Relief for pension contributions

1 June 2019

Accessing a small pension pot can cause difficulties with tax relief on future pension savings. Tell us if you know someone who has been affected.

Money purchase annual allowance

The pensions Annual Allowance (AA) is normally £40,000, but when someone accesses money purchase pension savings, the much-reduced Money Purchase Annual Allowance (MPAA) comes into play.

When the MPAA was reduced from £10,000 to £4,000 with effect from 6 April 2017, the Low Incomes Tax Reform Group (LITRG) expressed concern that people could be caught out by it and have their future access to pensions tax relief severely curtailed. We ask for readers' feedback.

A case study illustrating the point

Mrs X is aged 57.

She was employed for many years by a very small business. She started contributing to her own personal pension plan at around age 25 and contributed to it for many years, as did her employer. When the very small business she worked for was taken over by a larger business, this new company had a money purchase pension scheme that she joined (keeping her own personal pension separate, but not contributing to it at this time). Unfortunately, her new employer chose to make her redundant shortly after acquiring the business for which she had worked for many years. She was left with a small amount in that company's pension scheme.

After a period of being out of work, Mrs X found another job and started contributing to her own personal pension again.

Later, she received a statement from the company pension scheme that she had been a member of for less than a year, confirming the value held in that scheme. It was very small and Mrs X felt she did not want an annual reminder of that unfortunate time in her employment history. Accordingly, she thought she might cash it in as her own personal pension plan was of significant value. This small 'windfall' would be used for a treat to make up for the upset that redundancy had caused for the whole family.

Mrs X does not believe she was warned in advance that this withdrawal from the company pension scheme might prejudice further contributions to her own personal pension plan. Now, at a stage in her life when she can afford to pay more into her pension, she finds her tax relief is restricted by the MPAA.

Relevant legislation

The 'normal' annual allowance for pension inputs is defined in S228 FA 2004 as £40,000 per year (subject to carry forward of some unused allowance). But where an individual has flexibly accessed some pension benefits, a new annual allowance for money purchase pension inputs, the MPAA, is put in place by Ss 227ZA and 227B FA 2004 – £4,000 per year. The effect of this reduced allowance is exacerbated because any unused MPAA may not be carried forward to a future tax year.

Reader feedback requested

We do not know whether this is a very isolated incident or if this issue arises more often. The same 'trap' could catch people who, for example, are between jobs and perhaps take advantage of pensions freedom to draw sums from their pensions to tide them over.

Have you seen any cases? If you can provide us with any anonymised information, we would be grateful as this will help to inform LITRG's work. Please email litrg@ciot.org.uk [1].

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