filling the void

– funding to the maximum

Colin Jelley
Head of Tax and Financial Planning

April 2009

Colin Jelley explains how flexible use of tax wrappers can help clients affected by the freezing of the pensions Lifetime Allowance to maximise their retirement funding.

In recent months and following announcements in last year's Pre-Budget Report, my colleague Adrian Walker has explained the importance of identifying clients who need to register their pre A-Day pension rights for primary or enhanced protection before the 5 April 2009 deadline. That deadline has now passed, and upon reading this you may have further details of the changes from this year's Budget.

In summary, the Lifetime Allowance (LTA) and Annual Allowance applicable for the 2010/11 tax year will be frozen until the end of the 2015/16 tax year. While the freezing of the Annual Allowance at £255,000 will only affect a small percentage of those making pension contributions, the freezing of the LTA at £1.8 million has the potential to impact many more.

Consider, for instance, a 40 year old client with a personal pension pot of £330,000. If 7% growth (net of charges) is achieved and the LTA remains static beyond 2015/16, the fund will be on the cusp of the £1.8 million threshold by the time the client reaches age 65.

Is this a realistic scenario? Well it certainly needs to be considered in any recommendation, as for some clients continuing to fund at existing levels would risk a future charge of 55% on funding above the allowance where capital is taken or 25% where taken as income – on top of any income tax liability.

continued funding

If appropriate action has been taken with regard to primary or enhanced protection, should clients simply stop funding? To ensure that enhanced protection is not lost they will need to make sure that no relevant benefit accrual occurs after 6 April 2006. But what alternatives could be considered for money that may have previously been earmarked for ongoing pension provision?

For many such clients, ISA allowances will already be maximised and other areas of tax-efficient investments, such as national savings, are similarly likely to have been used.

maximum funding

One way to create a funding vehicle to run parallel to the existing or ongoing pension provision, and to ensure that pension allowances are not exceeded, might be through a maximum investment plan (MIP).

This could offer the client exposure to asset-backed investments without ongoing HM Revenue & Customs reporting requirements, and could even create an income taxed only at the equivalent to basic rate. In addition to this there would be no contribution cap – contributions could be increased or decreased (within certain parameters), and a small amount of life cover would provide additional peace of mind.

sheltered gains

Another key benefit of a MIP is sheltering investment income from future higher rate income tax rises. Effective capital gains and income tax rates have been falling in recent years. However, with current proposals to introduce a 45% tax rate for income over £150,000 alongside the loss of all or part of the income tax personal allowance for income from £100,000, the tide may be slowly turning.

A MIP (which is a regular premium life insurance policy) typically holds UK authorised investment funds. Income and gains on these suffer corporation tax in the hands of the life company. Due to the way life fund taxation is calculated, the actual rate suffered within the life fund is likely to be less than 20%. When benefits are drawn from the MIP after ten years, they are free from personal liability to income and capital gains tax.

Clearly, with no tax relief on contributions made and ongoing taxation at less than 20%, a MIP does not look as attractive as a registered pension vehicle. However, it's important to remember that pension income is taxed at up to 40% and that tax-free cash, once received, loses its exempt status and requires a new (probably taxable) home. And of course, access to the fund is limited by age. Funding over the LTA also comes with a potential tax rate of 55%. For those with high income levels in retirement, a MIP may well offer an attractive parallel funding vehicle.

Utilising the tax efficiencies of multiple product wrappers to fulfil a client's individual needs can further demonstrate the value of quality advice. A MIP may not be a mainstream product anymore, but for clients looking to protect existing valuable pension benefits, this unique savings vehicle could provide an ideal way to maximise retirement funding over a shorter time period.

This article was written prior to the UK Budget announcement on 22 April 2009.

This article is based on Skandia's interpretation of the law and HM Revenue & Customs practice as at March 2009. We believe this interpretation to be correct but cannot guarantee it.

www.skandia.co.uk

Calls may be monitored and recorded for training purposes and to avoid misunderstandings.

Selestia Investment Solutions investment platform gives you access to an ISA and Collective Investment Account provided by Skandia MultiFUNDS Limited, a Collective Retirement Account and Collective Investment Bond provided by Selestia Life & Pensions Limited and an Offshore Collective Investment Bond distributed by Skandia MultiFUNDS Limited for Old Mutual International (Guernsey) Limited.

Skandia fund platform gives you access to MultISA and MultiFUND provided by Skandia MultiFUNDS Limited and to products provided by Skandia Life Assurance Company Limited.

Skandia Life Assurance Company Limited, Skandia MultiFUNDS Limited, Skandia Investment Management Limited and Selestia Life & Pensions Limited are registered in England & Wales under numbers 1363932, 1680071, 4227837 and 4163431 respectively. Registered Office at Skandia House, Portland Terrace, Southampton SO14 7EJ, United Kingdom.

All companies are authorised and regulated by the Financial Services Authority with FSA register numbers 110462, 165359, 208543 and 207977.
VAT number for all above companies is 386 1301 59.

Old Mutual International (Guernsey) Limited is regulated by the Guernsey Financial Services Commission and is licensed to write long-term business under the Insurance Business (Bailiwick of Guernsey) Law 2002. Registered number 2424.
Registered Office at Fairbairn House, PO Box 121, Rohais, St Peter Port, Guernsey GY1 3HE, Channel Islands.