

SIPPS » HMRC is reducing tax relief on pensions to help refill the gaping deficit in Britain's reserves

Unscrambling the pensions nest-egg

Cracking up: adjustments have made already-complex rules even harder to understand



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You can always be sure the subject of tax will come up when you are talking about Sipp. Some would say it is the only reason to pay into one, even though the principle is surely to save for retirement.

It is clear, however, tax is a very important consideration of retirement planning, and there are a number of different issues that cause confusion, with the government recently suggesting more.

Controversial measures

So what are these changes and do we think this is the end of them? One of the most contentious introductions of 2009 were the anti-forestalling measures initially brought into effect on April 22, very slightly relaxed in July and tightened further in December 2009's pre-Budget report. The purpose of these restrictions is to stop large contributions being pumped into the pension system to receive tax relief before more permanent changes can be drafted, consulted upon and finally put into legislation ready for the 2011-12 tax year.

It seems highly unlikely the changes will be reversed. The implementation of the 2011 changes is already under consultation and legislation is being drafted. In addition, the reduction on tax relief paid out by HM Revenue & Customs (HMRC) to high earners is what is being counted on to help fill the overall deficit.

Money within the pension will be immune to these changes – in most cases, income within the Sipp rolls up gross. Take property: generally, you can reclaim any VAT on the purchase, the rental income is received gross by the Sipp, making repayment of mortgages efficient, and when the property is sold there is no capital gains tax (CGT) payable.

There are some cases where the roll up is not gross. Dividends, for example, are paid with a tax credit, which currently cannot be reclaimed within a pension.

Death in the accumulation phase is also generally very tax efficient. The fund can usually be paid free of inheritance tax to a nominated beneficiary, provided it is paid under the discretion of the trustees.

The tax charges on the decumulation phase of Sipp start to get more complicated. Unsecured income is taxed under PAYE, so it would depend on the client's circumstances when they retire and how much total income they receive.

Death in unsecured income should be free from inheritance tax (IHT), but there is a flat fee of 35 per cent to take account of.

HMRC is determined to get back some of

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the tax relief previously used to increase the fund.

If a client makes it as far as an alternatively secured pension (and currently, longevity rates indicate the chances are improving), again the income is taxed PAYE, but the complications start at death.

All is well if your client has a financial dependant: they can take an annuity, unsecured income or an alternative secured pension (ASP) dependent on age or preference. If there are no financial dependants, then it is possible to pay the fund to a registered charity tax free. If, however, it is left to another beneficiary, they would personally be subject to 55 per cent income tax charge, the scheme would pay a further 15 per cent from the funds, and the residual amount could also be subject to IHT. This could be as much as a further 12 per cent (40 per cent of the remaining 30 per cent).

Getting the balance right

What does this mean for high earners? It has been muted by many that the anti-forestalling measures and taxation on death in ASP would be the end of pensions for high earners. This is not necessarily the case, although it is a fine balancing act for whom Sipp are and are not suitable. For those earning in excess of £100,000 but below the £130,000 threshold, benefits can still be gained by using salary sacrifice in the future to reduce their income. This would not only reduce National Insurance contributions for the employer and employee while maintaining pension contributions, but also increase their personal allowance.

There are many pros and cons to contributing to a Sipp, and we cannot discuss them all here. Plus, it should not be forgotten that 70 per cent of Sipp business consists of transfers. It is safe to say all this change reinforces the need for advice, especially to those high earners at or near the numerous thresholds imposed by the ever-changing legislation.

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