Almary Green

> Independent Financial Advisers

Guide to Self Invested Pensions

The Real Alternative to Insurance-Based Pension Plans

April 2015

MoneyMarketing Financial Services Awards 2013 ADVISER AWARDS WINNER BEST TAX & LONG-TERM SAVINGS ADVISER

CHARTERED AWARDS '14 AWARD WINNER Chartered Financial Planners of the Year The Personal Finance Society

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Almary Green Independent Financial Advisers

Almary Green Investments Ltd provides independent financial advice and support to businesses and individuals throughout East Anglia and beyond. Their advisers have a collective depth of experience extending over many years and they are specialists in advising both individuals and businesses on how to prepare for a prosperous future.

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Winner Retirement Planner Awards 2014.
Winner Money Marketing Awards Best Tax and Long Term Savings Adviser and Best RDR Business Transition 2013 and Bronze finalist in Best Tax and Long Term Savings and Best Professional Development Awards 2014.
Winner Financial Adviser Awards' Group Pensions Adviser of the Year 2013.
Winner Moneyfacts Best Tax and Estate Planning Solution Provider 2013.
Winner of the Gold Standard for Independent Financial Advice in 2012, 2013 and 2014.
Winner of the Professional Adviser Awards' Charity Champion 2013, nominated for Best Small Adviser Firm 2013, Investment Adviser of the Year 2013 and Retirement Adviser of the Year 2013.

This guide is based on our understanding of the tax and pension rules as at 6 April 2015.

The value of an investment and the income from it could go down as well as up. The return at the end of the investment period is not guaranteed and you may get back less than you originally invested.

The tax treatment of investments depends on individual circumstances and is subject to change.

SELF INVESTED PERSONAL PENSIONS

Building a Pension Fund

There are two main alternative routes that offer the tax-favoured treatment available for those who wish to build up a pension fund to finance their retirement years. These are:

- Insurance-based Pensions—the standard pension package you can buy from an insurance company
- Self Invested Schemes

Self investment is becoming increasingly popular, as it offers wide-ranging flexibility in investment options together with the ability to retain control of the investments you make. Depending on your individual circumstances, self investment can take one of two forms:

- SSAS (Small Self Administered Schemes)
- SIPP (Self Invested Personal Pensions)

A SSAS is generally appropriate when a number of directors of a company want to jointly invest their pension savings. A pension scheme is established just for them and they will all be trustees.

This guide will look in greater detail at the workings of a SIPP and how it could be of benefit to you to secure your retirement income.

What is a SIPP?

When investing in a SIPP, the capital you invest in your pension fund is under your control—you take full responsibility for managing its investment growth. You decide where your funds are invested—you are no longer reliant on a Life Office for the performance of your pension fund investments.

The SIPP route requires you to take a more active role in both monitoring the performance of the investments you have made and in adjusting your investment portfolio accordingly.

One distinct advantage of this route is that the range of investment possibilities available is wider than those available through an insurance-based personal pension plan. We will look at this range later on in our guide.

Although you retain control of the investment capital that you hold within the SIPP, you must remember that the funds held in a SIPP cannot be withdrawn until age 55 at the earliest.

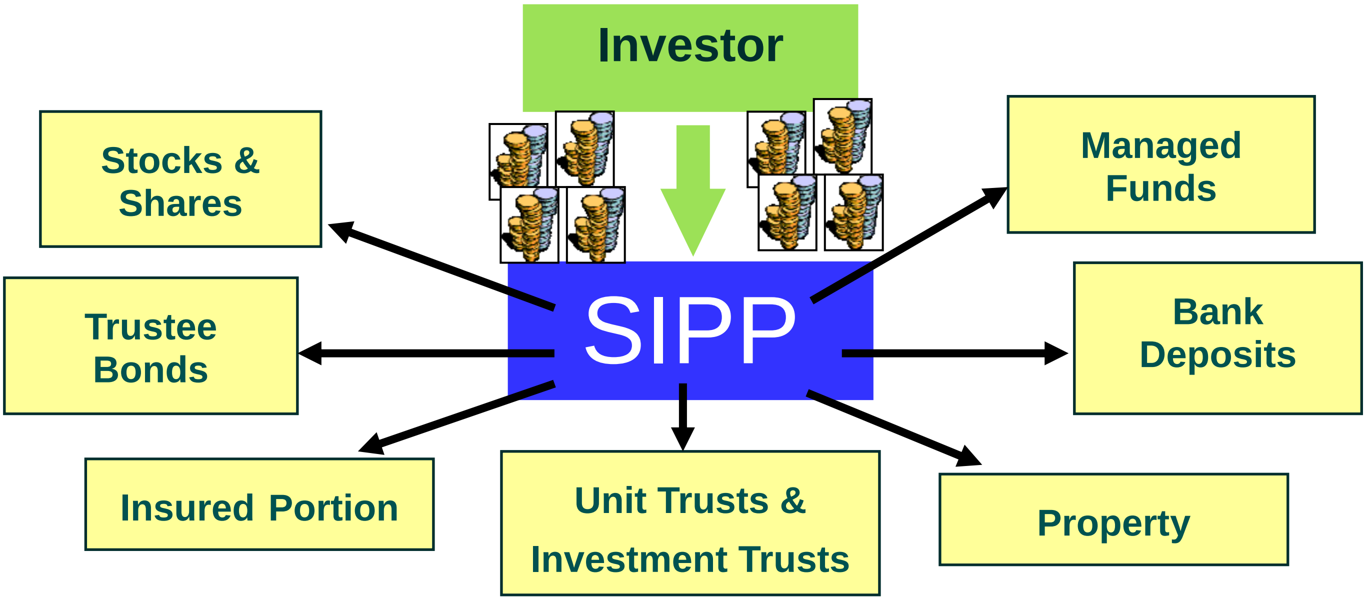
The SIPP route is not for those who are content to sit back and let their investments simmer—it is for the pro-active investor and allows you to match your investments to your resources and your attitude to risk.

Eligibility

You are eligible to invest for your retirement using a SIPP if you fall into one of the following groups:

- *Employees*
- *Self-Employed*
- *Partners in Business*
- *Directors*

How a SIPP works



Deciding where to invest your funds is the most important first step for any investor in a self-invested scheme. In order to maximise benefits, you will want to go for the highest possible return, but against that you must consider your attitude to risk.

Within the life of the fund, as its manager, you are permitted to buy and sell investments to maximise your returns, but all the proceeds and subsequent purchases must form part of the ongoing fund.

Contributions

Since the introduction of the new Pension Simplification rules in April 2006, the way maximum contributions are calculated has changed. There is now an annual contributions allowance, which is set by the Government. For the tax year 2015/16 this has been set at £40,000 and under some circumstances unused allowance can be carried forward from up to three previous tax years. The allowance is the maximum contribution you and your employer can make to all pension schemes, but tax relief on your personal contributions will be limited to your earned income.

The other restraint introduced by the Chancellor is a cap on the total amount of pension savings you can accumulate within your pension funds in your lifetime. The ***Lifetime Allowance*** applicable for the 2015/16 tax year is £1.25 million and is due to be reduced to £1 million on 6 April 2016. Historic changes in legislation has led to many people having personal Lifetime Allowances which may have an impact on the level of contributions you can make.

Money contributed to the SIPP fund can therefore come from a range of sources:

Earnings

- You can put up to 100% of your earned income into pension savings—provided these do not exceed the annual contributions allowance.

Non-Earnings

- Further contributions can be made from capital and cash holdings, although the total level of contributions should not exceed your earned income or the annual allowance because you will not receive tax relief.

Tax Relief

- HM Revenue & Customs will rebate the basic rate income tax you have paid on the earned contributions to your fund.
- HM Revenue & Customs will allow you to claim higher rate tax relief on your contributions via Self Assessment or through PAYE should you not complete a self assessment return.

Other Funding Sources

Rent from Property owned by the SIPP

- Rental income is paid directly into the SIPP and is not taxed.

Transfers from other Pension Funds

- You can arrange for the funds you have accumulated in other schemes to be transferred into your SIPP. A note of caution here—beware of low transfer values in comparison to the accumulated fund value, as some schemes will penalise you heavily if you move funds out. Check with your advisor before taking any action. If you are considering a transfer from a final salary scheme then you will be required to take advice, unless the transfer is less than £30,000.

Investment Income

- Just as with rental from a property, income from the SIPPs investments will generally be received tax free into the fund.

Risk

Investment is all about risk. You buy assets that you hope will accrue value, and use a range of information sources to judge the potential growth of the investment you have made. As an independent financial adviser, we can help you assess your attitude to risk and ensure that the investments you make fall within your comfort zone. All investment opportunities that are available to you carry risk and we can help you asses the degree of risk that you are taking on to ensure that the investments you make match your attitude to risk.

Spread Your Risk

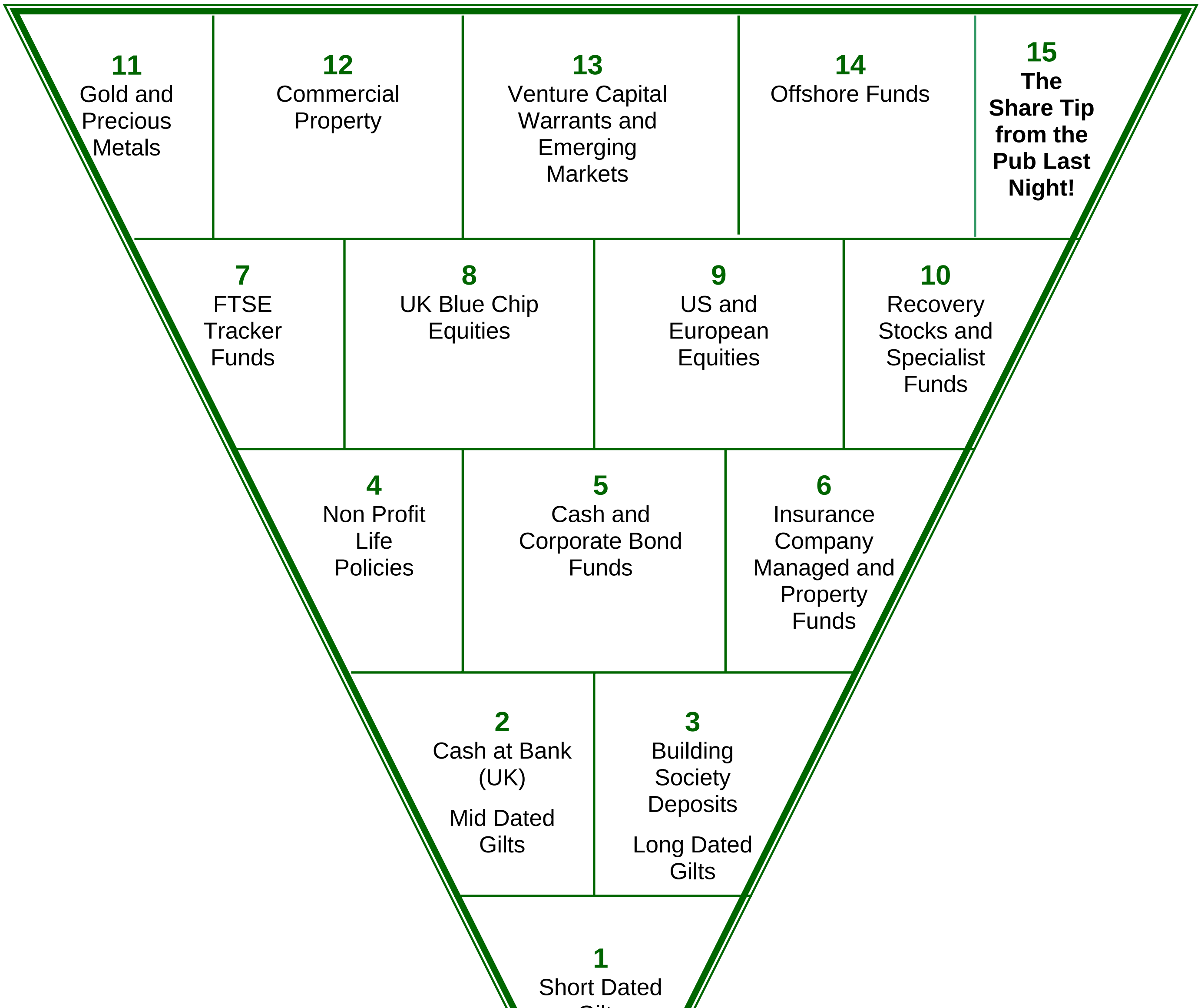
The age-old adage of not keeping all your eggs in one basket rings as true today as ever. Spread the risk by taking on a range of investments. Look at:

- Cash and Deposits
- Fixed Interest Securities or Bonds
- Equities
- Property

The key to investment success is diversification.

The Inverted Risk Pyramid

The diagram below gives you an idea of some of the investment opportunities that are out there, and the degree of risk involved with each. Number 1—at the bottom of the pyramid—involves the least risk, with Number 15 at the top involving the most.

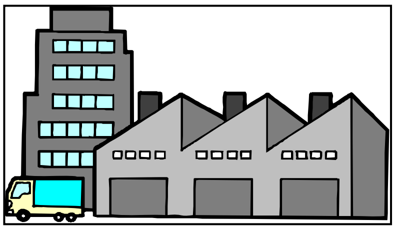


It's a balance of risk against reward

Self Investment in Property

Commercial Property:

A self-invested pension scheme can invest in a range of commercial properties:



- **Offices**
- **Shops**
- **Factories**
- **Warehouses**
- **Land**

Increasing property prices add value to the pension scheme, and any subsequent sale is free of Capital Gains Tax. Furthermore, the property is normally income producing and the rental income adds to the fund value.

Commercial property can now be purchased by the SIPP from both a connected party and a unconnected party and the maximum that the SIPP can now borrow to purchase the property is 50% of the pension fund value.

Non-Commercial/Residential Property:

Although a SIPP is only generally permitted to invest in commercial property, which is defined as anything you can't live in, there are a number of exceptions.

The permitted exceptions listed below must still meet certain requirements and should be reviewed in detail prior to considering a purchase.

- **Hotels**
- **Student Halls of Residence**
- **Residential Care Homes**
- **Hospices**
- **Prisons**

All the above can be funded via direct investment of SIPP funds (provided no personal use is involved).

The potential for a substantial return makes this an exciting opportunity.

The SIPP rules also allow for investment in residential property—provided it is via a “genuinely diverse commercial vehicle” or indirect investment (eg unit trust or OEICs).

Under this ruling, it is possible for a SIPP to be a member of a syndicate of private individuals investing in residential property.

However, there are restrictions:

- The SIPP must own no more than 10% of the investment vehicle
- The total asset value must be at least £1 million, or at least 3 properties are held in the investment vehicle.
- There must be no personal use of the property.

There must be no personal use of the property.

As a commercial entity, a Residential Syndicate could borrow up to 85% of the value of the property.

Pension Fund Size Limit

There is a limit set on the total value of your pension savings at retirement, known as the Lifetime Allowance. The limit (in the 2015/16 tax year) currently stands at £1.25 million and is due to be reduced to £1 million on 6 April 2016.

Funds in excess of the limits on retirement will attract a tax charge (55% on lump sums and 25% on pension income).

Distributing the Funds held in a SIPP

The SIPP is established to benefit an individual, and the assets contained in the SIPP are therefore available to fund the retirement of that individual. There are three potential withdrawal routes: Uncrystallised Funds Pension Lump Sums (UFPLS), flexi-access drawdown, or the purchase of an annuity. These options are explained in detail below.

An important point to remember is that there must be sufficient available "cash" in the fund to pay out the initial tax-free lump sum and to make the necessary pension payments. It's therefore important to regularly review the mix of investments you hold, so that any necessary changes can be made as retirement approaches.

When funds are required, the investor can withdraw funds as needed. Assets remaining in the scheme after the start of retirement will continue to bring in additional income to the fund through investment growth, rental income, etc.

Rental from property held in a SIPP can either be used to augment the fund, as happens prior to retirement, or can be paid as income when in a drawdown pension arrangement.

Pension Fund Withdrawal Options

Pension Flexibility

Since April 2015, anyone over the minimum retirement age has the freedom to access their pension savings at will, without an obligation to purchase an annuity at any point. However, it is important to recognise that generally only the first 25% of the fund can be withdrawn free of tax and that further withdrawals will be taxed at the member's marginal rate. This could potentially put the member into a higher tax band and therefore incur a 40% or 45% tax charge on the withdrawal. It will be important to time withdrawals carefully to ensure tax-efficiency and to take account of any other taxable income received from other sources.

Tax on your Fund's Growth

Investing in a SIPP offers a number of tax benefits:

- *Investment gains on your fund are free of Capital Gains Tax*
- *No Income Tax is payable on your fund growth*
- *Rental income from any property owned by SIPP is paid gross into the fund*

Despite the tax consequences, these new freedoms do offer you the opportunity to make pensions a more flexible element of your overall investment portfolio, as they are generally tax-efficient. Now that substantial sums can be released if required once you have reached the minimum pension age, it may be useful to build larger contributions into your strategy if you are likely to need withdrawals during the later years of your working life. Your Almary Green adviser will give you advice on the suitability of pension savings for your long-term investment goals.

Please remember, however, that your pension's official purpose is to provide you with an income in retirement. You should ensure that you do not deplete your pension savings, leaving nothing to live on in retirement.

Another factor to bear in mind when planning withdrawals from your pension savings is that once you have started to take benefits from your fund over and above your tax free lump sum entitlement, your annual allowance for contributions may be reduced to just £10,000 per year, unless you are in a capped drawdown arrangement and take further monies within the capped limits. If you are still working, this may represent a missed opportunity as you will be unable to continue to make contributions higher than this level.

Uncrystallised Funds Pension Lump Sums (UFPLS)

You are permitted under the UFPLS rules to take lump sum withdrawals from your pension savings without crystallising the remaining fund or entering into a drawdown contract. Each payment under UFPLS will be 25% tax free and 75% taxed as income. If you have an enhanced lifetime allowance with an associated tax free cash level then you may not be eligible to use this option and your should speak to your adviser before applying to take benefits.

If you are entitled to tax free cash in excess of 25%, it is not possible to pay the enhanced level under this option and you should consider using flexi-access drawdown.

Flexi-Access Drawdown

Drawdown involves cashing-in segments of your fund as needed and takes the form of a contract with a pension provider, who will continue to invest your remaining fund. Since April 2015, there are no limits on the amount that can be withdrawn in a given tax year, but generally only the first 25% can be withdrawn free of tax. The remaining fund will be withdrawn in the form of income and taxed at your marginal rate for that tax year.

It is important to remember that substantial withdrawals under UFPLS or Flexi-Access Drawdown could potentially put you into a higher rate tax band and you could, as a result, pay 40% or 45% tax on some of the funds you withdraw. Spreading payments over a number of years could minimize the level of income tax you will pay overall.

Annuities

Annuities have until recently been the route of preference for most retirees, but poor rates have made these unattractive in recent years. An annuity is a plan that will provide a regular guaranteed income—either for life with a lifetime annuity or for a fixed period of time with a fixed term annuity. The annuity rate you get will depend on your personal circumstances taking into account factors such as your age and your health.

When looking at the option to buy an annuity, it is important to remember that you are not bound to purchase a plan from the Insurance Company that provided your pension savings scheme—you have what is known as the "Open Market Option" (OMO) which entitles you to shop around at the time of retirement. Your Almary Green adviser will review all the rates available at the time of your retirement and help you decide if an annuity would be suitable for you.

Pension Death Benefits

Provided you are under the age of 75, the value of your remaining fund at your death will be paid out, free of Inheritance and Income Tax, to your nominated beneficiary. Those who die after the age of 75 will still avoid inheritance tax but the beneficiary will pay income tax at their marginal rate if the fund remains in the pension and income is withdrawn. If the beneficiary chooses to take the fund as a lump sum a 45% charge will apply. The lump sum rate is proposed to move to marginal rate income tax on the beneficiary in April 2016 although this isn't guaranteed at this stage.

Although legally it is the responsibility of the SIPP Provider to decide who gets the money, they will generally follow your wishes, as long as you have expressed them. The way to do this is to complete a **Pensions Beneficiary Nomination Form**. This is a really important document and it is vital that you keep it up to date if your circumstances changes (eg marriage, divorce, birth of children, etc). If you need to make any changes, just ask your Almary Green adviser for a new nomination form.

If the value of your fund on your death exceeds the Lifetime Allowance (see page 7), then there will be a tax charge on the excess of 55%, if paid as a lump sum or 25% if the beneficiary choses to leave the fund in the scheme and draw an income.

If you purchase an annuity with your pension fund, it is possible to build in some protection for your heirs using a joint life option and/or a guaranteed income period. You should discuss these options with your Almary Green adviser.

There may be further changes to the flexibility of annuities and their death benefits in future legislation.

Protection options can be built into an annuity arrangement, but there will, inevitably, be a cost penalty—as you build in more protection, you will get a less advantageous annuity rate.

Summary: why choose a Self-Invested Pension?

Financial Security

The assets held in a self-invested scheme are ringfenced for your future benefit. They are not susceptible to charges by creditors – even the taxman cannot touch them (but remember, neither can you, until you reach the minimum retirement age!).

Investment Freedom/Control

You can choose from a wide range of investment options and have day-to-day control of how the assets are being used.