

Nearing Age 75 or Avoiding Pension Contributions Because of Annuities? An Update on and a Solution to the Annuity Issue

The Private Member's bill of David Curry MP (Con), which would allow pensioners greater freedom in applying their pension funds to produce income once a modest annuity has been purchased, is likely to fall away during its committee stage. The government is conducting its own review of annuities but legislation to alleviate the problems of poor returns on death, low annuity income, compulsory purchase by age 75 and inflexibility is not expected in this Parliament.

However, the launch of London & Colonial's Open Annuity provides a solution for those approaching age 75 with unvested pension funds in excess of £250,000. Using a segregated cell structure, in the form of a preference share, London & Colonial provide a return of the annuity fund on death. Investment of the annuity fund is not restricted to gilts thus providing the opportunity for better returns.

Inland Revenue acceptance of the contract as an annuity was contingent upon the return on death falling into the policyholder's estate and not being subject to any form of trust. Where there is a surviving spouse and inter-spouse transfers remain exempt from inheritance tax, such payments should be free of tax. This contrasts with the position under an income drawdown policy where if a lump sum is paid following death it is subject to a 35% income tax charge even if the benefit is paid to the surviving spouse.

The Open Annuity may also be attractive to those in corporate pension schemes transferring to a personal pension plan prior to normal retirement date although an income drawdown policy will normally be the most appropriate choice at outset.

Those who have avoided paying pension contributions because of the annuity issue may now wish to consider catching up. The facility to carry forward un-used relief continues for retirement annuity policies (but not personal pension plans). The earliest year for which relief may be claimed in normal circumstances is 1994/95 subject to an appropriate contribution being paid by 5th April 2002 with an election to carry back that contribution to the year 2000/01 made before 31st January 2003.

For further information about the Open Annuity contact David Lovell on 020 7315 6503 or your usual Saunderson House director.

Protection Before Investment

The current level of interest rates raises the question of the adequacy of existing life assurance arrangements where the income from capital of £1 million may only be £25,000 to £30,000 per annum.

For Partners of long standing, with retirement annuity policies (taken out prior to July 1988), the return on death under the pension portfolio will form an increasingly large proportion of the life cover required.

Younger partners subject to the pension capping rules perhaps with a substantial mortgage and/or dependants, such as children where private education is intended, should consider whether they have adequate protection i.e. life insurance and critical illness insurance for capital liabilities, for example mortgages and future education fees.

To rely on protection provided centrally by partnerships alone may be unwise.

Permanent health insurance, commonly provided centrally by partnerships, is designed to provide a long term benefit, which is tax free, in the event of a Schedule D Partner having to step down for medical reasons. Benefits are normally restricted to 50% of earnings and there is generally a market limit.

Saunderson House will analyse existing cover and take into account current assets, liabilities and likely expenditure in the event of death or disability. Policies to cover any shortfall are recommended and the cost may be less than you might imagine.

The arrangement of appropriate catastrophe risk insurance should be a priority.

Retired or Retiring?

The post cessation of earnings rules, introduced from 6th April 2001, provide the opportunity for retiring partners to contribute up to £36,720 per annum (depending on age and previous earnings) to personal pension plans for the five years beyond that in which net relevant earnings cease, with full income tax relief. It can make sense to draw pension benefits to fund such contributions.

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This note is for general guidance only and represents our current understanding of law and Inland Revenue practice as at September 2001. We cannot assume legal liability for any errors or omissions and detailed advice should be taken before entering into any transaction. The value of investments and any income from them can go down as well as up and you may not get back the full amount you invested. Levels and bases of, and reliefs from, taxation are those currently applying but are subject to change and their value depends on the individual circumstances of the investor. For income drawdown policies, it should be noted that: high income withdrawals may not be sustainable during the 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 when the annuity is eventually purchased; annuity rates may be at a worse level when annuity purchase takes place and a certain investment return is required simply to "keep pace" with an annuity, because a pension withdrawal fund does not receive a benefit from the early death of other pensioners, 'mortality drag', as does an annuity.

Equitable Life Managed Annuities - A Way Out

We have previously highlighted that the holders of Equitable Life Managed Annuities (income drawdown policies) can now transfer to another provider's drawdown plan, but those invested in the With Profits fund will pay the market value adjuster penalty (10% at the date of writing) if such action is taken.

If an annuity is purchased the penalty is not payable. London & Colonial's Open Annuity (see leading article) facilitates continuing "drawdown" and should be seriously considered by Equitable Life Managed Annuity holders wishing to leave the With Profits fund.

FSA to end Polarisation and Commission for Independent Advisers

The Financial Services Authority's Consultation Paper 121 issued in January proposes the abolition of polarisation (the distinction between tied agents of one company and independent advisers). The FSA also proposes that independent financial advisers may only be remunerated by fees. Any commission must be rebated to the client (where permitted by the Inland Revenue - not allowed for pension commissions), offset against the agreed fees or used to enhance product terms.

Saunderson House has worked on a fee basis for new clients since 1996, using any commission to offset charges arising and/or enhance product terms.

With Profit Bonuses

The bonus season is well underway. Norwich Union and Scottish Widows have reduced both annual and terminal bonuses - others are expected to follow. For insurers not announcing their bonuses until March/April, there remain opportunities to crystallise terminal bonuses at present levels. This may be achieved by switching out of a with profits fund and then back in again, or by transferring from one policy to another. The effects of any market value reductions and, where applicable, potential loss of membership rights, guaranteed annuity or bonus rates, need to be carefully considered.

Spring Seminars

Saunderson House is holding lunchtime seminars on Wednesdays 6th and 13th February at Ironmongers Hall in Aldersgate Street (beside the Museum of London) for current and retired partners in professional firms, on the maximisation of retirement fund benefits. An update on the widening of pension fund exit options will be included.

Please call Sandra Pearson to reserve a place or email her at sandra.pearson@saunderson-house.co.uk.

Saunderson House provides in-house seminars for partners and any request should be directed to Sandra Pearson on 020 7315 6507 or their usual Saunderson House director.



Reply Slip

Name: (in block capitals).....

Firm:..... Email address:.....

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

Please telephone me to provide advice on:

- The open annuity
- Pension contributions
- Additional protection
- Equitable policies
- Fee based advice
- Other (please specify).....

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