing savings through a "capped drawdown" arrangement before 6 April 2015 and has not taken an amount from that arrangement that exceeds their maximum capped drawdown amount

Operation of the MPAA

2.9 A person's ability to make tax-free contributions to a pension scheme is subject to an annual allowance (AA), normally £40,000. If a person exceeds the AA in a tax year, the excess is subject to tax at the individual's marginal rate. However, once a person has flexibly accessed their pension, they are subject to the MPAA, currently £10,000, for all subsequent contributions to a DC pension.

2.10 Liability for an AA charge, whether under the standard AA or MPAA, rests with the member. In some circumstances a member can require the scheme to pay this on their behalf, reducing their pension pot accordingly, but this applies only if there would have been a tax charge of at least £2,000 if the standard (£40,000) AA had applied.

2.11 Normally, up to three years' unused AA can be carried forward and set against contributions in a subsequent year. However, unused relief carried forward cannot be used to bolster the MPAA. In addition, any unused MPAA cannot itself be carried forward.

2.12 When a person first accesses money purchase savings flexibly (a trigger event), the savings made in the tax year are apportioned into the amount that arose up to and including the date of the trigger event and the amount that arose after the trigger event. Only the latter are tested against the MPAA.

2.13 If a person is subject to the MPAA and they are also accruing defined benefit (DB) pension, rights, the total AA for DB and DC remains at the standard £40,000. DC savings are subject to the MPAA and, if these exceed the MPAA, any excess is charged to tax. However, the AA available for DB is also reduced to £30,000 (plus any unused AA carried forward) and the DB savings are tested against this alternative annual allowance, so no savings are tested twice.

2.14 For more information on the MPAA see https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm056500

[2] Exchange of pension for a small pot is available from up to three personal pension-type arrangements. There is no restriction on the number of occupational pension schemes from which a small pot lump sum may be paid.

3 Reducing the MPAA and the level proposed by the government

Focussing tax relief where it is most needed

3.1 The cost of tax and National Insurance contributions relief on pension savings is one of the most expensive sets of relief offered by the government. In 2014 to 2015 this cost around £48 billion, with around two thirds of the tax relief going to higher and additional rate taxpayers. In 2014 to 2015, the government also collected around £13 billion in tax from pensions in payment.

3.2 Since October 2012, a programme of automatically enrolling employees into a workplace pension scheme has been phased in. Under automatic enrolment, a percentage of an employee's qualifying earnings must be paid into a pension, with the employer liable for a minimum proportion of these. The government and pensions industry are proud of the success of automatic enrolment.

3.3 Minimum contribution rates under automatic enrolment (currently 2%) are due to increase to 5% in 2018 and 8% in 2019. There is also a review of automatic enrolment due to commence in 2017. As more people become pension savers for the first time and as automatic enrolment contribution rates increase, the cost of income tax and National Insurance contributions relief will increase. The government is committed to enabling individuals to save more so that they have security in retirement, but it is important that resources focus where there is most need.

3.4 The government does not consider that earners aged 55+ should be able to enjoy double pension tax relief i.e. relief on recycled pension savings.

Reducing the MPAA

3.5 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. It would be possible to return to a ban on further DC contributions, which would both simplify matters and protect against exploitation.

3.6 The government does not believe that this would be the right way forward. It believes that it is appropriate for the State to support those aged 55+ who have drawn from their pension but continue working, or return to work. However, the level of savings on which tax relief is offered should not encourage recycling of pension savings for a second round of tax relief.

3.7 The MPAA should be set at a level that focuses government support on those who genuinely need, rather than simply choose, to draw on their savings and who subsequently find themselves able to re-build their pension.

3.8 While setting the MPAA at £10,000 initially has helped to deliver a smooth introduction of the pension flexibilities, the government does not believe that a £10,000 MPAA is needed or appropriate on an ongoing basis. The government intends to reduce this to £4,000, from April 2017.

Who might be affected?

3.9 The MPAA applies only to individuals who have already accessed their pension savings flexibly who then make further DC pension savings. It does not normally affect anyone below age 55 and does not affect anyone unless they have also drawn pension savings flexibly.

3.10 The current MPAA of £10,000 is more than three times median DC contributions made by men aged 55+ and five times median DC contributions for women in the same age group.

3.11 Only 3% of individuals aged 55+ make DC contributions of more than £4,000 a year.

3.12 Setting the MPAA at £4,000 would ensure that where a person remained in, or returned to, employment having drawn benefits flexibly, pension savings could be made at a level that is above those required under automatic enrolment. The maximum legally-required savings under automatic enrolment are currently £743, rising to £2,974 from 2019[1].

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?

3.13 There is no direct link between the MPAA and automatic enrolment minimum contributions. It is the government's intention to ensure that the MPAA remains at a level that does not impact on the future development of automatic enrolment. Like all elements of the tax system, the MPAA will be kept under regular review.

3.14 Where additional support is offered for saving after a pension has been accessed flexibly, the government wants to focus it on those who genuinely needed, rather than simply chose, to draw on savings and who subsequently find themselves able to re-build some pension. People in this situation might include individuals who

- have divorced or separated
- have been made redundant
- have been declared bankrupt

Question 2

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

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.

Individuals affected by a £4,000 MPAA

3.15 All individuals aged at least 50 who have DC savings are encouraged to seek guidance from the government's impartial Pension Wise service and its successor on the different ways they can draw their pension savings. This includes guidance on how drawing benefits flexibly can impact on ability to continue saving into a pension.

3.16 If a person wishes to re-build savings beyond £4,000, there are other products into which they can save. Individual Savings Accounts (ISA) allow a diverse range of investments and offer flexible access.

3.17 If a person were to exhaust both a £4,000 MPAA and their ISA allowance for a year, they would have disposable income of more than £20,000. There may be a very small number of individuals

1. who have needed to access pension savings flexibly
2. who have that level of disposable income
3. for whom there might be special circumstances to suggest that additional pensions tax relief would not be unreasonable

However, these would be isolated examples and setting the MPAA to cater for such individuals would not be proportionate and would leave open the door to re-cycling.

4 Next steps and responding to the consultation

4.1 This consultation will run until 15 February 2017 and responses to this consultation will inform legislative changes that will take effect from April 2017.

4.2 Government will confirm the re-set level of the MPAA in Budget 2017.

How to respond to this consultation

4.3 The government would welcome the views of all stakeholders on the issues raised in the document. The consultation begins with the publication of this document and will last for a period of 12 weeks. Please respond by Wednesday 15 February 2017. Responses to the consultation should be sent, preferably by e-mail to:

MPAAResponses@hmtreasury.gsi.gov.uk

Or in writing to

Pension and Savings Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

When responding please state whether you are responding as an individual or as part of an organisation. If responding on behalf of a larger organisation, please make it clear whom the organisation represents and, where applicable, how the members' views were assembled.

Confidentiality

4.4 All written responses will be made public on HM Treasury's website unless the author specifically requests otherwise. In the case of electronic responses, general confidentiality disclaimers that often appear at the bottom of emails will be disregarded for the purpose of publishing responses unless an explicit request for confidentiality is made in the body of the response. If you wish, part, but not all, of your response to remain confidential, please supply two versions – one for publication on the website with the confidential information deleted, and another confidential version for the team managing the consultation.

4.5 Even where confidentiality is requested, if a request for disclosure of the consultation response is made in accordance with the freedom of information legislation, and the response is not covered by one of the exemptions in the legislation, the government may have to disclose the response in whole or in part.

Consultation principles

4.6 This consultation is being run in accordance with the government's consultation principles.

Confidentiality disclosures

4.7 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act (DPA) and the Environmental Information Regulations 2004). If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, among other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality will be maintained in all circumstances.

4.8 An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the department. The department will process your personal data in accordance with the DPA, and in the majority of circumstances, this will mean that your personal data will not be disclosed to third parties.

Freedom of Information

4.9 Any Freedom of Information Act queries should be directed to:

Correspondence and Enquiry Unit
Freedom of Information Section
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 4558

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

A Questions on which government is seeking views

A.1 There are two questions on which the government is seeking stakeholder views

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?

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

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:

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