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SIPPs 2014

Feeding growth

Will SIPPs flourish in the post-Budget environment?

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Beyond the headlines

Nigel Bennett considers the implications for SIPPs from the 2014 Budget and how clients can make the most of the changes

On 19 March 2014, the Chancellor George Osborne announced proposals for major pension reform - the most radical change since A-day. It is worth looking at the potential implications for SIPPs and highlighting some of the planning opportunities that arise.

The headlines

- From April 2015, it will be possible for members of money purchase pension schemes on reaching age 55 to withdraw their entire pension fund as a lump sum.

- These changes require amendment to primary legislation but in the interim, from 27 March 2014, certain limits have been increased: the triviality limit has increased to £30,000; the minimum income requirement for flexible drawdown has reduced to £12,000; and capped drawdown limits increased by a quarter from 120% to 150%. This means that for some, increased access is already here.

- There is a consultation period under way in respect of other aspects, the results are likely to be made public in September. Included within the consultation is how the "guidance guarantee" can be delivered (the Chancellor promised that everyone retiring with a pension pot would be able to receive free face-to-face guidance on their retirement options - although he accidentally used the word "advice" which has caused a stir) and whether the tax rate for lump sums paid on death should be reduced from the current rate of 55%.

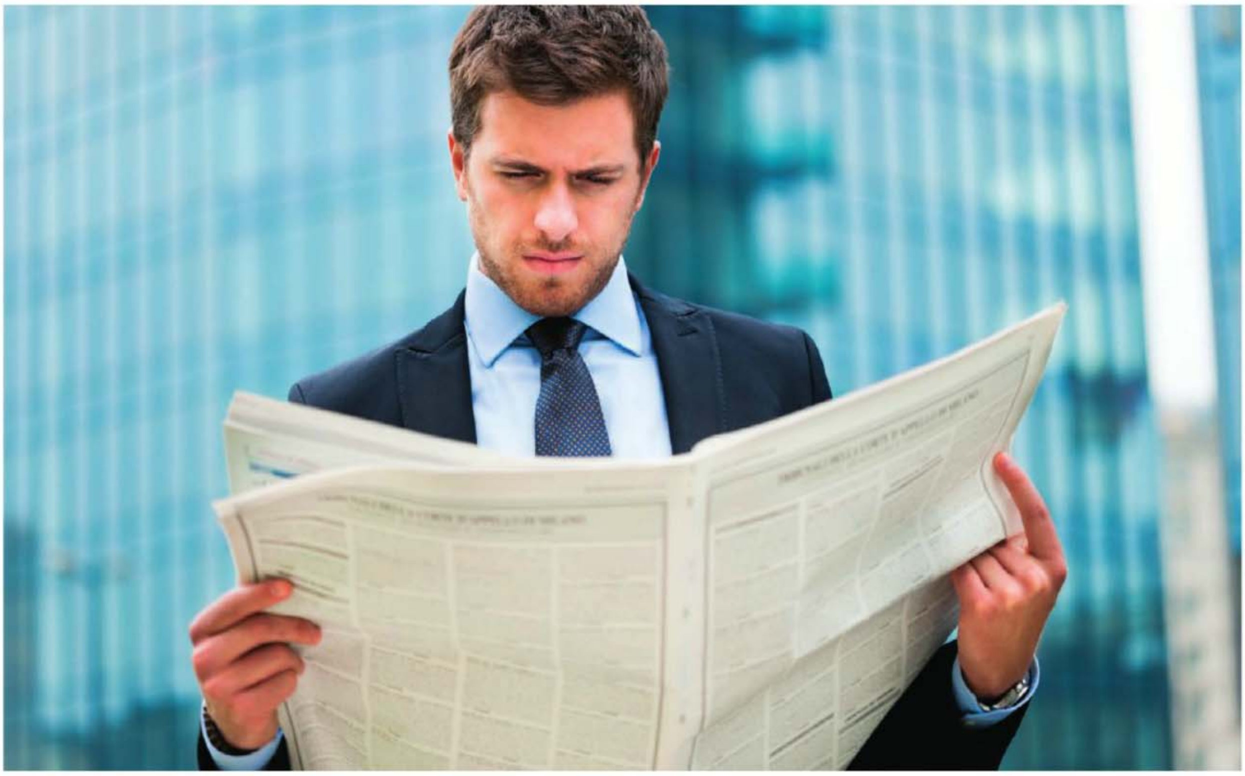
Our view as a SIPP provider

The changes outlined are a mixture of interim measures and proposals for what might happen next year. Initially, our view was that the proposals for income flexibility were probably "too good" and that they would be significantly reined back in when the final rules are published. However, the proposals have received such positive reaction and cross-party support that it now seems likely that the core elements of the proposals will survive into the final rules. There is no doubt that there will be some refinement to the proposals, if nothing else to shut down some of the newly created loopholes.

We are mindful that with such universally positive changes, the Chancellor could take the opportunity to release some less positive news in the run up to next April - we will not be surprised if we were to learn that higher and upper rate tax relief on pension contributions was to be reviewed. Watch this space.

Short-term SIPP investor

Since the Budget, we have seen an increase in enquiries for new SIPPs to "park" funds for a year or so, at least until April 2015. There are numerous deposit accounts that are available to SIPP investors, including fixed rates, and whilst returns reflect the current low interest rate environment, they usually beat insurance company cash deposit funds.



SIPPs and the Budget

We are not advocating long-term cash investment, but for individuals looking for security in the short-term then it can be a useful option. If a customer is looking for higher cash investment returns than those available from an insurance company, then a fixed price SIPP presents an interesting alternative.

SIPPs used to purchase physical commercial property

With average property values being considerably higher than average pension fund values, we find that many SIPPs are established as groups with two or more members collaborating to jointly purchase a property with the combined pension funds. This is an attractive option, but it can have its potential downsides when it comes to drawing benefits at retirement, for example, when one of the parties wants to retire before the property is sold.

The Budget proposals are a potential game changer as funds will be so much more accessible at retirement, allowing some or all of the property to be paid as an in-specie benefit, in lieu of cash (although income tax will still have to be paid to HMRC at the appropriate amount under PAYE). Should the review of lump sum death benefits result in a reduction in the 55% tax rate that can apply, then this will also provide an important boost to owning property via SIPP.

Commercial property purchase is one of the most exciting areas of pensions - particularly for the business owner that wishes to purchase a property via their SIPP and lease it to their own business. Even before the Budget, we had seen a significant increase in interest in new property enquiries.

Anyone considering a SIPP property purchase should use a specialist company with the expertise to handle the transactions efficiently and personally - after all, this is a complex transaction and the investment will often be held for a number of years - getting the choice of provider right is vitally important. We've seen some providers struggle to maintain their customer service in this area and we're happy to help those wanting to move providers or to make new purchases.

Retiring in the next year?

For anyone considering their options today, we think that they need to get good quality financial advice. We anticipate an increase in transfers to our SIPPs, particularly where existing pension schemes do not offer what the customer requires.

We were in the first group of providers to implement the interim changes to all our products on 27 March 2014 and we are committed to offer the future flexibility that the new rules are anticipated to allow.

Unintended consequences - tax reliefs

The new interim rules present an interesting scenario for anyone aged over 60 that may

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be eligible to use either the Triviality or Small Pots rules to pay a contribution and then withdraw the funds soon after. Here's an example, and this only works for someone that has sufficient "relevant UK earnings" to support tax relief on the contribution.

John, aged 61, is employed and has a salary of £30,000. He has never been a member of a pension scheme. On 1 May 2014, he makes a personal contribution of £24,000 and the SIPP provider claims basic rate tax relief for him of £6,000 which will be credited to his SIPP account a few weeks later. Then, after the tax relief is received by the SIPP, he crystallises his pension fund using the triviality rules, and receives payment as follows:

Tax free lump sum (25% of fund)	£7,500
Net income (£22,500 less 20% income tax)	£18,000
Total	£25,500

So, in other words, this has cost him £24,000 net and he receives £25,500 back. However, it's not quite that straightforward because he would be paying SIPP fees and he would have had to wait a period for the tax relief to be credited to the scheme.

This illustrates the unintended consequences of the new interim rules, and makes us think that this will be changed very shortly. In the example, it is important that the overall amount of his pension funds do not exceed £30,000, he is aged over 60 and has not previously used the triviality rule.

So is the Chancellor being generous?

Since 2001 the cost to the exchequer of pensions tax relief has doubled, yet in the same period the tax received from pension incomes has not kept pace, to the extent that pension tax relief now costs around three times the amount of tax collected from pensions in payment.

The baby boomer generation are now at or approaching retirement age and by increasing the amount of income that can be withdrawn the Government is likely to see a big increase in tax receipts. The press quickly picked up on this "tax grab" aspect to the Budget proposals with the Budget notes revealing estimated additional tax receipts of £3bn over the next five years. Ultimately it will be the choice of the individual - nobody will force anyone to take the maximum level of income and indeed for many that may not be the best course of action. The requirement for independent financial advice will be as relevant in the new regime as it is today.

The long-term

Since the Budget, pensions are back on the agenda - attracting lots of media coverage - but what is different this time is that pensions are being talked about in very positive terms and so, politics aside, George Osborne appears to have pulled a retirement rabbit out of the hat.

We are certainly of the view that pensions will be perceived to be far more attractive in future. Investors will be more content to make contributions for the long-term knowing that the end results will not necessarily be a relatively small and inflexible income in the form of an annuity. Although the proposals do increase choice and flexibility, annuities will remain the most appropriate option for some people.

Pension savings are likely to increase providing additional capital to be invested in stocks and shares, as well as commercial property. This will help grow the economy, and, at the same time, larger pension withdrawals will boost income tax receipts.

Although fewer people will opt for annuities, we think that it will be common for individuals to elect to withdraw their fund over a number of years rather than all at once. We've already seen this with flexible drawdown introduced in April 2011. Of the flexible drawdown SIPP cases we have arranged, only 25% have been fully withdrawn - the remaining 75% remain invested and we believe this will be reflected in the future experience of post-April 2015 pensions.

We are not sure what the outcome of the guidance guarantee consultation will be - but our opinion is that this will be a job best done by financial advisers rather than providers. The Government suggestion is that the pension scheme providers/trustees will be responsible for delivering this on a no cost face-to-face basis. We anticipate that after consultation it may well end up being done by the Money Advice Service, or a similar not-for-profit body.

Whatever the outcome, guidance is not advice, and this will mean that many individuals will need to seek the help of a good financial adviser - arguably many more than do at present as good guidance will usually highlight a need for good advice.

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