Winter2004

Pointers

Unused RAP Relief - A Hidden Asset?

The new pension legislation, which takes effect on 6 April 2006 (A-day), makes it particularly important to consider utilising all of your unused RAP relief immediately for, inter alia, the following reasons:

- If no pension contributions are made after A-day, you can opt for 'enhanced protection', which exempts you from the 25% tax recovery charge.
- A net investment of 47p is required to create £1 of capital from which to produce an income via a pension fund (see overleaf).
- You can make a pension contribution without taking any investment risk (pension funds can be held in cash).

If you are unable to fund a contribution from income or savings, some borrowing against other assets could be considered though only at the appropriate level:

- Interest on cash investments within a pension is not taxed. Assuming an interest rate of 4.5% p.a. on a gross contribution of £100,000, the gross interest would be £4,500 p.a.
- Tax relief of £40,000 is available on the £100,000 gross contribution. Assuming a loan rate of 5.75% p.a. (1.0% above the Bank of England base rate), the annual cost of financing the contribution is: £60,000 x 5.75% = £3,450.

The annual profit from borrowing is therefore £1,050. Those over 50 may also consider taking benefits to fund a contribution.

Post A-day Lifetime and Annual Pension Contribution Allowances

The Finance Act 2004 set the following limits for the lifetime allowance and the maximum permitted annual pension contribution, which will take effect from A-day and be reviewed quinquennially:

Fiscal Year	Lifetime Allowance	Contribution Allowance
2006/07	£1.50 m	£215,000
2007/08	£1.60 m	£225,000
2008/09	£1.65 m	£235,000
2009/10	£1.75 m	£245,000
2010/11	£1.80 m	£255,000

It will be possible to contribute the lower of 100% of earnings or the above contribution allowance in any fiscal year, though it will remain that up to £3,600 p.a. can be contributed without reference to earnings. The ability to carry back personal pension contributions will be removed, as will the carry back/carry forward facility under RAPs.

Standard Life Terminal Bonuses

Standard Life with profits policies often have non-guaranteed terminal bonuses which can account for up to circa 30% of the current policy value. Terminal bonuses have been cut several times since September 2002 and we anticipate further cuts. It may be more profitable to transfer out of the with profits fund now to crystallise terminal bonuses (which may be removed completely by 2006) rather than wait for any demutualisation benefit. This is particularly the case if overall exposure to Standard Life is abnormally high.

With Profits - Exit Where Possible

Many with profits funds continue to be subject to market value reductions (MVRs). Though the FTSE-100 rose circa 18% during 2003, annual with profits bonus rates declared for 2003 were generally below 4.5%.

Most insurance companies are using the majority of investment returns to replenish their with profits fund reserves, which were heavily depleted during the bear market which ended in March 2003. If MVRs are reduced or removed and bonus rates do not recover, it seems probable that substantial sums will be withdrawn from with profits funds. As with profits funds are a significant source of revenue, commercial considerations indicate that MVRs will persist. Liabilities for endowment mis-selling may adversely affect with profits funds too, though the magnitude of these liabilities is not entirely clear. For example, Standard Life has estimated that its potential liability is £1.5 billion.

With profits investments are generally unattractive: future bonus rates are likely to remain low, MVRs can be increased at the discretion of providers, charges are opaque and investors have no control over asset allocation. Some policies include guaranteed benefits, the value of which should be properly understood. Policyholders should review their with profits investments and take advantage of favourable exit options.

Life Cover - Are You Adequately Protected?

Many people have inadequate life cover. It is worth considering what capital and income your net assets could provide and use life cover to make up any shortfall, taking into account inflation. For example, an interest rate of 5% p.a. would produce gross annual income of £50,000 from £1 million of capital which, after tax, would equate to net income of £38,560 (assuming no other income).

Different policy types may be combined to solve needs economically. For example, term assurance is a low cost solution and can be used to cover school fees liabilities, mortgages or provide income while your children are dependent. Family income benefit is a type of term assurance suited to protecting income needs (e.g. a policy covering £50,000 p.a. for 20 years on which a claim is made five years from inception would pay out £50,000 p.a. for 15 years).

Inheritance tax liabilities, with the exception of potentially exempt transfers, cannot normally be covered effectively using term assurance policies. For a married couple, a joint whole of life policy on a second death basis is generally the most suitable. The sum assured should take into account the two nil rate bands which can be utilised if properly written wills are in place or by prior gifting up to the band limit (currently £263,000).

Saunderson House can provide advice on protection and estate planning. We often work with private client solicitors and accountants on estate planning for their clients and would be pleased to discuss any requirements.

Pension Term Assurance and the Lifetime Allowance

Under the new pension legislation that will take effect from 6 April 2006, pension term assurance policies will not be included in the calculation of pension fund values for the purposes of the lifetime allowance. Pension term assurance premiums paid after A-day will not invalidate enhanced protection. There is therefore no need for those who apply for enhanced protection (to avoid being affected by the tax recovery charge) to replace these policies.

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SAUNDERSON

Reply Slip

Name (in block capitals): ....

Firm: ....Email Address: ....

Telephone (Work): .... Telephone (Home): ....

Please contact me to discuss:

- ☐ Unused RAP Relief
- ☐ Life Cover
- ☐ With Profits
- ☐ Standard Life
- ☐ A-day Strategy
- ☐ Other (please specify): ____________________

WHERE IN THE WORLD CAN YOU GET A CAPITAL FUND FROM WHICH TO PRODUCE INCOME FOR LESS THAN HALF PRICE?

Pension Contribution of £100,000 Taking Immediate Benefits

	£		£
Gross Premium	100,000	Fund Value	100,000
Less Tax Relief at 40%	40,000	Less Tax Free Cash (25%)	25,000
Net Contribution	60,000	Fund for Annuity	75,000

Cost of Investment

Net Contribution	60,000
Less Tax Free Cash	25,000
Net Cost	35,000

Net Cost 35,000 → **47p in the £1**

THE ANSWER IS: FROM A PENSION FUND!

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