Beardmore & Company Ltd
Independent Financial Advisers

KEY GUIDE

Taking control of your pension plan

Flexing your pension

If you add together all the money you have in pension arrangements, the total may well dwarf every other investment you ever make. Despite this, many people are happy to leave their pensions in the schemes of previous employers and insurance company 'managed' funds, which may be fine for relatively modest pension funds.

Changes to pensions from 6 April 2015 mean that there is now more choice and potential flexibility about the ways in which you will eventually be able to draw your pension benefits.

Self-invested personal pensions (SIPPs) offer you the opportunity to take control of your pension. They give you a much wider choice of investments to suit your priorities and preferences, and if you have your own business you may be able to use your pension to help develop it tax-efficiently. For example, in a SIPP you can hold commercial property and company shares, or you can build up a portfolio of investments. A SIPP also offers a flexible and tax-efficient way to turn the pension fund you have accumulated into an income for your retirement. There are, however, downsides to SIPPs which will be touched upon later.

In this guide, we outline the main features of SIPPs so that you can consider whether they might be suitable for you, and we also explain the slightly different features of a small self-administered scheme (SSAS).

Focus point

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The value of pension contributions

Pensions enjoy unique tax breaks, though in recent years tighter limits have been imposed as governments try to cut down on the cost to national revenue. In brief:

- Pension contributions by individuals are eligible for tax relief, generally at their highest rate (currently 40% for higher rate taxpayers and 45% for additional rate tax payers). Contributions also reduce the income used to assess whether individuals lose their income tax personal allowance (for those with income over £100,000), or whether they suffer a tax charge that effectively removes child benefit (for those with income over £50,000). This means the effective rate of tax relief can be 60% or even higher.
- Contributions by employers reduce their taxable profits, as long as the contributions are accepted as being wholly and exclusively for the benefit of the business. Contributions by employers are not subject to national insurance contributions (NICs), and so are particularly tax-efficient. It may be possible to increase contributions at no extra cost by replacing some of your salary with employer contributions – a process known as 'salary sacrifice'.
- While money is invested in a pension, there is generally no tax on the investment income or capital gains of the fund, although it is not possible to reclaim corporation tax deducted before dividends on company shares are paid.

- Up to a quarter of the value of the pension fund is available as a tax-free lump sum from age 55. The remainder normally provides a taxable income, but the rate of tax you pay in retirement may be lower than when you were working, and pension income is not subject to NICs. Following the pensions reform on 6 April 2015, there is much greater flexibility than before in how you can use the proceeds of your pension. This includes taking your entire pension fund as a lump sum, but that may not be a good idea because three-quarters of it will be taxable and it may increase the highest rate of tax you pay.

Because of the tax benefits of pensions, the government has imposed limits on the total you can build up and the amounts you can pay in each year without suffering special tax charges. In particular, your total pension savings shouldn't exceed the lifetime allowance, which is currently £1.25m, and is expected to reduce to £1 million in April 2016. For any tax year you will only receive tax relief on pension contributions you make up to the level of your relevant earnings, and total contributions (yours plus your employer's, including the deemed value of any defined benefit pensions) should be kept within the annual allowance, unless you are able to carry forward unused allowance from previous years. The current annual allowance is £40,000. However, if you have not contributed in recent years it may be possible to pay in up to £220,000 in tax year in 2015/16.

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What is a SIPP?

A SIPP is a special form of personal pension that allows you as the pension scheme member to choose and control the investments within your pension plan. SIPPs are offered by most of the major insurance groups and a range of specialist providers.

The benefits that you can draw from a SIPP and the contributions that can be made are subject to exactly the same rules as any personal pension. The key differentiator is the range of investments available. These vary among providers, with insurance companies typically offering a relatively limited range that will suit most investors, while specialist providers may offer full range. Typically, investments options include:

- A very wide range of investment funds;
- Direct investment in stocks and shares;
- Cash deposits; and
- Commercial property.

SIPP as part of your investment portfolio

Most SIPPs include funds and quoted investments, which you may also hold among your other assets. It is important that your investments are integrated as far as possible and are considered together in your financial planning.

A key consideration is ensuring that your investment portfolio balances risk and reward in a way you are comfortable with. This will take account of the time horizon of your investments as well as your individual attitude. This will largely be reflected in asset allocation, which is simply the balance between secure but low-growth investments, such as cash deposits, and more risky but higher-potential investments, such as company shares. You will also need to consider the selection of investment funds, which are likely to make up a large part of your portfolio, and ensure they are suitably diversified and reviewed regularly.

Focus point

A major attraction of SIPPs is that they can invest in commercial property, although not in residential property.

The taxation of investments can also help determine whether they are held inside your SIPP or among other investments. For example, interest from bonds is marginally more tax-efficient in a pension, but equity dividends are marginally more tax-efficient outside the pension if the investor benefits from the tax credit.

Consolidating your pensions in a SIPP

Many of us build up several different pensions over the years. Some pension funds may still be with former employers while others are those we have saved in ourselves. Some may have high charges and under-performing investments. Consolidating old pensions into a SIPP can reduce charges and allow investments that meet your needs better.

This must be done with caution, though. Some employer schemes have very low charges, so you could pay more after switching to a SIPP and you will need to be confident this is justified by the additional investment flexibility. Even more importantly, you must be careful about giving up guarantees in your old pension arrangements. In particular, some older arrangements, which are usually on a 'with profits' basis, guarantee the terms on which you can convert your pension fund into an income through an annuity. Guaranteed annuity rates can give you a pension that could be significantly higher than buying the best annuity available on standard rates today.

Commercial property investment

A major attraction of SIPPs is that they can invest in commercial property, although not in residential property.

Commercial property can be let to the pension scheme member's company or partnership. You can even sell a property that you or your business owns to the pension scheme (although this might result in a tax charge on any capital gains). Any sale transaction must use an arms' length valuation, because there are tax penalties for 'value shifting'. Similarly, the business must always pay a full commercial rent, which the SIPP or SSAS will receive tax-free.

A SIPP or SSAS can borrow up to 50% of its net assets for property investment (or any other purpose). For example, a SIPP with net assets of £300,000 could borrow £150,000 and spend £450,000 on a commercial property. Often SIPP property purchase is financed by a combination of transfers from previous pension arrangements, new contributions and borrowing.

SIPPs that hold commercial property as an investment normally have higher annual charges than simpler pension arrangements with investments in listed securities, collective funds and cash.

Specialised investments and taxable investments

In theory, almost any investment can be held in a SIPP but those that are not approved by HM Revenue & Customs are subject to heavy tax charges that make them unattractive. They are known as taxable investments and include, for example, residential property, works of art, antiques, fine wine and other collectibles.

The maximum tax charge on a taxable investment can be 104% of the investment's value, most of which would fall on the member. Some forms of indirect investment in property and chattels are exempt from the tax penalty, but the definitions are strictly drawn.

Unfortunately, the way in which the legislation operates will potentially catch a controlling director's pension scheme investing in the shares of their own unlisted company. While there is a limited exemption for indirect investment in chattels with a market value of no more than £6,000, many providers ban investment in chattels and member-related unlisted securities. However, some SIPPs do permit investment in suitably structured residential property funds.

Focus point

The main benefit of SSASs over SIPP is the ability to make loans to the sponsoring employer.

Small self-administered schemes

A SSAS is a special form of occupational pension scheme, primarily designed for controlling directors of private companies. SSASs are offered mainly by pension consultants, but some insurance groups offer SSASs, often with links to their pension investment products.

A SSAS's benefit and investment flexibility is very similar to those of a SIPP, although strictly speaking the choice of investment rests with the trustees. The main benefit of SSAS over SIPP is the ability to make loans to the sponsoring employer.

A SIPP cannot lend money to a member or anyone connected with the member. The 'no connection' rule means that a SIPP cannot lend to the company of a director member. If pension-backed loans to an employing company are important to you, then a SSAS is the route to take. However, it is important to bear in mind that the company will have to provide full security for the loan, which must have an initial term of no more than five years and be repaid in equal instalments of capital and interest. SIPPs may offer greater flexibility and portability as well as less administration. But while SSAS seems to be becoming quite a niche product it still offers some advantages, particularly for controlling directors of private companies.

SIPPs and retirement

SIPPs give investment flexibility during your working lifetime, but after you retire they also give great flexibility in how you use the fund you have built up to provide lump sums and income. This flexibility is in theory available from all types of pension, but SIPPs are particularly suited to take advantage of it.

You can start drawing money from your pension from age 55, and you must stop paying in by the time you reach age 75. The period in between is the retirement window, and you can make the move all at once or in stages.

Focus point

We can advise on how you might use income drawdown in your SIPP.

Between ages 50 and 75, you may have two parts to your SIPP – one where you can pay in and one where you can draw out, which is known as income drawdown. Every time you move part of your fund to income drawdown you can take a quarter of it as a tax-free lump sum, which is almost always worth doing. The remainder is available to provide income.

Since 6 April 2015, the rules provide much greater flexibility than before, with no restrictions on how much income you can take each year from drawdown and the ability to take withdrawals direct from the paying-in part of a SIPP, with a quarter tax-free and the remainder taxed as income. The best way to structure withdrawals from your SIPP will depend on your personal circumstances.

We can give guidance on how you might take lump sums and income from your SIPP, including ways to combine them with other income sources, what happens if you die and when it may be beneficial to buy guaranteed income through an annuity. We can also help you understand how you can take advantage of the increased flexibility available now. Income drawdown is a more complex area of pensions and advice must be sought before considering income drawdown.

How we can help

There are many SIPP and SSAS providers, offering a range of services however SIPPs can be complicated and are more likely to be suitable for sophisticated investors. As financial advisers we can provide advice on:

- Tax-efficient investment in a pension.
- The selection of a pension provider to meet your investment requirements.
- The appropriate investment strategy within your SIPP.
- Transferring existing pension arrangements into your pension arrangement.
- Situations where a SSAS rather than a SIPP may be appropriate.
- The use of a SIPP in drawing retirement benefits including taking advantage of the changes from April 2015.

The value of tax reliefs depends on your individual circumstances. Tax laws can change. The Financial Conduct Authority does not regulate tax advice.

The value of your investment can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance. Investment in a registered pension fund is subject to many restrictions on access and how the funds can be used.

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