

Self – Administered Pension Schemes SSAS, SIPP & FURBS – Current Issues

SEPTEMBER 2008

Barnett Waddingham

This year's Finance Act deserves a prize for including the least amount of pensions tax "simplification" reforms since the Act which was supposed to do the job in 2004. The reforms actually came into force on 6 April 2006, but have been updated significantly with each Finance Act since then. This newsletter summarises the new developments, and we have taken the chance to offer some opinion on matters affecting members of SSAS, SIPP and FURBS.

Finance Act 2008 – Taxation on Death

As outlined in previous newsletters, the government has confirmed that it will extend the penal rates of taxation upon residual pension funds when a member dies after reaching age 75 to those in receipt of a Scheme Pension, in the same way as tax is imposed on the funds of members who were drawing Alternatively Secured Pension. We already knew from the Pre-Budget Report in October 2007 that this was their intention, and the Finance Act includes the relevant amendments to legislation. The total tax bill on any residual funds on death after age 75 could now be as high as 89.2%, whether it is an "Alternatively Secured Pension" or a "Scheme Pension".

This confiscatory level of tax on residual funds has had the effect of encouraging members to draw pensions at a high level, to reduce the exposure to tax on death should they live beyond age 75. This in turn increases the risk of pension funds running dry before the member's death. Effectively, the tax is imposed on the second death of the member or spouse.

"Scheme Pension" is an alternative way of drawing pension. It is less flexible than the more usual "Alternatively Secured Pension" (ASP) which is used after age 75. ASP has to be within the range of 55-90% of the "market" pension (as determined using Government Actuary's tables) which could be paid to a 75 year old, regardless of the member's actual age.

The change will not stop the use of Scheme Pension instead of Alternatively Secured Pension after the age of 75. Scheme Pension has no artificial limit on the amount of pension which can be drawn, and the trustees could set a pension more in line with the "market" pension for the member, taking account of actual age, state of health, and the investment return.

Once pensioners reach age 70 they should consider their strategy carefully with their Barnett Waddingham consultant.

Age Discrimination

In 2000, the European Union passed a Directive outlawing employment related discrimination on the grounds of age. This directive came into force in the UK in May 2007 and does apply to pensions. This is because, under a landmark European court case of 1990 (Barber v GRE) pensions are "deferred pay" and hence an employment benefit. There should in theory be no difference between the treatment of one pensioner over another on the grounds of age.

The UK legislation which requires pensions paid from the scheme to be set differently after age 75 arguably conflicts with the requirements of the directive! We are told that, if a challenge to the age 75 legislation were mounted in the courts, it would be likely to succeed, but unfortunately it would be very expensive, perhaps around £500,000. We are not aware of anyone planning such a challenge. Governments

never accept defeat gracefully, and it would doubtless drag its feet if it lost, and even perhaps bring in new restrictions for those under 75. Government policy does nothing to encourage people to save for their retirement.

Finance Act – The Rest

The 2008 Finance Act this year also included provisions to close some minor loopholes in the spreading of tax relief on employer contributions, and to make the treatment of UK members of overseas pension schemes fairer. Unfortunately there was nothing to reduce the heavy administrative burden placed upon trustees by the legislation and by HM Revenue & Customs. You will see in the letter below that we do press the Revenue for a lighter touch.

The Administrative Burden

Our last newsletter highlighted the levels of paperwork imposed on SSAS and SIPP administrators by the supposedly "light touch" HM Revenue & Customs regulation of pension schemes. So far, the Revenue have not responded to complaints, and Barnett Waddingham's recent letter to the Revenue is reproduced below.

D Hartnett Esq
Acting Chief Executive
HM Revenue & Customs
100 Parliament Street, London SW1A 2BQ

Dear Mr Hartnett

Pensions tax simplification

It is more than two years since the "simple" tax regime was introduced for pension schemes. Sadly the simple regime that we all signed up to (HMRC kindly included wide consultation on the new arrangements) is not the regime that has been delivered. Rather than leading to savings in administrative expenses, and simpler rules, our clients with small self-administered pension schemes are not alone in finding that costs have increased under what has become a complicated regime.

A particular example of the additional work is the annual registered pension scheme return, which is an information-gathering exercise that appears to serve no useful purpose. We were told that a risk-based approach would be adopted

by the Revenue when determining which schemes would need to provide annual returns. Schemes with professional trustees were described as low risk yet all SSASs have apparently been issued with files to return.

There are ambiguous questions on the returns, and since there is no guidance on how to interpret such questions, there are conflicting views as to how to complete the returns correctly. The different interpretations suggest that no firm conclusions can be drawn from the information provided. Despite there being virtually no queries raised on the returns submitted for the first year, the process is being repeated for a second year with no further guidance.

The new rules dealing with "taxable property" are restricting investment in small businesses just when such investment might be needed, and also illustrate how complicated the system has become. You are no doubt aware of the serious concern about the disproportionate level of tax that is applied if funds are distributed following death of an aged pensioner in income drawdown. The tax position is of course set by Parliament but the application of five different tax charges on the funds leads to the high level of tax and is hardly "simple". There is also uncertainty: most report the total tax charge to be 89.2% but some cite a total tax take in excess of 100%!

Is it unreasonable to expect a review as to whether the "simple" objectives have been met and if not could they be re-captured?

Yours sincerely

SIPP and Protected Rights

The Pensions Act 2007 introduced legislation which from April 2012 will remove from the Statute Book the concept of "Protected Rights". This is the jargon for pension funds which arise as a result of "contracting out" of the second tier of the state pension scheme (now called the State Second Pension or S2P, and previously called the State Earnings Related Pension Scheme or SERPS). "Contracting out" has been popular over the years. It has long been possible to have a portion of National Insurance contributions paid to a Personal Pension arrangement, in lieu of entitlement to part of the state pension, and many company pension schemes were also "contracted out". However, there were rules which

prevented these "Protected Rights" from being transferred into a SIPP. Many clients still have Protected Rights in separate, insured arrangements.

Since 2007 SIPPs have been regulated under the Financial Services Authority, and the Department of Work & Pensions has accepted that there need no longer be a bar to Protected Rights being held in SIPPs, and from 1 October 2008 this is to change. Barnett Waddingham is altering the rules of its SIPP so that members will be able to move their existing Protected Rights pension funds into the SIPP from that date.

Protected Rights transferred to a SIPP may be drawn at retirement in the same way as the rest of the fund. There is no obligation to use the Protected Rights to buy an insured annuity, and the usual pension rules apply. This will doubtless be popular among SIPP members: the addition of Protected Rights funds will increase the funds available for investment or to help pay off SIPP mortgages. However, until 2012, there will still be some rules governing the provision of pensions by way of insured annuity from protected rights. There will also be more restrictions on the death benefits, and for these reasons, transferred in Protected Rights will be given a separate pension "pot" within the SIPP.

It will also still be relatively complicated to deal with ongoing National Insurance rebates from the state, so for the time being at least, the BW SIPP will not be able to receive new contracted out pension rebates from HM Revenue & Customs. From 2012, it is expected that contracting out will be abolished for all "defined contribution" schemes, and from that point, all distinction between protected rights and other pension monies should fall away completely.

Protection from the Lifetime Allowance – Watch the Deadline!

The new pensions tax regime imposes a limit on the amount of tax efficient pension money which an individual may accumulate during his working lifetime. This limit, the "Lifetime Allowance" was originally set at £1.5M for the year ending 5 April 2007, and increases to the Lifetime Allowance were built into the Finance Act 2004 for the subsequent five years (in 2008/09 it stands at £1.65M). If a member accumulates pension assets in excess of the Lifetime Allowance at retirement, the excess is subject to tax, effectively at 55%.

The legislation recognises that this may be unfair to members who had legitimately accumulated significant funds before the new regime came into force on 6 April 2006. Members were given until 5 April 2009 to elect for exemption from the Lifetime Allowance. However, in order to register for this "protection," the appropriate paperwork must be lodged with the Revenue before the 5 April 2009 deadline. This is now approaching, and members who might benefit from protection, but have not yet registered, are urged to do so straight away, before the deadline becomes pressing: there is usually a significant amount of information which must be gathered before the registration takes place.

FURBS – National Insurance and Contributions In Specie

National Insurance was imposed upon contributions paid to Funded Unapproved Retirement Benefit Schemes in 1998. Some advisers felt that the legislation was worded in such a way that contributions made "in specie" as opposed to in cash would be exempt from National Insurance, because the law only imposed National Insurance Contributions on "sums" paid into FURBS.

HMRC challenged this in the Courts, and the Court of Appeal recently found in the Revenue's favour. This means that many employers who made contributions to FURBS in specie will now face demands for National Insurance on the contributions. The judgement will not make much difference in future: contributions to FURBS are unattractive under the post April 2006 tax regime.

It has been our view that when tax-free lump sum benefits are taken from a FURBS, that this should be in the form of cash, rather than assets, because of the old definition of "sum" as cash. The new definition means, in theory, that these lump sum benefits could now be drawn in the form of assets. There would be no loss to HMRC, as the payment of benefits is still a "deemed disposal" for capital gains tax purposes, but is it wise to expect a consistent approach from HMRC? We are not entirely convinced that the Revenue *would* be consistent, and as such our advice is that while we think lump sums in specie should not be subject to challenge, we still prefer lump sums to be taken in the form of cash.



Do You Wish to Retire Early?

At present it is possible for a member to draw his benefits at any time from age 50, regardless of employment status (although earlier dates can apply in cases of serious ill-health). As set out in the Finance Act 2004, this minimum age for drawing benefits is set to increase from 50 to 55 from 6 April 2010.

This notice period does however throw up a potential pitfall which might trap unwary members. For example, if a member is 50 in 2008 then they can draw benefits now without impediment. However, if benefits are not drawn before 6 April 2010, when that person will be 53, then they will have to wait until they reach age 55 before they may access their pension funds. This 'trap' will only affect members born between 5th April 1955 and 5th April 1960.

If you fall within this five year window, and are considering taking benefits from your pension scheme, you will also need to consider your retirement options carefully. For example, if you have taken only a part of your benefits, and have only 'switched on' a portion of your fund, if the remaining funds are not turned on by 6 April 2010, then that segment cannot then be touched until you reach 55. It is worth noting that it is perfectly acceptable to draw benefits without the need to change employment status, so the tax-free lump sum can be taken without the need to cease employment, if required.

Please contact your usual Barnett Waddingham LLP consultant if you have any query regarding the newsletter.

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