

## NO HERITABILITY AFTER 75, BUT COUNT YOUR PENSION BLESSINGS

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Despite much industry representation for reprieve, the Treasury confirmed in the Budget that it will not allow pension fund heritability after age 75. This has been achieved by levying a 70% tax charge plus inheritance tax of up to 40% on funds passed on after age 75 (other than to charity, which is tax free). While this is less than good news, we encourage clients to think back to before 6 April 2006 when the only option for pensions, on reaching age 75, was to buy an annuity. At least now the remaining fund on death can be left to a charity without being subject to inheritance tax. For some, this will be helpful and makes an Alternatively Secured Pension (“ASP”) a viable alternative to annuity purchase.

We must also focus on the substantial tax relief that is provided, the tax free growth available and the tax free cash lump sum facility which survived the Budget – the very reasons why pensions are less flexible than other forms of saving. The effect for higher rate taxpayers is that each £1 used to provide an income has only cost 47p. Compared to leaving 47p in the bank or building society, over time contributing to pensions remains a highly attractive investment for part of an individual’s overall net worth. This is especially the case given that a fund is generally needed to provide an income in retirement and, if guaranteed in the form of an annuity, the income can provide flexibility for gifting non-pension assets.

## KEEPING IT IN THE FAMILY

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When considering estate planning, it is important to pass on both wisdom and assets as, without the former, the latter may do more harm than good. We find discussions on the subject of inheritances and gifts between parents and their children can be left too late and proper planning should often be started sooner. Complications can arise, for example, when a family home is left to more than one child with no plans in place for how the inheritance should be shared.

At Saunderson House we recognise the importance of educating younger family members and preparing them for the receipt of assets, be it from gifts or from the death of relatives. We are always delighted to help families plan for the future and to establish relationships with family members of all ages by facilitating a meeting or “family conference”.

**This note represents our understanding of law and HM Revenue & Customs practice as at 18 July 2007.**

## TO DRAW OR NOT TO DRAW...

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Given that the treatment of death benefits for pensions is now reasonably settled and the ability to draw 25% tax free cash remains, the question on the minds of many clients who are under 75 and have significant surplus assets, is whether or not pension fund benefits should be drawn, especially when the income is not needed. Before examining the question, it is important to point out that, firstly, there is no right or wrong answer and, secondly, the strategy is likely to depend ultimately on your long term gifting strategy (whether to children, charity or other).

There are 3 scenarios to consider: two before age 75, i.e. whether the pension is deferred (unvested, scenario 1) or whether it is taken (vested, scenario 2); and that after age 75 (scenario 3), where remaining unvested is not an option. The two main considerations of choosing scenario 1 are that on death there is (currently) no inheritance tax to pay and growth in the pension fund is tax free. Choosing scenario 1 is only an option if you do not need the capital or income, but the question to draw or not to draw remains. Is it more efficient to extract capital (tax free) and income (taxable) from the pension while you can, or is it better for it to compound up on a largely gross basis?

One reason for moving from scenario 1 to scenario 2, when the income or capital is not required, would be to increase gifting during one’s lifetime. Drawing the tax free cash and income provides the opportunity to increase gifting of both capital and surplus income as part of an overall estate planning strategy. It also serves to minimise the amount that would, on or after age 75, have to be passed to an insurance company in the form of an annuity purchase or to a charity on eventual death after 75 (these being the two options in scenario 3).

**There are many factors that need to be taken into account and expert guidance is essential in arriving at a solution appropriate to your circumstances and objectives.**

**We would be pleased to advise as necessary, therefore please contact your usual adviser at Saunderson House or Nick Fletcher, Managing Director, on 0207 315 6504 (direct) or at [nick.fletcher@saunderson-house.co.uk](mailto:nick.fletcher@saunderson-house.co.uk), who will either help you personally or guide you to the appropriate adviser.**

## INSTANT ACCESS CASH RETURNS OF 6.80% UP TO 8.50% PER ANNUM

If you are a long term holder of cash and require instant access, the following may be of interest. It is rare that we include details of a specific product in Pointers, but here is one which we believe merits your attention.

For many people, cash is and should be a very important part of their overall asset allocation and net worth, representing the safer side of the portfolio. Its attractions include preservation of capital and liquidity, both of which are appropriate for a proportion of one's net worth. Cash is generally not tax efficient, however, and this, together with the low real yields available, can make it unappealing. For example, higher rate taxpayers earning the base rate of 5.75% p.a. on a deposit receive just 3.45% p.a. after tax and virtually zero after inflation at current rates.

By using a certain insurance company who have specialised in 'cash plus' products for many years, it is possible to substantially enhance returns on cash. The products can be thought of as instant access with a loyalty bonus after 7½ years (all rates as at 5 July 2007). If held for the long term, it is currently possible to achieve a gross equivalent return of up to 8.50% p.a., which equates to 5.10% p.a. net of 40% tax – an uplift of nearly 50% on the base rate described above. If the cash is being held for the shorter term, higher rate tax payers can achieve a gross equivalent rate of up to 6.80% p.a.

These returns are achieved by investing through qualifying and non qualifying insurance policies in a money market cash fund held with an AA credit rated insurer. We largely avoid insurance company products due to their significant entry and/or exit charges, but in this case there are none.

The highest rates are achieved by investing for more than 7½ years, after which the accumulated fund can be protected from higher rates of tax for as long as the qualifying policy rules continue. The rates are variable and fluctuate with market rates, but are likely to be consistently higher than bank and building society rates. This is due to a combination of the qualifying status of the life policies used, the more favourable rate of insurance company taxation in the US and the high level of cash under management.

## WHAT DO YOU WANT TO LEAVE TO WHOM AND WHEN?

Given the certainty of death and taxes (as Benjamin Franklin once said), deciding what happens to your assets when you die is a big question in many people's minds. It is a responsibility which most people with substantial assets take very seriously and on which our guidance is often sought.

To us, there are three questions which must be answered in adopting an estate planning strategy: **what** do you want to leave **to whom** and **when**? The 'what' could be the whole estate or perhaps the family home; 'to whom' could be children or charity or a combination and the 'when' could be during your lifetime or on death.

As a first step, clients should ensure that they have wills which reflect their current wishes and, where appropriate, appoint a sufficient amount of capital to bypass the spouse, either directly or to a trust, to utilise the nil rate band of inheritance tax (currently £300,000). Trusts may be used where control over the assets is to be retained (e.g. for minors), but they are less tax efficient than they once were and professional advice should be sought in this area.

We work together with your solicitor and can provide a referral if appropriate to ensure that your financial and legal objectives are aligned.

## BLUE CHIPS - THE MAIN COURSE ON THE EQUITIES MENU

Small and mid cap. stocks in the UK have strongly outperformed in the last 4 years and are now looking expensive relative to large cap. stocks. We have therefore been recommending, where appropriate, that clients shift the weighting of their UK equities towards larger companies in search of greater value.

**For specific advice on your own portfolio, please contact your usual adviser at Saunderson House or Nick Fletcher, Managing Director, on 0207 315 6504 (direct) or at [nick.fletcher@saunderson-house.co.uk](mailto:nick.fletcher@saunderson-house.co.uk), who will either help you personally or guide you to the appropriate adviser.**

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It is important to note that the value of many investments and the income derived can fall as well as rise. Few investments are guaranteed and you may not get back the amount you originally invested. Past performance is not a guide to the future. All taxation is based on our current understanding of the law, which may change in the future from time to time. For Unsecured or Alternatively Secured Pension policies you should note the following: High income withdrawals may not be sustainable during the (annuity) deferral period. Taking withdrawals may erode the capital value of the fund, especially if investment returns are poor and a high level of income is being taken. This could result in a lower income if and when an annuity is eventually purchased. Annuity rates may be at a worse level if and when the annuity purchase takes place than are available now or indicated in any illustration. A certain investment return is required simply to "keep pace" with an annuity, because an unsecured pension withdrawal fund does not receive a benefit from the early death of other pensioners, as does an annuity. This lack of subsidy possibly requires a return of 1-2% per annum above that which could be obtained from the medium-long dated gilt investments on which annuity rates are based. This effect is known as mortality drag. Even if investment returns are strong, there is a possibility of the future income reducing if there is a significant decline in the factors affecting the GAD rate. These factors are the yield on medium-long dated gilts and mortality rates. If the purpose of the unsecured or alternatively secured pension is to "beat the annuity rate" (attempt to purchase an annuity when rates are higher whilst also maintaining the overall level of income that could have been provided through annuity purchase), investment in (more risky) equities is necessary in order to simply overcome the effect of mortality drag; City forecasts are for equities to outperform gilt investments by only 2-3% per annum over the next few years, so the chances of "beating the annuity rate" are remote if this forecast is correct. If an annuity has not been purchased by age 75, the maximum income from an Alternatively Secured Pension after age 75 is significantly less than the maximum that applied before age 75 under an Unsecured Pension.