

## **SMALL SELF ADMINISTERED PENSION SCHEMES (SSAS) AND SELF INVESTED PERSONAL PENSION SCHEMES (SIPPS)**

SSAS and SIPPS are tailor-made tax efficient pension vehicles for high net worth individuals who are either controlling directors of their own family company or self-employed on their own account or a partner. They both have their advantages and disadvantages, of which the main ones are explained below. The circumstances and requirements of the potential SSAS and SIPPS member are most important in choosing the correct pensions vehicle and we shall be pleased to advise in relation to your own case.

### **SSAS**

A SSAS is a money purchase occupational pension scheme paying the normal benefits on retirement and death allowed by the Inland Revenue. It allows the directors of a family company to be the trustees and members of the scheme, but because of this non-arms length relationship an independent trustee, the Pensioner Trustee, must be appointed. By definition SSAS have less than 12 members and only one SSAS is permitted for any one company. A SSAS cannot be wound up without the unanimous consent of all the trustees and the Pensioner Trustee cannot resign or be removed without an immediate replacement.

### **INVESTMENTS**

SSAS may invest in a wide range of investments which the trustees administer themselves. However, because the parties involved are connected there are certain restrictions, but these are not too onerous. Loans to members are banned as are transactions between the trustees and members, but the trustees may undertake transactions with the company. So loans may be made to the company and property bought from and leased back to the company on open market terms. Loans can be extremely useful to the company, but they must be at a commercial rate of interest and for a business purpose. In the first 2 years of the life of a SSAS such loans in conjunction with other investments in the employer company must be no more than 25% of the value of the fund rising to 50% after 2 years.

Income accruing to a SSAS and capital gains realised are exempt of tax, but SSAS cannot reclaim the tax credit inherent in any UK dividends received.

## **NASH HARVEY LLP**

### *Factsheet*

Commercial property of any kind can also be a useful tax planning tool when leased to the family company. The company obtains tax relief on the rent it pays and the rent received by the SSAS is tax free. The ownership of the property by the trustees protects it from any predator or liquidator of the company.

Unquoted shares may be acquired including those of the employer, but no more than 30% of the issued share capital and the same 25% and 50% restrictions as to their cost apply in aggregate with loans. Investments may be made elsewhere in equities, gilts, life policies, but residential property is not allowed.

Borrowings are permitted, secured or unsecured, and limited to 45% of the value of the fund plus 3 times the ordinary annual contribution paid.

### **OTHER FEATURES**

Funding of SSAS is controlled to avoid surpluses in the early years with larger contributions payable later. Usually the company pays all the contributions to a SSAS and of course obtains Corporation Tax relief thereon. Whilst an employee, in theory, could make additional voluntary contributions, there would be a National Insurance liability on both employer and employees in respect of the marginal remuneration represented by the payment, so it is more cost efficient for the employer to pay all contributions.

Once a member retires the usual lump sum and pension benefits may be paid from the SSAS until age 75 by which time an annuity must be purchased from a life office. The SSAS may continue to exist to pay benefits even if the company has been wound up. Income withdrawal is available with fluctuating payments, but is not advantageous as it carries liquidity restrictions on loans, property and borrowings.

SSAS have to complete self assessment tax returns and are subject to a 90 day reporting regime for certain investment transactions and a 28 day reporting regime for transfer payments of £250,000 or more. They are exempt however from most of the 1995 Pensions Act requirements unless any member is not a trustee.

### **SIPPS**

A SIPP is a money purchase personal pension scheme from which may be paid the usual personal pension scheme benefits of a tax free lump sum of 25% of the fund and pensions and death benefits. Membership is generally open to anyone with

taxable earnings in the UK who is self employed or employed including directors. Because of the administration costs and investment returns, most SIPP providers set a lower limit to the funds invested so they are best suited to high net worth taxpayers. The self employed are ineligible to join an occupational scheme anyway, so if they have substantial earnings, a SIPP is most likely to be the ideal vehicle for them.

SIPPS are mostly funded by personal contributions from the members themselves in the absence of an employer's contribution for self employed taxpayers, and a general reluctance of employers to make contributions to personal pension schemes; it not being compulsory. Contributions are based on taxable earnings on an increasing percentage scale according to age, but for a director the maximum contributions payable which are eligible for income tax relief are not as great as the company could pay to a SSAS.

Anyone who is not in an occupational pension scheme is able to contribute personally up to £3,600 per annum into a SIPP regardless of the size of his or her earnings. Any company contributions paid into the scheme on behalf of an employee reduce the employee's own contribution on a £1 for £1 basis. Individuals are also allowed to contribute in excess of £3,600 in each of the five years after they cease working or their level of earnings decreases, subject to a complex set of rules which is outside the scope of this Memorandum to address. Tax at the basic rate of income tax (currently 22%) must be deducted from the contribution paid by both employed and self-employed taxpayers and they keep this relief even if they pay no tax or pay tax below the basic rate.

If the taxpayer pays tax at 40%, then "top-up" relief can be claimed, so that the relief on the contribution totals 40%.

## **INVESTMENTS**

SIPPS may also invest in a wide range of investments with members deciding on their own investments. There are certain Inland Revenue restrictions though. Loans of any kind are banned, not just to the members themselves. Transactions between a SIPP and its members are also banned. However, commercial property is permitted, even though it cannot be acquired from a member's business, and it may be leased on commercial terms to the member's business with the same advantages as a SSAS. This facility to purchase, say offices, for a partnership can be very useful. The purchase may be funded additionally from borrowings or a transfer payment from a previous retirement annuity contract. Residential property and

unquoted shares are not allowed, but the full range of equities, gilts, life policies, managed funds etc are permitted.

Borrowings are only permitted to purchase or renovate commercial property. They are limited to 75% of the purchase price or the cost of renovations plus the VAT involved which can be reclaimed. If a loan is taken to purchase a property it must be secured on the property.

## **OTHER FEATURES**

The facility to carry back contributions to secure income tax relief in respect of the previous tax year can be very advantageous although this must be elected for by the following 31 January.

The great advantage of SIPPS is the income draw-down facility which may be used between ages 50 to 75 whether earnings have ceased or not. It is easily understood and much more flexible than the SSAS facility to defer purchasing a pension until age 75 or taking occupational income draw-down. The rates of income withdrawal are based on the gilt yield from the FTSE 15 year Government Securities and the Government Actuaries Department tables, according to the member's age, sex and residual fund value. For instance, for a man aged 65 on 1 May 2004 having taken the maximum lump sum of £40,000 from his fund of £160,000, the residual fund of £120,000 would provide a maximum level of draw-down of £10,680 pa (the 100% level) or a minimum of £3,738 pa (the 35% level).

Income drawn-down may also be phased from part of the SIPP and varied in amounts. This facility could aid personal income tax planning to preclude a higher rate liability in a particular year. In addition, reducing drawn-downs or taking benefits from part of the SIPP mean that more capital is retained in the tax exempt structure which should increase overall returns. For example, the same member with a fund value of £160,000 may activate his benefits from part of the fund only, say £60,000. This provides a lump sum of £15,000 and the residual segmented fund of £45,000 would provide drawn-down of between £4,005 pa (maximum) and £1,401 pa (minimum). The balance of the fund undrawn of £100,000 can be similarly activated at later dates up to age 75. The various options available on the approach of retirement have a distinct advantage over SSAS and often lead to a transfer from a SSAS to a SIPP at the optimum time where the Inland Revenue allow it.

There are also Inheritance Tax advantages to a SIPP in draw-down, as larger amounts can be handed on to the next

generation on the death of a member before an annuity has been purchased.

Finally, SIPPS do not have to complete self assessment tax returns and the 1995 Pensions Act requirements generally do not apply to them.

### **FOR GENERAL INFORMATION ONLY**

It should be noted that the Inland Revenue has proposed the introduction of a new common tax regime for all occupational and personal pension schemes to come into effect from 6 April 2006. It is proposed that both SSAS and SIPPS will be part of the new regime. Our Client Memorandum, "Pensions And The New Tax Rules: Where Are We Now?", gives details of the main proposals and their implications for SSAS and SIPPS.

Please note that this Memorandum is not intended to give specific technical advice and it should not be construed as doing so. It is designed merely to alert clients to some of the issues. It is not intended to give exhaustive coverage of the topic.

Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.