TO DRAW OR NOT TO DRAW THAT IS THE QUESTION

(or at least until the next 'U' turn!)

Buried in the undergrowth of press releases etc. issued after Gordon Brown's Pre-Budget Report on 6th December 2006, are announcements of further proposed changes to the new "simplified" pensions tax regime - plus new taxation for SSAS's (small self-administered pension schemes) and SIPPS (self-invested personal pension). These could have a major impact on many of our clients' wealth strategy and planning.

This note summarises our understanding of the latest proposals.

The thrust of the proposals affect the benefits permitted to a member of a SSAS or a SIPP or their dependants, after age 75, where an annuity has not been purchased.

The original simplified regime introduced in The Finance Act 2004 abolished the previous requirement for the compulsory purchase of annuities by age 75 and permitted an option to draw varying "Alternatively Secured Pensions" ("ASPs") ranging from zero to a fund-size related maximum instead.

Since summer 2006, Ministers had, however, threatened to backtrack and reintroduce compulsory annuities. **Following widespread representations and negative reactions, it now appears that the Government have decided against enforcing compulsory purchase but instead decided to introduce a more complex and prescriptive set of regulations – together with unparalleled, substantial new taxation on the death of pensioners and their dependants, who utilise ASP.**

The new proposals now imply that instead of insurance companies inheriting pension savings on the death of an annuitant, the new principal beneficiary will be the taxman!

Most of the proposed changes will be legislated for in The Finance Act 2007 – but are intended to take effect from 6 April 2007.

Our understanding of these may be summarised as follows:

1. Members and Dependants who have not bought annuities by 75

a) The option of not taking any pension after age 75 will be cancelled - and there will be a requirement, **after that age**, to draw a minimum income of 65% of the comparable annuity for a 75-year-old person that could be purchased with the member's pension assets.

b) Failure to draw this minimum pension will result in a 40% charge to the Scheme Administrator on the difference between the minimum pension and the amount, if any, actually drawn.

c) The maximum pension that can be drawn in ASP will rise to 90% of the annual amount payable from a comparable annuity for a 75 year old from the current maximum of 70% - **which we welcome as an improvement.**

d) The Finance Act 2004 provided that where a member or dependants were in ASP, residual funds on the death of the last survivor could be transferred to the pensions pots of other scheme members. This facility was defined as the “Transfer Lump Sum Death Benefit”. The Finance Act 2006 provided that Inheritance Tax charge would apply to such transfers.

e) The new proposals keep the Inheritance Tax charge in place but will remove the Transfer Lump Sum Death Benefit option as an Authorised Payment. Any transfer of residual funds will, therefore, “attract an Unauthorised Payment charge of up to 70%”.

f) The combination of Inheritance Tax, unauthorised payment charges and other penalties and charges **could create effective total taxation in the range of 82%-90% on residual funds remaining on the death of pensioners and their dependants – post age 75**.

g) The exact working of these rules is not yet certain – not least to the Government who are considering “how best to ensure how the rules work and interact directly”. The Government’s principle is now redefined as **“the widely touted use of scheme pensions as a route to pass on tax favoured pension savings will be stopped with effect from 6 April 2007.”** – which is curious as they did a lot of the touting!

2. <u>Members and Dependants under age 75 who draw pensions without purchasing an annuity.</u>

a) Where, since 6 April 2006, an annuity is not purchased and consequently “Unsecured Pensions” are drawn prior to age 75, the maximum pension payable is fixed for 5 years. **The Government now proposes that annual reviews may be made, if required – which we welcome**.

b) Tax free cash sums (now known as “Pensions Commencement Lump Sums” – which were previously only available before pensions commenced - may now be paid within 12 months of pension commencement, even if this means that some lump sums will be paid in the year following the member attaining age 75.

3. <u>UK-REITS – more tax!</u>

SSASs and SIPPs which - together with associated persons - hold more than 10% of a UK-REIT (real estate investment trust) will be treated as holding “taxable property”. The investment will be subject to effective penalties of up to 70%, or even higher, with effect from 1 January 2007.

OUR INITIAL COMMENTS

1. We stress that, currently, these proposals highlighted above are not yet law and will only take effect from 2007.

2. **We are glad that as a result of the representations that we and others have made, the Government has not reintroduced compulsory annuities.**

3. The swingeing proposed taxes on residual funds left on death, after age 75 where the ASP regime is applied, will be widely resented as a yet another stealth tax – and possibly as an act of pique as a result of not being able to enforce compulsory annuities.

4. **If these proposals are, however, implemented all clients will have to rethink their plans regarding drawing benefits and, in particular, will wish to consider: -**

   a) Whether benefits should be triggered rather earlier than anticipated, albeit at the loss of Inheritance Tax advantages in the event of premature death.

   b) Whether it is beneficial to draw a lower tax-free cash sum and/or commence drawing taxable pensions at an earlier age, rather than defer benefits.

   c) The effect that triggering benefits early will have on the taxation of residual fund in the event of death either before or after age 75.

   d) The planning of the interaction of pension resources with other assets – taking account of the effect of drawings on the size of a member's estate.

   e) The desirability or otherwise of making drawings from a tax-exempt fund.

   f) Scheme funding.

We look forward to consulting with and advising clients over the next few months - in conjunction with their other professional advisers - with a view to developing individual strategies, reflecting members' preferences and circumstances, and maximising each individual's position.

NIGEL SLOAM **8th December 2006**