ACCESSING YOUR PENSION EARLY? BEWARE!

THE REDUCTION IN THE MONEY PURCHASE ANNUAL ALLOWANCE ALTERS THE DYNAMIC OF THE PENSION FREEDOMS. BUT WHAT ACTION WILL TRIGGER IT?

Philip Hammond's Budget Statement in 2016 announced a proposed change to the Money Purchase Annual Allowance (MPAA) whereby it will be reduced from £10,000 to £4,000 a year. This change has not yet taken effect but this article explains the potential issues surrounding it.

If the reduction takes place then, once you start accessing money from a flexi-access pension, the maximum you will be able to continue paying into a pension with tax relief falls by £6,000, i.e. 60%.

People exercising 'Pensions Freedoms', as promoted by George Osbourne, will face a tax charge on any pension contributions over £4,000 per year once that flexibility is utilised. This, of course, includes those over 55 who may be forced to access pensions early but with the intention of rebuilding those pension savings. Examples include:

- Older workers taking time off to look after elderly or sick relatives.
- Those facing health issues themselves and not able to work full time.
- Those made redundant and forced to re train or accept a lower paid job.
- The self employed and "gig economy" workers who may have gaps between contracts.

Rebuilding pension savings will be capped at £4,000 per annum if a flexi access pension arrangement is used and income taken.

UNDERSTANDING THE ORDER OF PRIORITY WHEN ACCESS TO CASH IS NEEDED

We are often asked by employees if they can access their pension early to pay off a large debt. This route should only ever be considered if they have no other cash available from other sources. Everyone's circumstances and financial needs are different but advisers are well placed to help their clients understand the significance of the order in which they access savings, and to make sense of the new MPAA rules.

WHAT ARE THE NEW MPAA RULES?

The money purchase allowance was introduced ahead of the Pension Freedoms legislation to prevent the 'recycling' of pension savings which involves a process of taking money that has already benefitted from government tax relief- 20%, 40% or 45% depending on their tax band- and then adding it back to a pension, thereby receiving the government top-up again.

If, however, you are planning to access your pension early, then the reduction could create a problem. Instead of being able to keep saving up to the £40,000* annual allowance into a pension, the amount you will be able to pay in will fall to just £4,000 and any contributions above this will be taxed at your marginal rate.

Here are the implications of the rules:

PENSION TAX-FREE CASH

Up to 25% of your pension fund can be accessed as tax-free cash. You can access this from age 55 and, as the amount is tax-free, it will not affect the amount of tax you pay- nor will taking a 25% cash trigger the MPAA limit.

SMALL PENSION POTS WORTH LESS THAN £10,000

With the exception of the 25% tax-free cash withdrawal from your pension, any further income will be taxed under the income tax rules. Cashing in up to three small pension pots, however, does not trigger the MPAA limit and means you can keep saving within the annual allowance of £40,000*.

PENSION INCOME:

You should generally access your pension last after accessing ISA, and pension tax-free cash, as any pension income will be taxed under the income tax rules- and will trigger the MPAA. This will also help your retirement income last longer.

In conclusion, the reduction in MPAA to £4,000 could impact many people's future plans.

*Note that anyone subject to tapered annual allowance may not have the full £40,000 annual allowance.

TO DISCUSS ANY OF THE ISSUES RAISED IN THIS ARTICLE, YOU CAN CONTACT NICOLA PRINCE, DIRECTOR OF EMPLOYEE BENEFITS, ON 01284 754500 OR NICOLA.PRINCE@BECKETTINVEST.COM

IMPORTANT NOTE – THE CONTENT OF THIS ARTICLE IS FOR GENERAL INFORMATION ONLY AND IS BASED ON OUR UNDERSTANDING OF ANNOUNCEMENTS MADE IN THE 2017 BUDGET. AS ALWAYS, SPECIFIC PROFESSIONAL ADVICE SHOULD BE TAKEN ON A CASE BY CASE BASIS BEFORE TAKING OR REFRAINING FROM ACTION BASED ON INFORMATION IN THIS ARTICLE.

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