

Annuity Reform

The Private Member's bill of David Curry MP (Con.), which proposed to allow pensioners greater freedom in applying their pension funds to produce income once a modest annuity has been purchased, was defeated in the House of Commons on 10 May. In the meantime, the Government continues to conduct its own review of annuities.

Scottish Widows Changes Stance on Guaranteed Annuity Rates (GARs)

Advice should be sought regarding possible loss recovery by all holders of Scottish Widows with profits retirement annuity policies and certain with profits executive and personal pension policies who between 1 January 1999 and 31 January 2002 took any of the following actions:

- Deferred their retirement date;
- Transferred to another policy;
- Took their benefits;
- Switched out of the With Profits fund.

Scottish Widows has notified holders of these policies that GARs are now to be honoured in full; their practice between 1 January 1999 and 31 January 2002 was to exclude most of any terminal bonus from the calculation, thus reducing overall benefit values. Some policies permit any GAR option to be exercised only at the originally selected retirement date, whilst others permit the option to be taken whenever benefits are taken from the policy. Guaranteed rates exceed current market rates by up to 20%, so this matter should be given careful consideration. Where the GAR may only be exercised at age 75, policyholders might wish to consider whether the period for which the annuity will be paid will recoup the purchase price (fund value).

Basis Years and the Earnings Cap

Higher contributions can be made to personal pension policies following the 2002 Budget where basis year earnings exceed the cap for the current year. It is now possible to use the earnings cap applicable in the year of contribution as opposed to the basis year for personal pension funding purposes. This allows greater contributions to be made to personal pensions where a basis year has been elected to support contributions for a further five years. Before the change, for example, if the elected basis year had been 1997/98, contributions would have been subject to the 1997/98 cap of £84,000, as opposed to £97,200 under the new rule. Hence, someone aged 57 using 1997/98 as a basis year with earnings in excess of £97,200 can now make a gross personal pension contribution of £34,020 rather than £29,400. The current personal pension contribution limits and earnings above which higher contributions may be made to existing retirement annuity policies are set out below:

Age on 6.4.02	Maximum % of up to £97,200* payable for 2002/03 to PPPs	Maximum premium payable for 2002/03 to PPPs	Maximum % of earnings payable for 2002/03 to S226 policies	Earnings required to pay premiums shown in Col. 3 to S226 policies i.e. breakeven point
35 or under	17.5	£17,010 (£16,695)	17.5	£97,200 (£95,400)
36 to 45	20.0	£19,440 (£19,080)	17.5	£111,085 (£109,028)
46 to 50	25.0	£24,300 (£23,850)	17.5	£138,857 (£136,285)
51 to 55	30.0	£29,160 (£28,620)	20.0	£145,800 (£143,100)
56 to 60	35.0	£34,020 (£33,390)	22.5	£151,200 (£148,400)
61 or over	40.0	£38,880 (£38,160)	27.5	£141,381 (£138,763)

Maximum payment to existing Personal Pension life assurance policies is 5% of earnings not exceeding £97,200.

*For 1992/93, 1993/94, 1994/95, 1995/96, 1996/97, 1997/98, 1998/99, 1999/00, 2000/01 and 2001/02 the figures are, £75,000, £75,000, £76,800, £78,600, £82,200, £84,000, £87,600, £90,600, £91,800 and £95,400 respectively. The figures in brackets are the 2001/02 maxima.

PEP Portfolios and Unit Trust Holdings

Many investors have built up substantial unit trust holdings over the years and some are administratively onerous to manage. It is now possible to consolidate unit trust holdings without incurring a capital gains tax charge to ease administration. One statement will cover the whole portfolio. PEP investments should be reviewed and, depending on performance, it may be beneficial to transfer to other investment managers to reduce charges and potentially increase investment returns.

Saunderson House Ltd, 1 Long Lane, London, EC1A 9HF

Tel: 020 7315 6500 Fax: 020 7315 6550 Email: shl@saunderson-house.co.uk
Regulated by the Financial Services Authority.

This note is for general guidance only and represents our current understanding of law and Inland Revenue practice as at June 2002. 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.

Inheritance Tax Issues

Major changes to IHT have been anticipated ever since Labour publicly criticised the lack of bite in the inheritance tax regime five years ago. Although nothing serious has materialised, complacency should be avoided, and it would be prudent in anticipation of possible future changes by this Government to make maximum use of the current rules. In brief, the main advantages of the current regime are as follows:

- a nil-rate band of £250,000 with a flat rate of 40% tax thereafter on death;
- the potentially exempt transfer (PET) rules, which eliminate IHT if the donor of a lifetime gift survives the gift by seven years;
- a 100% maximum level of business and agricultural property relief;
- planning using deeds of variation;
- lump sum IHT schemes which avoid the gift with reservation rules;
- advantageous rules for excluded property trusts.

Possible changes to the regime include removing PETs and imposing an immediate lifetime charge to IHT for all transfers over the nil-rate band. The Government may also reintroduce tiered rates of tax for transfers above the nil-rate band, perhaps starting at 30% and rising to 60%.

Equitable Life

With profits policy values have been further reduced. The Market Value Adjuster (MVA) has recently been increased by 40% to 14%, and the 4% applies even where exit is at a contractual date e.g. maturity. Final pension bonuses for 2001 have been reduced effectively from 3% to 2%. Subject to detailed consideration of individual circumstances our recommendation to policyholders remains to switch out of the With Profits fund.

Retained Final Salary Scheme Benefits

Following the introduction of a new financial reporting standard, FRS 17, companies are now facing up to the costs of running their defined benefit pension schemes. Some have closed their schemes altogether, while others are considering changing the manner in which they calculate benefits.

For anyone with retained benefits, it is important to understand exactly how pension benefits are calculated, whether the scheme is properly funded, and what the employer's plans are for the scheme. In some instances, there can be distinct advantages in transferring to a private arrangement, such as a Section 32 buy-out bond or personal pension.

Moreover, changes have occurred in the certification rules which, in a number of cases, make it more attractive to transfer out of a final salary scheme to a private arrangement in order to increase the tax free cash at retirement. Rather than a maximum lump sum of 1.5 x final salary (capped for post-87 members), 25% of the pension fund may be taken tax free. The issues are complex and we would be happy to provide you with a full review of your pension arrangements.

Venture Capital Trusts

VCTs have become more attractive for investors following the Budget. The advantageous income and capital gains tax reliefs now remain intact if a VCT merges with another VCT or is wound up prematurely, whereas the reliefs would in the past have been lost immediately.



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| <input type="checkbox"/> Equitable Life policies | <input type="checkbox"/> Estate planning |
| <input type="checkbox"/> Scottish Widows policies | <input type="checkbox"/> Retained final salary pension benefits |
| <input type="checkbox"/> Pension contributions | <input type="checkbox"/> Consolidation of PEPs/ISAs/unit trusts |
| <input type="checkbox"/> Venture Capital Trusts | |

Mrs Sandra Pearson
Saunderson House Ltd
FREEPOST
London
EClB 1SH