

Talking points – In specie revisited

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Many providers, Suffolk Life included, have felt compelled to decline *in specie* contributions.

In this bulletin we look at why the market moved in this direction, and the ready alternative provided by the removal of the connected party rules.

The background

The rules for *in specie* contributions were set out by HMRC earlier this year. They published their requirements at short notice, given their growing concerns on how *in specie* contributions were being carried out, especially in relation to tax relief. Concerns as to whether assets were being valued correctly were also highlighted. Intensive lobbying by the Association of Member-directed Pension Schemes (AMPS) to determine the legislative basis of these requirements has so far fallen largely upon deaf ears.

The HMRC "simplified" procedure

HMRC do not want providers to pre-check and value proposed assets in advance, but in reality this would have to take place.

- » investor declares their intention to make a contribution (this must be a monetary amount)
- » SIPP provider creates an irrevocable debt in the SIPP
- » The debt is met by assets transferred from the contributor
- » up until the point of the payment in lieu of cash a scheme provider may not give a legal commitment to accept a specific asset to settle the debt
- » Differences between debt value and asset value must be resolved.

Mutual inconvenience

Once created, the debt must be irrevocable and the scheme administrator must pursue the investor for settlement. Given the time taken to transfer assets, values may fluctuate with the result that the contribution may be more or less than anticipated. If the resulting value does not cover the debt, the scheme administrator is obliged to pursue the investor for the outstanding balance. If more, the scheme must either return the excess in specie or in cash. Alternatively the investor can have it treated as an additional contribution.

A price worth paying?

All this additional administration places additional burdens on all three parties – the administrator, the adviser and the investor together - ultimately resulting in higher costs for the investor, including:

- » legal costs of establishing these arrangements
- » processing the transactions
- » potentially the costs of pursuing a debt.

This begins to make *in specie* contribution unacceptably expensive to administer.

Tax relief

Tax relief on the *in specie* contribution is not claimable on establishment of the irrevocable debt but rather on the date that the actual transfer takes place. Because of this, care must be taken when approaching the end of any tax year, especially if it is likely to take time to bring the assets into the SIPP.

The contribution will be treated as a disposal for tax purposes and this should therefore be taken into account in tax planning. In addition stamp duty at the applicable rate would also be payable.

Practical solutions

Fortunately a practical alternative exists – the connected party transaction route. For those who are asset rich and cash poor, the restrictions on *in specie* contributions need not be the end of it. The following process could be transacted by the investor:

- » borrow either personally or through their company
- » pay this as a cash contribution to the SIPP (personal or employer)
- » receive tax relief (where applicable)
- » purchase the assets as connected party transactions, then
- » repay the borrowing with the cash received from the SIPP.

Overall the tax treatment is the same.

As with an *in specie* contribution, there could be delays between the cash contribution and the SIPP completing the purchase – the value of the asset could fluctuate resulting in insufficient funds in the SIPP to purchase the asset or market value of the asset being insufficient to repay the loan.

An ingenious alternative

A further alternative could be for the SIPP to borrow against existing assets within the SIPP to create enough cash to purchase the desired asset. In doing this the cash received by the individual for the asset could then be paid into the SIPP. The contribution would receive tax relief, where applicable, which would then with the contribution repay the SIPP borrowing. This option would remove the need for personal borrowing, but could incur charges within the SIPP.

Our view

The current *in specie* contribution guidelines are unwieldy and certainly are at odds with a 'simplified pension regime'. *In specie* contributions were supposed to provide a simple solution for asset-rich cash-poor investors to simply move their existing assets into a pension 'wrapper' instead of funding the pension through a contribution. Instead we are faced with a cumbersome and costly operational process which for many investors will make this option look unattractive. It is hoped that with continued lobbying the Treasury will be prepared to remove the obstacles that face any investor considering contributions *in specie*. In the meantime connected party transactions provide a very useful alternative.