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Self Invested Personal Pension (SIPP)

Fact Sheet

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Self Invested Personal Pensions

1. What is a SIPP?

A Self Invested Personal Pension (SIPP) is a regulated Registered Pension Scheme that allows the member a far broader range of investments compared to a traditional personal pension.

A SIPP enables the scheme member and trustees – rather than an insurance company – to retain control over the investment selection process for their retirement savings. The SIPP is tax-exempt and therefore investment returns (except the dividends from UK Equities) and realised capital gains will not be subject to tax within the scheme.

The SIPP can accept transfers from other types of registered pension schemes, including Protected Rights. If a SIPP member wishes to use their SIPP in this way they do not have to make any further contributions unless they and/or their employer wish to do so. Having their pension funds under one "umbrella" may mean that they can take advantage of the wide-ranging investment opportunities afforded to the SIPP.

The SIPP member may either choose to make the investment decisions themselves, or appoint an investment manager or adviser of their choice.

In some circumstances assets may be transferred into the SIPP "in specie". This means that, for example, quoted stocks and shares, commercial property, Trustee Investment Plans and Insured pension arrangements could be transferred to the SIPP without the need to realise the asset. This would avoid surrender costs and the cost of reinvestment under the SIPP.

The SIPP will be able to provide benefits such as a tax-free Pension Commencement Lump Sum (PCLS) and an income from the age of 55 without the member having to retire or having to buy an annuity from an insurance company.

The SIPP member can plan their retirement benefits around their personal circumstances, as under the SSAS they do not have to take all of their benefits at the same time; they can choose "phased retirement" (see section 5).

Talbot & Muir will:

- Provide guidance on whether a proposed investment falls within the range of investments permitted by HM Revenue and Customs (HMRC).
- Open a pension scheme bank account for the SIPP.
- Assist with any transfers to the SIPP on the member's behalf (but we will not provide advice as to the suitability of such transfers).
- Provide full documentation and comprehensive technical support.
- Calculate and pay the member's retirement benefits and provide them with guidance as to their options.

2. Investments

HMRC regulations allow registered pension schemes to invest in a wide range of assets including:

- Securities listed on any stock exchange, including the Alternative Investment Market (AIM)
- Fixed interest securities
- Unlisted securities
- Loan notes
- UK Government Treasury gilts
- Bank deposit accounts
- Offshore deposit accounts
- Investment Trust shares listed on any stock exchange
- Exchange Traded Funds (ETFs)
- Authorised unit trusts
- Open Ended Investment Companies (OEICs)
- Real Estate Investment Trusts (REITs)
- Trustee Investment Plans (TIPs)
- Insurance company funds
- Commercial property
- Overseas commercial property
- Warrants
- Futures, options and derivatives
- Contracts For Difference (CFDs)
- Venture Capital Trusts (VCTs)
- Enterprise Investment Schemes (EIS)
- National Savings & Investments (NS&I) products
- Loans to unconnected third parties
- Intellectual property

It should be noted this list is not exhaustive, and if requested we can provide further guidance on whether a specific investment is allowable.

When assessing investment opportunities, it is important that members are mindful of the taxable property provisions, and whether the investment they are seeking to make will result in the scheme having a direct or indirect holding in taxable property. The consequences of making such an investment are severe not only for the members but also for the scheme administrator. Therefore, we would strongly advise members to contact us when considering what could be deemed a more esoteric investment.

The taxable property provisions and subsequent charges have resulted in many providers applying their own restrictions on what HMRC consider to be permitted investments. In many cases, such restrictions could be considered onerous, effectively negating the increased investment scope offered by the pensions legislation, and ultimately restricting individuals from achieving their investment objectives. Our approach is to look at each investment within the broad context of the pensions legislation. If the investment can be undertaken without detriment to the scheme member and us as co-trustee, we will do our utmost to accommodate it. However, we will at no point enter into an investment where we feel that the client will incur a tax penalty.

3. Lifetime Allowance

The Lifetime Allowance (LTA) was introduced on 6th April 2006 ("A Day"), and limits the amount that an individual can accumulate in all of their pension schemes. The LTA for 2011/12 is £1.8 million, however the government has announced that on 6th April 2012 it will be reduced to £1.5 million.

The LTA is an aggregate limit which applies to the total amount of pension savings built up over the whole period of an individual's life, including those in payment.

The value of pension savings will be tested against the limit in force at the point any benefits are taken, called a Benefit Crystallisation Event (BCE). If the amount falls within the limit, taking into account any benefits that have already been taken from any pension savings, the benefits can be paid out without a "recovery" tax charge being levied.

If the LTA is exceeded when benefits are taken, any excess funds will be subject to a recovery tax charge before benefits can be paid out. If the benefits from the excess funds are to be paid as a pension, the excess will incur a 25% tax charge and the reduced excess fund will be used to provide a pension that will be taxable as income. If the excess is taken as a lump sum, it will be subject to a tax charge of 55%.

Any uncrystallised or unsecured pension funds will also be tested against the LTA once the member reaches the age of 75. Unsecured pension funds are tested to measure the growth in the fund value since they were originally crystallised. Secured pension funds (i.e. where an annuity or scheme pension has been purchased) are not tested against the LTA at age 75.

To protect accumulated pension funds at the point the LTA was introduced, and also once the LTA is reduced to £1.5 million in 2012, various types of protection are available:

Primary Protection: Available to those who had pension benefits valued in excess of the LTA of £1.5million at A Day. It attributed qualifying individuals with a Primary Protection factor, measuring the extent to which their pension benefits exceeded the LTA at A Day. When benefits are drawn from their pension the value of their fund will be tested against the Standard Lifetime Allowance, increased by their Primary Protection factor. Individuals crystallising their pension funds from 6th April 2012 will continue to have their Primary Protection factor applied to an LTA of £1.8 million, rather than the reduced LTA of £1.5 million. As long as benefits crystallised are within an individual's personal Lifetime Allowance no tax charges will be incurred.

Enhanced Protection: Available to anyone, regardless of the size of their pension benefits at A Day. No recovery tax charge will apply, regardless of the value of their pension rights when crystallised. However, no further pension accrual is allowed from 6th April 2006 and no further contributions can be paid. If further pension contributions are made, Enhanced Protection will be lost, and if the fund value at retirement exceeds the LTA, the appropriate recovery charge will be made on the excess when the benefits are vested.

Individuals had to apply for Primary or Enhanced protection before 6th April 2009.

Fixed Protection: Introduced to protect pension benefits from the reduction in the LTA to £1.5 million on 6th April 2012. Anyone can apply for Fixed Protection, regardless of the value of their pension rights, provided they do not already have Primary or Enhanced protection. Pension benefits up to a value of £1.8 million will be protected from a recovery tax charge, but no further benefit accrual or pension contributions are permitted from 6th April 2012.

Applications for Fixed Protection must be made before 6th April 2012.

4. Contributions and the Annual Allowance

The Annual Allowance limits the amount by which an individual's pension savings can increase in each pension input period. In 2011/12 the annual allowance is £50,000.

Any contributions made to an individual's pension schemes that exceed their available allowance will incur an annual allowance tax charge set at their highest marginal rate of income tax.

It is important to be aware of the distinction between an allowable contribution and a tax relievable contribution. A contribution is allowable if it is within an individual's available annual allowance; the criteria by which a contribution is deemed tax relievable depend on the type of contribution:

- A personal/employee contribution is tax relievable if it is within the higher of £3,600 or 100% of the individual's relevant UK earnings in the tax year of the contribution.
- A company/employer contribution is tax relievable if it is deemed by HMRC to be "wholly and exclusively for the purposes of trade".

Only tax relievable contributions are tested against the annual allowance. Contributions made by an individual aged 75 or over are not tax relievable, and are therefore not tested.

What are Relevant UK Earnings?

- Employment income such as salary, wages, bonus, overtime and commission providing it is chargeable to tax under Section 7(2) ITEPA 2003.
- Income chargeable under Part 2 ITTOIA 2005 i.e. income derived from the carrying on or exercise of a trade, profession or vocation (whether individually or as a partner acting personally in a partnership).
- Income arising from patent rights and treated as earned income under section 833 (5B) ICTA 1988.
- General earnings from an overseas Crown employment which are subject to tax in accordance with section 28 of ITEPA 2003.

Pension Input Periods

The annual allowance does not simply apply to all pension contributions made in a certain tax year e.g. the total pension input amount for the 2011/12 tax year is not the total of contributions made between 6th April 2011 and 5th April 2012. Instead the level of contributions to be tested against the annual allowance is the total of all contributions made to pension schemes with a Pension Input Period (PIP) ending in a given tax year.

The first PIP for a pension scheme starts on the date that the first contribution is made to that scheme, and normally ends at the end of that tax year i.e. on 5th April. For example, if someone joins a pension scheme on 10th April 2011, and makes their first pension contribution on 1st May 2011, the first PIP starts on 1st May 2011 and ends on 5th April 2012. The next PIP starts on 6th April 2012 and ends on 5th April 2013, and thereafter subsequent PIPs will end on 5th April each year.

It is possible, however, for the scheme member or the scheme administrator to nominate to alter the end of a scheme's PIP. In the example above, the member could decide to end the first PIP of the pension scheme on 31st December 2011. The next PIP would begin on 1st January 2012 and end on 31st December 2012, and so on. The scheme member can nominate to change their PIP whenever they like, provided that no PIP lasts longer than twelve months, and the nomination is made in advance of the end of the PIP in question e.g. a nomination cannot be made to alter a PIP that ends on 5th April 2012 on or after that date.

Changing the input period in this way can affect which tax year's annual allowance an individual's contributions are tested against, and could mean that in any given tax year they could make contributions in excess of the annual allowance without incurring a penalty from HMRC.

In determining how much of the annual allowance someone has used, or still has available to them, they must add together all of the pension contributions they have made to pension schemes with a PIP ending in the tax year in question.

Carrying forward unused annual allowance

An individual can carry forward their unused annual allowance from up to three previous tax years, based on an allowance of £50,000 having applied during each of those years. An individual can carry forward their allowance from previous years provided:

- They were a member of any registered pension scheme in that year i.e. they do not have to have been an active member of any scheme, and they do not have to have been a member of the scheme to which they wish to contribute.
- The allowance of £50,000 has not been used up in any subsequent year.

For example, if an individual has been a member of a registered pension scheme for the last three tax years without having made any contributions, in an input period ending in 2011/12 they can personally contribute up to £200,000 without penalty (although whether tax relief is available depends on earnings, as above).

Note that whereas large pension contributions in an intervening year can reduce the amount carried forward from a previous tax year to the current tax year, this does not apply if the intervening year(s) is 2009/10 or 2010/11.

5. Taking Benefits

Benefits may be taken from a private pension from the Normal Minimum Pension Age (NMPA) of 55. When taking retirement benefits there are several choices as to the form in which pension payments are made. The main options are:

- Lifetime/Open Annuity
- Scheme Pension
- Capped/Flexible Drawdown Pension
- Phased Retirement

Each time an individual elects to take the benefits from (crystallise) one of their pension plans this is treated as a Benefit Crystallisation Event and will be checked against the Lifetime Allowance (LTA) at that time. Exceeding the LTA at a Benefit Crystallisation Event can lead to a tax charge deducted from the pension benefits.

Lifetime Annuity

In simple terms, an annuity is an insurer's promise to pay an income for life – on terms agreed by the purchaser and the insurer – for a set purchase price. An annuity is a secured form of pension income, and there are several types of annuity available.

Adding factors such as a spouse's/dependant's pension or inflationary increases on pensions in payment will reduce the initial income payable.

There are also capital protected annuities, which pay a lump sum on the death of the annuitant. These allow an annuity provider to return the capital used to purchase the annuity less any payments made. Any lump sums returned in this way are taxable at 55%.

Lifetime Annuities have many advantages:

- Annuities are a simple structure. The pension fund is passed to an insurer and in return the insurer provides a guaranteed level of income for the life of the annuitant.
- It is possible to guarantee future pension payments for up to 10 years after commencement to provide some protection of the capital on early death.
- Annuities guarantee the level of retirement income, and therefore eliminate exposure to any direct investment risk during retirement. The investment risk is ordinarily passed to the insurer.
- Upon the annuitant's death, a dependant's annuity can be paid to a surviving dependant for the remainder of their lifetime, although making provision for this will reduce the income payable during the lifetime of the original annuitant.
- A Pension Commencement Lump Sum can be taken at the outset.
- Income from Lifetime Annuities counts towards the Minimum Income Requirement for accessing Flexible Drawdown (see below).

Annuities do have certain disadvantages:

- The structure of the annuity means that once established the terms cannot be changed in any way.
- The income under investment-linked annuities could fluctuate in payment.
- Control of the capital value of the pension is lost, and is passed instead to the annuity provider (although investment-linked annuities do offer some investment control).
- Under many circumstances benefits cannot be passed on to future generations, although capital protected annuities do offer a degree of protection.

- Over recent years, annuity rates have remained at historically low levels but may be even lower in the future. Alternatively, if annuity rates increase after the purchase of an annuity the chance to secure a higher income will have been lost.
- Non-increasing annuities will not offer protection against inflation, reducing the value of the payments over time.

Open Annuities

- This is a relatively new product, which offers the following features:
- Wide investment powers.
- Variable income levels.
- Income level reviewed every five years or annually.
- Convertible to a conventional annuity.
- On death, remaining funds can be left to a nominated charity.

Scheme Pension

Like an annuity, a scheme pension is a secured income, and will be payable from retirement for the remainder of the lifetime of the scheme member. The most common form of scheme pension is that paid under a defined benefit pension scheme (in fact no other form of pension income can be taken from a DB scheme). A scheme pension may also be paid under a money purchase scheme.

A scheme pension is calculated according to a range of actuarial factors: age, gender, health, and attitude to risk can all be factored into the calculation.

A scheme pension must be paid at least annually and, except under very limited circumstances, once the pension has been calculated it must be paid for life. Actuarial reasons – including a reduction in the value of the pension fund – may be used to justify a reduction in the level of pension income, but HMRC will only allow this under certain circumstances.

A scheme pension has the following advantages:

- A Pension Commencement Lump Sum can be taken at the outset.
- A scheme pension can offer a higher level of income than that available under an annuity or a capped drawdown pension.
- The level of payments can be guaranteed for up to 10 years.
- When paid by the pension scheme administrator, investment control over the pension scheme assets can be maintained. Equally, a scheme pension can be paid by an insurance company, and the investment control and investment risk passes to the insurer.
- Benefits used to purchase a scheme pension are not subject to a Lifetime Allowance test at age 75.
- On the death of the member a scheme pension can be used to provide a dependant's pension or annuity, the continuation of guaranteed payments, or a lump sum subject to a 55% tax charge.
- Scheme pensions paid by an insurance company can count towards the Minimum Income Requirement for Flexible Drawdown (see below).

Scheme pensions also have the following disadvantages:

- If the scheme pension is reduced except under circumstances covered by an HMRC exemption any future pension payments are deemed to be unauthorised payments (attracting a minimum 55% tax charge).
- If the scheme pension is reduced below 80% of its original level the pension commencement lump sum paid at the start of the scheme pension may also retrospectively be subject to tax charges.

- Scheme pensions cannot be increased in excess of the growth in RPI, or a further test against the Lifetime Allowance will be triggered.
- The operation of a scheme pension is fairly complex and will require a review at least once a year. The complexity and requirement to review these arrangements regularly means that, from a charges perspective, scheme pensions are more expensive than conventional annuities.

Drawdown Pension

A Drawdown Pension is an unsecured pension arrangement, and offers the opportunity to take the maximum tax-free cash and invest the remaining fund whilst also taking regular withdrawals from the fund if desired. Under a capped drawdown arrangement the maximum level of drawdown income available is calculated with reference to limits set by HM Revenue & Customs. If an individual is entitled to a certain level of secured pension income they can access potentially unlimited income withdrawals under a flexible drawdown arrangement (see below).

Strictly speaking drawdown pensions are not income payments but withdrawals of capital, which may reduce the pension fund. Any income/capital withdrawals received are taxable as earned income under the PAYE system.

Taxation is subject to future legislative change and depends on individual circumstances.

The funds invested need to achieve a sufficient investment return if the level of income withdrawals over time is to keep pace with the total benefits that would have been achieved had an annuity been secured at outset. A portfolio of low risk investments such as bonds and cash is unlikely to generate the returns required to make income drawdown a viable proposition. Exposure to equities is potentially more suitable, but consideration should be given to whether the risk associated with equity-style investment is appropriate for the individual.

The main attractions of drawdown pensions are:

- A Pension Commencement Lump Sum can be taken at the outset.
- The ability to defer locking into annuity benefits whilst drawing income from the pension fund in the meantime. It should be noted, however, that annuity rates could be lower in the future.
- Flexibility to vary income as circumstances require.
- All or any proportion of the fund can be used to provide a drawdown pension. Any funds not utilised can be used later.
- Investment control of the pension fund is maintained, and investment returns on the fund will continue to be largely tax-free.
- The ability to pass on retirement funds to future generations, subject to Inheritance Tax as applicable.
- Benefits for a spouse/dependant do not need to be purchased at the outset, and various options are available to the member's spouse or dependants concerning the way that they receive retirement benefits following the death of the member.

Drawdown pensions do have certain disadvantages:

- Income is not guaranteed, as the fund is subjected to an ongoing investment risk. The value of the funds invested can go down as well as up.
- If investment returns are poor and/or annuity rates fall, the member could receive inferior overall income from a drawdown pensions than if a conventional annuity had been purchased at the outset.
- As annuity rates fluctuate, it is possible they may be worse if the member eventually decides to purchase an annuity.

- The operation of drawdown pensions is fairly complex and will require a review at least once a year. The complexity and requirement to review these arrangements regularly means that, from a charges perspective, drawdown pensions are more expensive than conventional annuities.
- Drawdown pension income does not contribute towards the Minimum Income Requirement.

Capped Drawdown

Under a capped drawdown arrangement the maximum pension withdrawals are calculated at 100% of the age-related income factors produced by the Government Actuary's Department (GAD). The minimum withdrawal is nil. These limits are recalculated every three years before age 75, and every year after age 75. Income can be received monthly, quarterly, or annually, and the frequency of income can be varied as required (up to the GAD maximum allowable).

Flexible Drawdown

Provided an individual is entitled to receive a certain level of secured pension income for life, they can apply for unlimited drawdown pension payments under a flexible drawdown arrangement.

The level of secured income required to access flexible drawdown is called the Minimum Income Requirement (MIR), and is currently set at £20,000 per annum. The MIR will be reviewed by the Treasury at least every five years. The following types of secured income count towards the MIR:

- Payment of a scheme pension or dependant's scheme pension provided by a defined benefits scheme that has 20 or more pensioner members.
- Payment of a scheme pension or dependant's scheme pension provided by a money purchase arrangement that is not paid by the scheme administrator, or that has 20 or more members receiving a scheme pension.
- Payment of a lifetime annuity or dependant's lifetime annuity.
- Payment from an overseas pension scheme which, if it were a relevant UK scheme, would fall into any of the above categories.
- State pension benefits.

Like income under a capped drawdown arrangement, income withdrawals under flexible drawdown are subject to income tax under the PAYE system.

Phased Retirement

This option may be suitable if the maximum tax-free cash payment is not required when benefits are first taken.

Phased retirement works on the basis that the fund is notionally divided between a large number of segments. This allows specific segments to be vested each year to generate the net income required. When benefits are taken from each segment, ordinarily up to 25% of the value of the segment is available as tax-free cash. The remaining 75% is used to provide income in the form of a secured pension, an unsecured pension, or a combination of both (see above).

Phased Retirement needs to be monitored carefully as each tranche of withdrawal represents a Benefit Crystallisation Event and could result in a tax charge if funds exceed the Lifetime Allowance at that time.

Phased Retirement is suitable for individuals who:

- Do not require their full tax-free cash entitlement when benefits are taken.
- Require the ability to vary their income during retirement to suit circumstances.
- Wish to reduce their income tax liability. Using tax-free cash to form part of an individual's annual income can reduce their overall income tax liability.
- Wish to defer the decision of purchasing benefits for a spouse as long as possible. Various options are available to the spouse/dependants following the member's death.
- Would like the potential to pass funds on death to future generations.
- Require control of their pension funds, are prepared to take an active role in their retirement planning, and accept the investment risks associated with Phased Retirement.

6. Death Benefits

On death prior to drawing benefits, and before age 75

- A tax-free lump sum will be available up to the Standard Lifetime Allowance (SLA). Any amount paid as a lump sum over and above the SLA will be subject to a 55% lifetime allowance charge. This tax charge does not apply for members that have Enhanced Protection. For members that have Primary Protection, the indexed value of their funds as at 5th April 2006 will replace the SLA as the member's own lifetime allowance. Any funds over and above this new lifetime allowance will be subject to the above tax charge. For members with Fixed Protection, funds in excess of £1.8 million will be subject to the tax charge.
- Alternatively, a pension may be paid to the member's spouse, civil partner or other dependant. Benefits paid in this way are not subject to a test against the Lifetime Allowance.

On death after drawing benefits, or after age 75

- A lump sum may be paid subject to a tax relief recovery charge of 55%, but inheritance tax free.
- Alternatively, pensions may be paid to any dependants/spouse and will be taxed as income.
- In the case of scheme pensions and annuities, any guaranteed payments may continue until the end of the guarantee period.

A dependant of a member is defined as a child under the age of 23 – or a child that has reached age 23 but is deemed dependent due to physical or mental impairment – and/or any other person deemed financially dependent or mutually financially dependent, or dependent due to physical or mental impairment. A spouse or civil partner is always considered a dependant.

Where the member has more than one dependant the remaining fund can be split between them according to the wishes of the scheme member, and each dependant can choose to receive a lump sum or a dependant's pension, or a combination of both.

Please note that the above summary reflects our understanding of the likely position on death under the current pensions regime. Advice should always be sought before proceeding and decisions should not be made based on the information contained in this document.

7. Establishing a SIPP

Our SIPPs are set up either on a Master Trust or individual trust basis. Each scheme member is a trustee of their own SIPP, and in addition each of our schemes has a professional trustee, TM Trustees Limited.

The Scheme Administrator

Any scheme applying for registration on or after 6th April 2006 must have appointed a person or persons to be responsible for carrying out the duties imposed on the **Scheme Administrator** by HM Revenue & Customs. For our SIPPs the Scheme Administrator will be TM Trustees Limited.

Talbot & Muir

Talbot & Muir is an independent pension administrator established in 2000 to provide pension administration and trustee services to self invested personal pensions. Our prime aim is to ensure an innovative and flexible approach to self investment whilst dispensing with unnecessary bureaucracy. By doing so, we have obtained the reputation of specialists within this market.

If you would like further information or would like to discuss establishing a SSAS, please contact us.

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