A Guide to

Self Invested Personal Pension Schemes

(SIPPS)

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Introduction

This guide is intended to provide you with a summary only of the main features of a SIPP.

In his budget speech in 1989 Nigel Lawson said:

"I propose to make it easier for people in personal pensions to manage their own investments".

A SIPP is a sophisticated and flexible personal pension scheme giving you the ability to invest your pension fund assets in areas other than insurance company pension funds.

SIPPs are generally established under Irrevocable Trust by a Trust Deed and Rules and you join by executing a Supplemental Deed.

Within insurance company pension funds, investments would normally be restricted to the individual funds managed by the insurance company administering the scheme leaving little flexibility or choice for the member. If a member wished to reduce or suspend contributions or transfer to another insurance company then typically large penalties would be applied to the funds, particularly if this occurred in the early years of the contract.

With a SIPP you have the flexibility to pay contributions at whatever level you choose within Her Majesty's Revenue & Customs (HMRC) limits and generally there is no contractual minimum contribution.

A SIPP can also invest in commercial property, with the assistance of a mortgage if required, when can then be leased to a third party or back to your own business at a commercial rent.

SIPPs were designed to take full advantage of the Income Drawdown rules first introduced in the Finance Act 1995 and when combined with the phased retirement facility, they undoubtedly offer one of the most flexible and sophisticated tax planning tools available.

As Francis Bacon said nearly 400 years ago:

"Chiefly the mould of a man's fortune is in his own hands"

Eligibility

You are eligible to join a SIPP if:

- You're resident in the UK, or
- You're working overseas as a crown servant, or
- You're the husband, wife or civil servant of a crown servant working overseas

Please note you can in fact contribute up to £3,600 gross (you actually pay £2,880 net after basic rate tax relief, the Government adding £720!) without any earnings whatsoever, either for yourself or perhaps on behalf of a child or grandchild.

Where an individual is under 16, their legal guardian must:

- Sign any application forms on their behalf
- Be responsible for making sure that HMRC contribution limits are not exceeded
- Be responsible for the contract as if they were the member until the individual reaches adulthood

It is possible for you to be an active member of an employer's occupational pension scheme and contribute to a SIPP in respect of the same source of earnings.

Transfer payments in respect of other approved pension benefits can be accepted without the requirement for further contributions and it is therefore possible to establish a SIPP purely to receive transfer payments, although we strongly recommend that professional advice be obtained before transferring any benefits.

Contributions

HMRC impose an upper limit on the total contributions that can be paid in any tax year, and we can advise you on the maximum level of contributions applicable in your own circumstances.

If you wish contributions can be paid on a regular basis, although there is no obligation to maintain these contributions.

Contributions can be reduced or increased to reflect individual circumstances and contributions can be paid by you or your employer provided the total contributions do not exceed HMRC limits.

Contributions may be accepted in the form of property i.e. “in-specie” (a Latin term meaning “in the actual form”) contributions.

You can contribute up to 100% of your net relevant earnings i.e. your taxable earnings, and qualify for tax relief at your highest rate, subject to an annual allowance of £50,000 p.a. You can carry forward any unused annual allowance for up to three tax years, based on the amount of £50,000 p.a.

Taxation of Contributions

Contributions are normally eligible for tax relief in the tax year of payment.

Under current legislation your contributions will qualify for tax relief at the highest rate of tax you pay.

Your personal contributions are paid net of basic rate tax, which will be reclaimed from HMRC and credited to your fund. If you are a higher rate tax payer you claim the extra tax relief from HMRC.

If your employer contributes on your behalf you will not be taxed on the amount of these contributions and your employer will normally be able to claim the contributions as an allowable business expense for Corporation Tax.

The Scheme cannot be used to contract-out of the State Second Pension (S2P), although we can arrange this for you separately.

Lifetime Allowance

The Revenue set a Lifetime Allowance on the total retirement benefits you can receive from all your pension plans without a tax penalty. If your benefits exceed this allowance, there is a Lifetime Allowance charge of 55% on the excess if it is paid as a lump sum, and 25% if taken as a pension.

Your benefits must be tested against the Lifetime Allowance before your 75th birthday.

The Lifetime Allowance is currently £1,800,000, but will fall to £1,500,000 from the 6th April 2012.

You may be able to register with HMRC for pre-2012 Protection, which would allow your Pension to exceed the £1,500,000 limit, but NO further contributions can be made after the 5th April 2012.

Transfers

It is possible to transfer previously accumulated approved pension scheme benefits into your SIPP although transfers cannot be received in respect of “contracted-out” liabilities.

Permitted Investments

SIPPs have been designed to allow maximum flexibility with regard to your choice of investment strategy and the Trustees will be the legal owners of all assets held within your fund.

Your SIPP can be invested in any of the following ways:

- Unlisted shares (though note most SIPP providers don't allow these)
- UK quoted stocks, shares, gilts and debentures
- Shares quoted on the Alternative Investment Market (AIM)
- Warrants, Futures and Options
- Permanent Interest Bearing shares
- Stocks and shares traded on a recognised overseas stock exchange
- Authorised unit trusts, investment trusts and OEICS
- Insurance company funds
- Deposit accounts
- Commercial property and land
- Hedge funds

Certain categories of investment may result in tax charges. These include:

- Residential property and associated land from which you derive personal benefit
- Personal chattels (capable of private use)
- Loans to connected parties such as Scheme Members, their relatives and partnerships in which they are partners

If you wish us to consider any particular asset that does not clearly fall into any of the allowable asset classes then full details should be disclosed for clarification.

Property Purchase

One very attractive and popular feature of a SIPP is the ability to invest in commercial land and property.

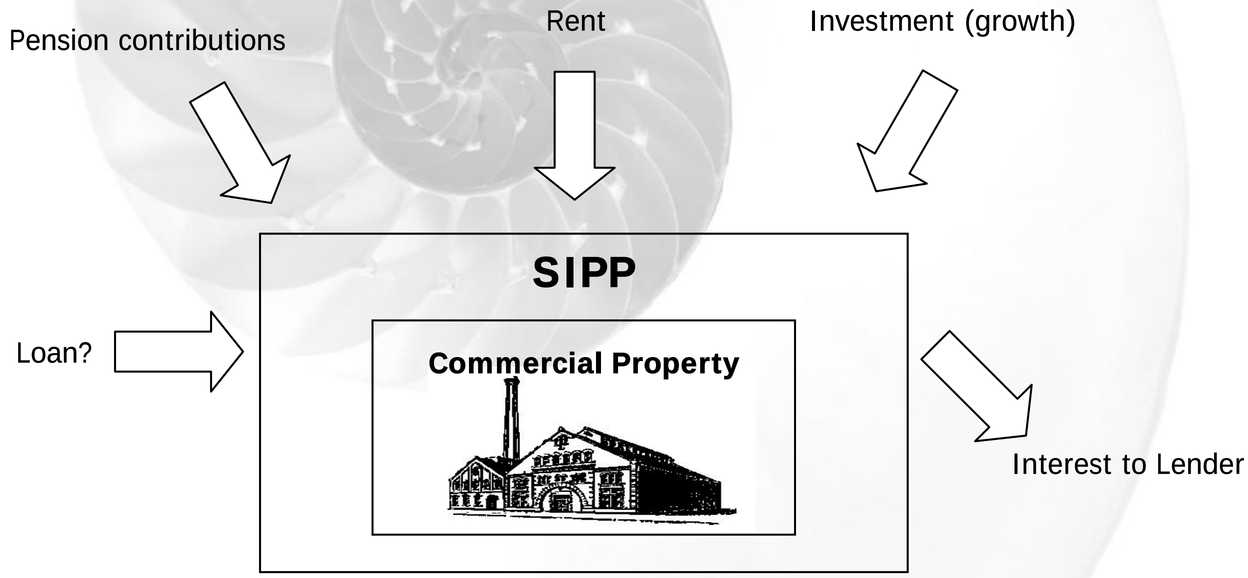
A property can be purchased by an individual or a group of SIPPs, which can then be leased on commercial terms. The SIPP can also borrow funds from a commercial lender to assist with the acquisition of a property, up to a maximum of 50% of the pension fund value.

Property Purchase

The maximum borrowing that can be utilised by the SIPP is 50% of the current scheme assets before the purchase.

Joint purchases (with a Company, Partnership or other third parties) can also be considered.

Actual process of monies received and paid out:



Property Purchase (cont…)

Any gain on the property is free of Capital Gains Tax (CGT), the rental income is tax free and the tenant i.e. your partnership/company, is eligible for tax relief on the rent, so extremely tax efficient.

The main advantages of buying your property within your pension scheme are:

- An initial saving in cost – in effect it costs less to buy a property if the purchase is via a pension fund as the contributions have attracted tax relief

- The SIPP has no liability to CGT on a subsequent sale, as capital growth is free of UK tax

When the pension scheme is set up your business is installed as a tenant of the property and therefore the rent paid by you to your pension is an allowable expense for income tax, and there is no tax liability on the rent received by the pension scheme.

As with an ordinary property purchase all of the normal procedures need to be actioned such as instructing your Solicitor, instructing a Surveyor (who will also set the commercial rent to be paid to the SIPP by you), associated costs i.e. stamp duty, etc, and the appropriate lease agreements with the business. Your pension scheme can register for VAT and you will need to speak to your Accountant with regard to this specialist area, or we can introduce you to a VAT specialist.

Example of Commercial Property Purchase for a Limited Company

	Company Purchase	SIPP Purchase
Taxable Profit	£98,000	£98,000
Pension Contribution	NIL	£98,000
Taxable Profit	£98,000	NIL
Corporation Tax (using 20%)	£19,600	NIL
Profit after tax	£78,400	NIL
Property purchase	£100,000	£100,000
Borrowing	£21,600	£2,000
Money retained in Company/Pension	**£78,400**	**£98,000**

Taxation of Investments

Your fund will accumulate free of any liability to UK income tax or CGT, although tax deducted at source on dividends from equities can no longer be reclaimed.

Borrowing

The SIPP can borrow funds to assist in the purchase of property or to create liquidity for the provision of retirement or death benefits.

SIPP borrowing is restricted to 50% of the pension fund value before the purchase takes place, to include existing borrowing and any amount borrowed to finance VAT on the property purchase.

Connected Party Transactions

Transactions between the SIPP and connected parties are now fully allowable provided they are on an ‘arms-length’ commercial basis i.e. an appropriate independent valuation is undertaken.

HMRC will be keen to ensure that no “value shifting” takes place and if it does will make a tax charge.

Payment of Benefits

There are a variety of benefit options available that you can receive on retirement, or that your spouse, dependants or nominated beneficiaries, can receive in the event of your death.

A broad summary of the options is provided below, although it is strongly recommended you seek our advice in considering your own circumstances.

Retirement

You can draw benefits at any time from age 55 without any penalty. At this date you can use all or part of your fund to provide you with a tax free lump sum and an income.

It may be possible to retire earlier than your 55th birthday if you are in serious ill health or are in a specialised occupation.

You can draw benefits from your scheme irrespective of whether you continue to work.

At retirement you can elect to receive a tax free lump sum of generally up to 25% of the value of your fund. The date you commence benefits is referred to as your crystallisation date. You can have several crystallisation dates if you only take part of the fund each time.

After payment of the tax free lump sum, your residual fund can be used to provide you with an income that will be taxed under Schedule E and this income can be provided in one of three ways:

Annuity Purchase

This involves passing your fund (after payment of your tax free lump sum) to an insurance company of your choice who in return will provide you with a regular income throughout your life. The income may increase during the course of payment, may be guaranteed for up to 10 years i.e. paid irrespective of whether or not you are alive and may then continue, normally at a reduced level, to your surviving spouse or dependents.

The annuity available will depend on the value of your fund and annuity rates at the time of purchasing the annuity. It may also be possible to obtain 'impaired life' annuity rates which will provide a higher income if you are in poor health.

The insurance company will usually pay the income to you net of tax and will deal with all aspects of PAYE.

Payment of Benefits (cont…)

Income Drawdown

The concept of Income Drawdown was introduced by the Finance Act 1995 and it enables monies to be paid to you directly from the fund rather than by purchasing an annuity.

The amount that can be withdrawn each year is subject to a maximum based on 100% of the annuity rates provided by the Government Actuary's Department. There is no minimum amount, so you could just take your Tax Free Cash if you prefer.

The limits are calculated at your pension date and are reviewed every 3 years thereafter, but every year once over age 75.

Monies can be withdrawn at irregular intervals to suit individual circumstances as long as the payments are in accordance with the above limits.

Income Drawdown allows you to decide on the most opportune time to buy an annuity taking into account your personal circumstances and annuity rates in force from time to time.

Further contributions may be made after benefits have commenced under certain circumstances.

Phased Retirement

Your individual fund is normally divided into 1,000 segments so that benefits can be taken gradually to suit your own personal circumstances. The restrictions and rules applying when benefits have commenced do not apply to segments for which benefits have not commenced.

Payment of Benefits (cont…)

Pension Flexible Drawdown

Under Flexible Drawdown there's no limit on the amount of income that can be drawn each year – it may be possible to take the entire fund in one go if you wish!

To be able to do this you must meet the Minimum Income Requirement (MIR), a Government safety net so you can't spend it all and fall back onto State Benefits.

To meet the MIR an individual must have a secure pension income of at least £20,000 (either in their own right or as a dependent) in payment in the tax year they opt for Flexible Drawdown, which can come from a combination of:

- State pensions
- Lifetime annuities (although for With Profits or Unit Linked annuities only the guaranteed minimum amount can be counted)
- Scheme pensions (only as secured by annuities unless at least 20 members receiving Scheme Pension)
- Top up payments from the Financial Assistance Scheme, and
- Secure pensions from Overseas Pension Schemes

Death before Pension Date

In the event of death before pension date the full value of the fund (subject to the restriction below and reaching age 75) can be paid to your nominated beneficiaries.

The benefits on death are normally written under discretionary trust and therefore any lump sum payments should not be subject to Inheritance Tax (IHT). Specialist advice will need to be taken with regard to your own individual circumstances.

A spouse or dependent entitled to a pension may elect to continue to take Income Drawdown rather than purchase an annuity.

In the event of the death of a spouse or dependent during Income Drawdown, the whole value of the fund can be paid to nominated beneficiaries, minus a one off 55% tax charge.

Payment of Benefits (cont…)

Death after Pension Date

In the event of death after pension date and after an annuity has been purchased, the benefits payable will be determined by the terms of the annuity contract.

If death occurs during Income Drawdown then the value of the fund may be paid to your spouse, dependent or your nominated beneficiaries net of a 55% tax charge.

If a spouse or dependent elects Income Drawdown we will calculate the revised maximum limit at the date of death based on the spouse's or dependent's fund value and annuity rates provided by the Government Actuary's Department for the spouse or dependent.

In the event of the death of the spouse or dependent during Income Drawdown the value of the fund can be paid to nominated beneficiaries subject to the 55% tax charge.

Under phased drawdown the segment of the fund not drawn is not subject to tax on death before age 75. After age 75 the 55% tax charge applies.

Establishment and Ongoing Administration of a SIPP

We offer a full range of bespoke services to establish and operate your SIPP and our sister company, jch investment management limited (www.jchim.co.uk) can provide specialist financial planning and investment advice.

Notes

Please note that legislation regarding taxation could be subject to changes that cannot be foreseen.

This guide is based on our interpretation of legislation and HMRC practice, which may be subject to change at any time. Every care has been taken to ensure accuracy but it must be appreciated that neither the Company nor its Representatives can accept responsibility for errors or omissions.

The guide is provided for information purposes only and does not constitute a recommendation, implied or otherwise. You are strongly recommended to take professional advice on any transfer to or from a SIPP.

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