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Following the pre Budget report many accused the Government of a u-turn on Alternatively Secured Pensions (ASPs).

Adrian Walker gives details of the proposed changes to be introduced from April 2007 and highlights the issues that are still to be clarified.

time for an alternative route

Following the Chancellor's pre Budget report in December 2006, the Government has indicated significant changes to the proposed tax treatment of funds that could be applied to ASPs beyond age 75.

In summary the proposed changes are as follows:

income payments

The zero income level set out in current legislation will be abolished. Instead income will need to be drawn each year at between 65% and 90% of the GAD income factor applying to a 75 year old.

guaranteed annuity period

If an annuity is purchased prior to age 75 an individual will have the ability to secure a guaranteed payment period of up to ten years on those payments. The pre Budget report states that if the decision is left until age 75 or beyond,

clients will not have the ability to secure any guaranteed period of payment on the Lifetime Annuity.

As such, on death (or second death if a joint life annuity is purchased) the remaining capital will be retained by the annuity office - the very issue that has plagued the demand for pensions over recent years. Such a change to current legislation clearly indicates that annuitisation is still the Government's preferred route.

treatment of death benefits

As the situation stood previously, a 40% inheritance tax (IHT) liability was indicated as being payable on the ASP fund either after the member's death, or on the death of a dependant in ASP. The remaining fund could then be applied as a transfer lump sum death benefit to other nominated members of the same registered pension scheme.

The pre Budget report announced that the option of using a transfer lump sum death benefit would be removed from legislation. If funds were still transferred in this way the transfer would be treated as an unauthorised payment. As such, the tax charge applicable for such transfers would significantly increase. The first two charges are:

- **Unauthorised payment charge - 40%**
To be paid by the person inheriting the fund. Under current legislation, unauthorised payments cannot be taken from the transfer lump sum death benefit paid into the pension. In other words, the recipient will need to find another source of cash to pay it.
- **Unauthorised payment surcharge - up to 15%**
In almost all cases the amount passed on will be more than 25% of the total



example: ASP charges post pre Budget report

Assume a pension scheme member dies with an ASP fund of £100,000 with no spouse or other financial dependant. The member indicated that a transfer lump sum death benefit should be paid to the pension fund of their grandchild, aged 30.

The potential tax charges on the fund would be (assuming the client's IHT nil rate band has been applied on the balance of their estate):

Withholding charge of 40% for IHT
= £40,000

Unauthorised payment charge of 40%
on residual capital of £60,000
= £24,000

Unauthorised payment surcharge of
15% on residual capital of £60,000
= £9,000

Summary of tax to the beneficiary

- The beneficiary receives a pension fund of £100,000 with a withholding charge for IHT of £40,000, leaving £60,000.
- The beneficiary will be subject to an unauthorised payment charge of £33,000 (£24,000 + £9,000) and an unauthorised payment surcharge.
- With the IHT charge taken into account, the overall tax charge on the ASP fund at this point is 73%.

Unlike the IHT charge, we do not know whether the proposed legislation will alter the situation and allow the new charges to be paid by deduction from the pension fund itself.

In addition to the above, the provider will also incur a Scheme Sanction Charge. This will be between 15% and 40% of the unauthorised payment, depending on the unauthorised charges paid by the beneficiary. This charge has to be paid by the scheme administrator and cannot be deducted from the client's pension fund. Assuming the client can fully pay the member unauthorised payment charge and surcharge, the provider will be subject to a scheme sanction charge of £9,000 (using the above example).

Note: This example assumes that HMRC will apply IHT charges before they impose unauthorised payment charges.

unauthorised payments made in that tax year. If this is the case, a surcharge of an extra 15% will also be added.

As with the unauthorised payment charge, this will also have to be paid by the person inheriting the fund.

HMRC have indicated that the interaction of the IHT charge and unauthorised payment charges, including the order in which they are taken, have yet to be discussed with the industry. But whatever the order, the effect of the inheritance tax liability plus the additional charges will still amount to an effective tax charge of 82% on the remaining capital.

The use of the unauthorised payment charge legislation as part of the change appears to indicate that the Government wishes to cut off the supply chain for ASPs by imposing charges on the scheme administrator, as well as the recipient beneficiaries of a transfer lump sum benefit.

You should note that if after the member's death, or death of a dependant using ASP, the remaining fund is paid as a charity lump sum death benefit no such charges will apply.

future planning

If the Government cannot be persuaded away from this heavy-handed approach towards ASPs in the run up to the Budget there will be a question mark over the appetite for providers to offer ASPs.

There will still be a marketplace for such an option, especially in situations where the spouse is much younger and where, on the partner's death, the remaining fund may initially pass into an Unsecured Pension.

However, the options available within such a facility may be more limited and the option of a transfer lump sum benefit on death may not be something which providers will offer if it means subjecting their scheme to a sanction charge.

In reality these changes will mean that retirement planning from pension funds may need to be reviewed well before the age of 75 so that clients can consider taking income from unsecured pension funds. This could be used for inheritance tax planning outside of the direct pension wrapper, or to pay contributions for their intended beneficiaries while they are alive. Such contributions will be treated as contributions of the recipient, who will receive tax relief on the payments but with the ability to transfer assets to the intended beneficiary at a lower tax charge than would apply from an ASP fund.

There is no doubt that the proposed changes to ASPs are disappointing. However, it is also clear that they will further underline the need for financial advice and create opportunities for you to contact your clients to help them formulate effective future planning solutions.

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