

FEATURE



SIPPS The blow of changes to pension tax relief can be softened with a Sipp and some sound planning



MARTIN
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Fighting back

The announced restrictions to relief on contributions for higher earners at the Budget and pre-Budget in 2009 are well publicised, and while this creates a few headaches for advisers, other changes in personal tax rates create opportunities for them as well.

A new tax bracket of 50% is being introduced for individuals earning above £150,000, and anyone with income over £100,000 will be subject to a reduction in their personal allowance by way of a £1 reduction for every £2 of taxable income. So how will these individuals ensure their income and investments remain tax efficient?

Ordinarily, an option would be to make pension contributions and be able to reclaim tax on them at up to 100% of relevant UK earnings and obtain relief at the individual's marginal rate. The only limit applicable on employers' contributions was that set by HM Revenue & Customs (HMRC). However, the aforementioned changes have made this option less tax-efficient and therefore less attractive for some. The antiforeshalling rules restrict relief for individuals whose income exceeds either £130,000 or £150,000, depending on whether company contributions are being made, to either £20,000 or £30,000, depending upon frequency of previous contributions. For this

reason, each client should be reviewed individually.

The first obstacle, perhaps, might be to check whether your high earner might have a protected pension input, in their existing arrangement. If so, first impressions are that the client faces a choice of retaining their higher relief on contributions, or the flexibility of an investment that a self-invested personal pension (Sipp) affords. Another example of the government's ridiculous continuation of tightening controls is with protection on a scheme-specific basis rather than a personal one; its argument that this would add complication to administration falls flat after what has been introduced post simplification.

However, the best of both worlds can be achieved in most circumstances, as the majority of insurers segment their plans and will allow a partial transfer, of perhaps 90% of the plan's assets, to a Sipp, while retaining the original plan open to accept future contributions. It is possible future contributions could be swept across at periodic intervals until such time as the plan is emptied.

So with the regular pension relief route restricted for some, how else can a pension be used to assist in reducing clients' income and, therefore, tax burden?

One option would be to use existing pension assets to purchase the client's own commercial property or land through a Sipp. This has the

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effect of removing the income from the property away from the client and instead placing it in a tax-exempt environment. The cash received as the purchase price is then liquid in the member's hands for potentially more efficient tax strategies. Further, any future capital gain made on the property value is free from capital gains tax, and this at a period where commercial property is widely thought to be at the beginning of a period of growth. If existing pension assets are not sufficient to allow total property purchase, Sipp's have a borrowing facility, enabling them to borrow up to 50% of the Sipp assets. In addition, many of the better Sipp providers will now allow joint ownership of property, split between the member and the Sipp thus allowing partial, if not full transfer of the property income.

Even if the property includes an element of residential accommodation, it is often possible to split title, stripping out the commercial aspect as a long-term leasehold, while the member retains the residential interest.

The property can also potentially be part contributed as an asset in specie, subject to the contribution tax allowances mentioned above and the provider's approval. Use of any 2010/2011 contribution allowance immediately after April 5 could further remove income from the clients in that year.

The sale of a commercial property to a Sipp would, should one exist, crystallise a capital gain in the hands of the member, and as concern has been raised that the current 18% capital gains tax (an anomaly in itself) may be revised upwards, now might be an appropriate time to consider this.

A further method of crystallising a capital gain might be to transfer by way of purchase, or by contribution in specie of, client-held unquoted shares.

For a Sipp to invest in shares in an unquoted company, and for the investment to be efficient, it must avoid the taxable property rules. To do this, a number of conditions need to be satisfied, including:

- the company's main activity is the carrying on of a trade, profession or vocation;
- the Sipp, either alone or with associated persons, does not have control of the company;

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- neither the member nor any person connected to him/her is a 20% director, ie a director to whom paragraph (b) of section 417(5) Income and Corporation Taxes Act 1988 applies;

- the Sipp, directly or indirectly, will not hold an interest in the company for the purposes of enabling the member, or a connected person of the member, to occupy or use the property.

It is important to stress here that each unquoted equity investment would need to be individually assessed at the time of purchase and monitored throughout the period of investment to ensure any subsequent changes in shareholding outside of the Sipp would not alter its exemption from the taxable property rules.

While it is usually not possible to assign share options to a pension scheme due to specific grant and ownership requirements, once the right has been exercised, switching into a pension plan could be a possibility.

Some clients will already be in receipt of pension, and for them the loss of allowances and/or higher 50% tax rate from April may make the consideration of either increasing their pension or changing the frequency of it attractive, to bring more of it into the current 40% tax rate. An example might be an individual currently drawing at the maximum withdrawal limits on a monthly basis, on a pension with a year-end date of March 28. There is still time to contact the provider to increase the current year's pension to the maximum, and at the same time switch frequency for the next year's pension to annually in advance. A cautionary note, however, is that such action would need to be balanced against the consequences of potentially reducing the maximum pension in subsequent years and the client's likely financial requirements.

Of course, it is extremely important for the adviser to research the Sipp market carefully before choosing a provider for their client. Not all providers offer the same investment facilities; for example, some may restrict the type of investments they accept, or insist a certain wrapper provider is used, thus restricting the investment flexibility to the investor. It is essential the Sipp can fulfil not only the client's

immediate needs, but also those that may arise as a result of changes in their circumstances and those that might be brought about by legislation.

Fees vary from provider to provider and the level of service is often reflected in the charging levels applied. Some providers offer bespoke services involving highly experienced and individually assigned staff, for which the fees may appear higher than a company that does not offer such an individualistic approach. A very complex investment involving investment expertise is again going to be reflected in the charges incurred, the same as you would not expect to pay an identical price for a high performance sports car as you would for a small family runaround.

Advisers are encouraged to complete a lengthy due diligence process when assessing the market and relying only on headline fees and costs is no longer the limit of assessing best in market. It is advisable to choose a well-established, financially secure company that is able to demonstrate its experience and expertise across all ranges of investments.

While pension investment should be viewed as a longer-term investment, there are situations when monies need to be held within a cash environment, for example when a property is being purchased and the funds need to be easily accessible for completion. With current interest rates being so low for such a prolonged period and no predicted sizeable increases, it is important the investor is treated fairly and receives an appropriate return on their investment.

It is often not appreciated that a poor interest rate reduces the return to the scheme and, as return reduces value, it is effectively a further cost to the client. A Sipp provider should offer the opportunity to invest cash as widely as its other assets so that the highest rates can be sourced and obtained.

Although at first glance the recent changes may have been a heavy blow to high net worth pension provision, a flexible Sipp and informed adviser can still offer innovation and value to their clients. **PM**

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