

## New Pension Legislation

The Finance Bill 2004, published on 8 April, included new pension legislation which will be implemented on 6 April 2006 (A-day). The proposals drafted in the 10 December 2003 consultation paper have largely been adopted.

The lifetime limit will be £1.5 million, rising annually to £1.8 million by 2010 (where funds exceed £1.5 million on A-day, the fund value can become the lifetime limit). When benefits are paid from funds exceeding the limit, a 25% recovery (tax) charge will be levied on the excess before pension income is paid. Alternatively, funds exceeding the lifetime limit may be drawn entirely as a lump sum, though subject to a 55% tax charge. Current rules will continue to apply to funds below the lifetime limit.

From 6 April 2006, the annual pension contribution allowance will be the lower of £215,000 (rising annually to £255,000 by 2010) or net relevant earnings. Pension contributions up to £3,600 p.a. can be made without reference to net relevant earnings.

Exemption ('enhanced protection') from the new legislation, including the recovery charge, can be obtained if no pension contributions (excluding pension term assurance premiums) are paid or further pension entitlement accrued (for example under a non-contributory final salary scheme) after 5 April 2006. The Inland Revenue must be notified of an individual's intention to rely on 'enhanced protection' i.e. it is not granted automatically.

Those whose funds are likely to exceed the lifetime limit at retirement should consider maximising contributions prior to A-day and then opting out of the new regime. After A-day, tax-efficient non-pension investments should be used to build up capital. Saunderson House can provide strategic planning advice, including cash flow analysis, to help clients select the strategy most suited to their circumstances.

## Standard Life Demutualisation

On 31 March 2004, Standard Life announced its intention to demutualise to raise capital to fund business growth. Its traditional source of capital, with profits policyholders, is declining.

A proposal will be put to members by the 2006 AGM and all with profits members who signed a three-year waiver before 31 March 2004 will be eligible to vote and participate in any demutualisation benefits.

In general, with profits policyholders should remain in the with profits fund to benefit from any demutualisation benefits payable. Those whose policies mature prior to 2006 could exercise any options to maintain seamless membership rights.

## Alternatively Secured Income (ASI)

Alternatively Secured Income was included in the Finance Bill 2004 and allows income to be drawn from a pension fund beyond age 75 as an alternative to compulsory annuity purchase. It will be available from 6 April 2006.

Using ASI avoids the need to lock pension benefits into fixed annuity rates by age 75 and there is also no need to purchase a spouse's pension until the annuitant dies. Under current rules, a spouse's pension must be purchased at outset if required, which increases the cost of the annuity. If the spouse subsequently predeceases the annuitant, the benefit is lost.

## Venture Capital Trusts (VCTs) - Changes to Tax Relief

From 6 April 2004, income tax relief on VCT investments increased from 20% to 40% (provided shares are held for three years), the annual subscription limit rose from £100,000 to £200,000 and reinvestment relief for deferring capital gains tax has been removed. These are temporary changes which will only apply to subscriptions made in this fiscal year and the next.

There is no tax liability on gains realised from the sale of VCT shares and dividend income remains tax free.

The various tax reliefs make VCTs attractive. However, they are high risk and should generally be considered after pension contributions have been made and mortgages reduced.

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Authorised and 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 2004. 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 may go down as well as up and you may not get back the full amount you invested. Levels and bases of, and relief 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 the investments 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 the 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, known as 'mortality drag', as does an annuity.

## Tax Relief on Pension Contributions for US Nationals

US Nationals working in the UK have always been able to pay pension contributions in the UK up to UK contribution limits. No US tax relief has been available, but UK relief has applied up to the level of excess foreign tax credits, which is the difference between the UK and US tax liability (currently UK income tax is higher than US income tax).

All growth on UK pension funds has been subject to US wealth tax. In addition US Nationals have been able to pay into 401k contracts (\$41k for the self employed and \$13k for employees) with US tax relief on contributions and tax free fund growth.

The new UK/US tax treaty has made the following changes with effect from 1 January 2004.

1. Contributions up to the 401k limit may now be paid to either a UK or US plan and are US tax deductible up to the 401k limit for employees or those on secondment packages.
2. Growth on funds from contributions to UK plans that have received US tax relief will now be free from US wealth tax.

Additional contributions to UK plans may be paid with UK income tax relief up to the excess foreign tax credit level, subject to UK pension contribution limits, but funds derived from such contributions will continue to be assessed for US wealth tax.

It is now more attractive to pay UK pension contributions and substantial contributions may be payable with UK tax relief from 6 April 2006, subject to excess foreign tax credits (which can be carried forward for five years).

Care should be taken to separate different classes of contributions into discrete pension pots because growth on some parts may be subject to US wealth tax and not on others.

We recommend that contributions are maximised and that US Nationals wishing to pay UK pension contributions take advice from an IFA that understands the new regulations and can provide strategic investment advice on worldwide assets.

## ISAs

On 6 April 2004, the 10% tax credit formerly available on UK dividend income received in PEPs and ISAs was removed. This will mostly affect holders of UK equity income funds and will have a minimal effect on international funds, which tend to receive lower dividends than UK funds.

Higher rate tax payers are still £25 better off within an ISA for every £100 of net dividend income received. Investors should also consider holding bond funds within their ISA and PEP portfolios because yields will remain tax free.

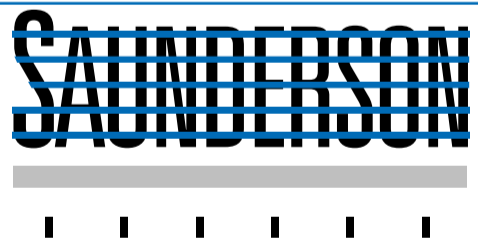
UK residents aged 18 or over should maximise ISA contributions to utilise the current £7,000 annual allowance (which will be £5,000 from April 2006). PEP and ISA portfolios can provide a useful source of tax free income and capital in retirement.

## Taxation of Trusts

From 6 April 2004, the tax rate applicable to realised capital gains and non-dividend income within trusts increased from 34% to 40%. Dividend income received in discretionary and accumulation and maintenance trusts will be taxed at 32.5% (previously 25%).

Trustees are obliged, under the Trustee Act 2000, to ensure that the investments held in their trusts are suitable. Trustees should review their existing assets in light of the increased tax rates to see if their investments remain appropriate. Non-income producing assets such as growth OEICs and single premium bonds may be suitable trust investments.

Saunderson House can assist trustees to ensure that they fulfill their obligations under the Act.



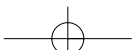
## Reply Slip

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*Please contact me to discuss:*

- The new pension legislation
- Maximising my pension contributions before A-day
- Taking pension benefits
- Single premium investment bonds
- Venture capital trusts
- ISAs
- Trust fund investments
- Tax relief on pension contributions for US nationals

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