Guide to SIPP's

HARGREAVEHALE

contemporary thinking with traditional values

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Self Invested Personal Pension (SIPP)

A SIPP is a personal pension plan which gives the plan holder freedom to choose and change the investments within it. SIPPs have been around since 1990, but have grown rapidly in popularity since the mid-90s. It is estimated there are now more than 300,000 SIPP plans holding more than £100 billion.

A SIPP must be set up with a recognised provider and professional trustee. The paperwork is more extensive than an ordinary personal pension or stakeholder pension plan because each SIPP is unique to the individual. However, a number of packaged plans are available to streamline the set-up and running procedures.

Important Note

The text below is our understanding of the SIPP market and relevant HMRC rules at the time of writing. These rules may be subject to change without notice. Benefits derived from a SIPP will depend on individual circumstances. We recommend that professional pension advice is obtained.

Concept

Although investors have many different reasons for setting up a SIPP the attraction to some is:

- Greater control, more bespoke approach to managing pension savings
- Wider range of investments
- Ability to appoint own manager

Investments

There are a wide range of permitted types of investments for SIPPs, including Unit Trusts, OEICs (open ended investment companies), investment trusts and stocks and shares from across the world, provided they are quoted on a recognised stock exchange. A number of different investment types are also eligible to be held in a SIPP as long as the SIPP provider will permit them. These include such things as commercial property, insurance funds and traded endowment policies. It is also possible to invest in hedge funds ("alternative" investments that seek high returns, irrespective of the direction of the stock market) provided they are publicly quoted, regularly priced and freely tradeable.

Certain investments which are known as "taxable property" are subject to tax charges, the most notable of these is investment by a SIPP directly or indirectly in residential property.

Allowable investments include:

Collective Investment Funds

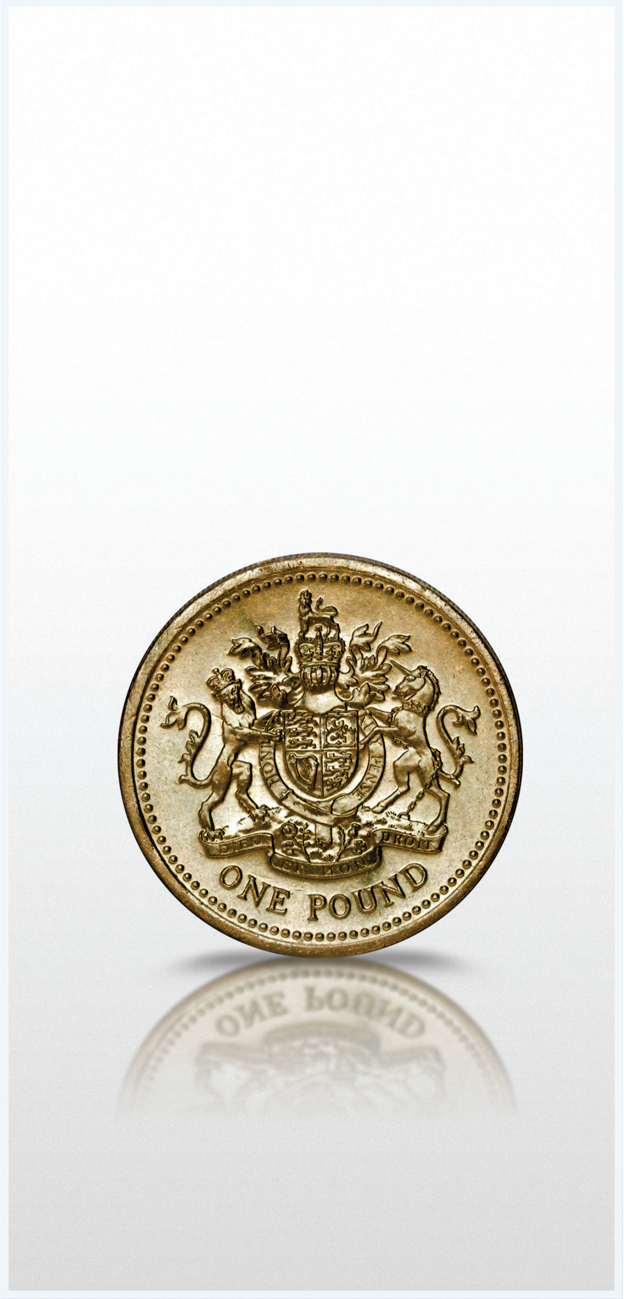
- unit trusts
- investment trusts
- OEICs (open ended investment companies)
- insurance company managed funds and their range of funds run by other managers

Stocks and Shares

- individual UK equities
- overseas equities, for example US or European shares
- UK gilts and overseas government securities
- bonds and other fixed interest securities
- PIBS (permanent interest bearing shares)

Some of the other investments include:

- cash and deposits
- traded endowment plans
- commercial property and land
- loans
- UK real estate investment trusts (REITS)



Charges

The SIPP wrapper is effectively separate from the contents (ie the investments), the charges are separate. In the set up and running of a SIPP there are normally two types of charges:

- SIPP Administration Charge
- SIPP Investment Management Charge

The Administration Charge is often a fixed monetary amount and not related to the size of the fund, so there is economy of scale.

The Investment Management Charge is calculated on a set period throughout the year based on the value of the SIPP on those dates.

It is worth comparing the charges and the services provided when picking which SIPP package is suitable for you as there is a large variety in the types and levels of charges levied eg dealing charges, discount if use SIPP providers funds.

Some providers will make an all-inclusive charge, while other charge on an itemised basis. For example, you need to consider things like: are you paying for services that you do not use? Would you be better off with an inclusive rate if you actively change your investments? Some investment companies or insurance companies offer reduced charges provided you invest a minimum amount in their funds (this can be worthwhile if you would have chosen their funds anyway). Other charges may be included within the investments you choose, such as the initial charge or bid/offer spread and annual investment management charges.

If you appoint an investment manager to run your SIPP investments on an advisory or discretionary basis, you will be charged according to their terms of business. If you take advice from a financial adviser or pension consultant regarding suitability or choice of a SIPP, then you may also be charged a fee or commission may be payable, on certain investments.

Whatever services you choose, you should be clear about the charges and the way in which they are calculated before committing yourself to proceed.

Pension Input Period

This is the period of time used to measure contributions paid into a pension or benefits accrued and compared to the annual allowance. Usually the pension input period runs for 12 months and does not have to run with the tax year.

The annual allowance used for testing purposes is the annual allowance in the tax year that the pension input period ends not when the pension scheme was started. A charge equal to your marginal tax rate is levied if the annual allowance is breached at the end of the pension input period. It is your responsibility to inform HMRC if you have exceeded the annual allowance in any pension input period.

Annual Allowance

The annual allowance for 2012/13 is £50,000, this is fixed until the tax year 2015/16, therefore maximum contributions will be 100% earnings or £50,000.

Example: Mr Smith started a personal pension plan on 1st November 2011, he pays his first contribution over that day. The first pension input period runs from 1st November 2011 to 1st November 2012. Subsequent pension input periods for Mr Smith will run from 2nd November to 1st November each year. As the pension input period ends in the 2012/13 tax year then Mr Smith will need to comply with the £50,000 annual allowance for 2012/13, anything above this will have a charge levied. The annual allowance in a tax year applies to the total contributions made to all plans that Mr Smith has with pension input periods ending in that tax year.

Contributions

You can put money into a SIPP by way of contribution, contributions made attract certain tax benefits. Each tax year you can pay as much as you earn into a SIPP and get tax relief (subject to the annual allowance, which is effectively capped at £50,000 for 2012/13).

Personal contributions (Self Employed and Employees) are made when funds are paid directly by the SIPP holder , contributions to receive tax relief can only be up to 100% of earnings in any tax year or up to the annual allowance. If this is the case, when you contribute to your pension scheme basic rate tax relief is automatically added to your contribution by the Government. If you are a higher rate tax payer you can claim a further 20% tax relief via your tax return. If you income falls in the super high tax rate band (50%) you will instead be able to claim 30% tax relief.

Example: For each £100 contributed into a SIPP the member only pays £80, the Government adds the extra £20 as tax relief. If you are a higher rate taxpayer, then in addition to the above, the Government will add a further £20 of higher rate tax relief. If your income falls within the super high income tax band you will receive £30 tax relief. The Annual Allowance stands as £50,000 for 2012/13, and this applies to the aggregate of any tax relievable contributions paid by you or on your behalf and any employer contributions. Therefore, this will limit the amount you can save in a pension each year.

Contributions are subject to HM Revenue & Customs rules as apply to all registered pension schemes.

Employers can make “Company contributions” by paying funds into SIPPs held by their employees. This can be particularly tax efficient as employer contributions do not attract National Insurance.

Employers can contribute more than the pension member earns if individual earnings are below £50,000, subject to the profitability of the company.

Even non tax payers such as children or pensioners (who are under 75) can still contribute £2,880 to which the Government adds £720 making a total of £3,600 gross.

Carry Forward

This will allow unused annual allowance from pension input periods ending in the three previous tax years to be carried forward, this can be added to the annual allowance for the current pension input period. For someone who is just starting pension saving for the first time, carry forward would not be an option.

Example: Mr Smith has paid £50,000 to his personal pension plan in the 2011/12 pension input period (Annual Allowance is £50,000). His contributions in the previous three pension input periods were:

2010/11 - £30,000

2009/10 - £25,000

2008/09 - £20,000

	2008/09	2009/10	2010/11
Notional Annual Allowance	£50,000	£50,000	£50,000
Less Pension Input Amount	£20,000	£25,000	£30,000
Unused Annual Allowance	£30,000	£25,000	£20,000

Mr Smith could carry forward unused annual allowance of £75,000 (£30,000 + £25,000 + £20,000) to the 2011/12 pension input period. Along, with the annual allowance for that year (£50,000), Mr Smith could pay a total contribution of £125,000 in the 2011/12 pension input period.

Remember tax relief is only available on individual contributions of up to 100% of earnings in any tax year. Mr Smith would therefore need to have earnings of at least £125,000 to get tax relief on this amount of contribution.

Standard Lifetime Allowance

This Lifetime Allowance was introduced by the Government on “A Day” 6th April 2006. This sets a limit on tax efficient pension savings, its a ceiling for the pension value which accumulates for the individual from membership. The lifetime allowance has been reduced from £1.8m and capped at £1.5m with effect from 6th April 2012.

This reduction will have implications for certain individuals, therefore individuals should speak to a professional adviser.

Transfers

Transfers into a SIPP can be made from a variety of other personal or company pension schemes. There are no specific limits on earning or employment requirements to be met when making a transfer, although a test may be applied in some circumstances where money comes from an employer's scheme.

From 6th April 2012 "Protected Right" will cease, in the past it was possible to transfer or hold contracted-out "Protected Rights" pensions into a SIPP, this has now ceased, Protected Rights pensions will be treated the same as Non Protected Right schemes. Individuals should seek advise as there are some transitional rules affecting existing Protected Rights.

Taxation

Once invested in your SIPP the scheme will grow free of UK Capital Gains Tax and Income Tax (tax deducted from dividends cannot be reclaimed).

Everyone is given a personal income tax allowance (an amount of income you can earn before paying tax). The standard personal allowance is £8,105 (2012/13). However, the Government will take away £1 of your tax free personal allowance for each £2 you earn over £100,000. This means you will lose your tax free personal allowance completely if your income exceeds £116,210. By making a pension contribution will reduce your income for these purposes. Get your income below £100,000 and you will regain in full your personal allowance as well as getting tax relief on your pension contribution.

Benefits

There are a number of options available to the pension member to choose from when accessing funds for when they reach retirement, or another age at which they choose to draw benefits, provided that the minimum age from which you can draw benefits is 55. When you retire up to 25% of the value of your pension fund can normally be taken as a tax free lump sum, with the remainder then being used to provide you with a taxable income.

Below are details of ways an income maybe taken from the remainder of your pension plan, please contact a professional adviser for further information.

There are two ways in which you can access your pension funds, the Drawdown Pension, these take two forms the "Capped Drawdown" or the "Flexible Drawdown".

Capped Drawdown is a method of drawing an income direct from your pension fund from the age of 55 and throughout your retirement, there will be no upper age limit for drawing benefits. If the individual prefers to defer taking an income to sometime in the future this is possible as there will be no age restriction. Income is available to the individual up to a maximum level, the limits introduced will be similar to single life annuity rates from 6th April 2011. Maximum income limits will be reviewed every 3 years if under age of 75 and every year for those over 75.

Flexible Drawdown, is a form of income drawdown that can be taken from the age of 55 and throughout your retirement, there will be no upper age limit for drawing benefits. Income is drawn directly from your SIPP and there are no limits on the amount of income you can take. This option is only available to individuals that can demonstrate they have a guaranteed income (known as the "Minimum Income Requirement" of at least £20,000 per annum from other sources. Only certain types of pension income can count towards meeting the Minimum Income Requirement and further details on this can be provided on request.

From 6th April 2011, the requirement to buy an annuity by the age of 75 has been removed, however contributions made into a members pension after the age of 75 will not receive tax relief.

Death Benefits

If the scheme member dies before age 75 and before taking any retirement benefits, the whole fund may be paid tax free to nominated beneficiaries, or used to provide the member's dependants with a pension benefit. If the scheme member dies after age 75 and before taking any retirement benefits, the whole fund may be paid as a lump sum, but will be subject to a 55% tax charge. If death occurs after the fund has been vested then there are three options for the surviving spouse.

- Take the fund as a lump sum
- Continue drawdown
- Annuity purchase

As an alternative the surviving spouse may opt to continue to draw down the pension fund in which case there will be no tax charge and drawn down continues based on his/her age and income limits.

The third option, annuity purchase, means the fund is lost on death, although the annuity or the scheme pension may continue to provide income for a guaranteed minimum period (up to ten years). In certain circumstances a pension income will continue to be paid to dependants.

Frequently Asked Questions

Who can invest in a SIPP?

Generally anyone who is classified as a "UK relevant individual", you are a "UK relevant individual" for any tax year if:

- You have relevant UK earnings chargeable to income tax for that tax year, or
- You were resident in the UK at some time during that year, or
- You were resident in the UK both at the same time during the five tax years immediately before that year when you became a member of the pension scheme, or
- You have, or your spouse has for the tax year general earnings from overseas Crown employment subject to UK tax (sections 28 Income Tax (Earnings & Pensions) Act 2003).

If you leave the UK, you can still contribute to a SIPP for the first five years after departing.

Also an individual with no relevant earnings can also contribute to a SIPP up to a maximum of £3,600 pa.

What charges will I have to pay?

Charges under a SIPP vary depending on the type of investment you select and the specific charging structure of the relevant SIPP provider. Some people consider the charging structure of a SIPP more transparent than a standard personal pension. There is usually a flat charge for setting up the SIPP and an annual administration fee. Some charges are not related to the size of your pension fund, so the more it grows the smaller the charge appears. With some SIPPs you have to pay an all inclusive fee, meaning you are charged for services you may not use, whereas others charge only for each service used.

Further charges are related to the investments you choose. For example, you may have to pay an initial charge and an annual management charge if investing in an investment trust through the scheme, or pay a transaction fee each time you trade a share. Consulting a financial adviser about investment choices or whether to invest in the scheme will also usually attract a fee.

Can my employer contribute to the scheme?

Yes. Combined (member and employer) contributions are subject to the "annual allowance" and "lifetime allowance" limits set by HM Revenue & Customs.

Any contributions that you make to an occupational pension scheme will also be included for the purposes of the allowances mentioned above.

What are the risks?

Talking to a pension adviser before joining a scheme may eliminate your questions about whether this type of pension arrangement is appropriate for you. As with all pensions, your underlying SIPP investment may be invested in the stockmarket and as a consequence you will be subject to the fluctuations and risks associated with this type of investment. The level of risk is also down to the choices you make; for example, whether you talk to a financial adviser before making investments or choose them yourself. You will need to check before hand the exact nature of the investments your SIPP provider will permit, as some SIPP schemes only allow investment in specific areas, such as investment trusts and unit trusts.

How do I open a SIPP?

You would need to contact a recognised SIPP provider, these include unit trusts and OEICs, banks, building societies, stockbrokers and pension or life insurance companies. All SIPP operators must be fully regulated by the Financial Services Authority.

If you are transferring an existing pension fund into a SIPP there can be extensive paperwork involved and you may wish to enlist the help of an IFA. It is also worth confirming that you are not losing valuable benefits from your existing provider. As soon as the application forms have been processed you will be able to choose your investments.

How do I claim tax relief?

For non tax payers and basic rate tax payers tax relief is automatically added to contributions by the Government. If you are a higher rate or super high rate tax payer you will need to complete a tax return in order to gain the additional tax relief due.

Is it possible to transfer inspecie?

Transferring stock into a SIPP would seem straightforward, the practicalities are less so as such transfers may cause tax charges. Therefore many SIPP providers will not allow in specie contributions.

It is strongly recommended that individuals seek advice from an IFA as there are a number of issues that need to be considered.

Can my employer put my bonus into my pension scheme?

Yes your employee can contribute your bonus to your pension scheme, this will also be without the deduction of National Insurance.

Can a SIPP be held in joint names?

No, SIPP's must be registered in an individuals name.

Tax Disclaimer

This document is prepared in accordance with our understanding of current tax law (April 2012) and there are risks that tax legislation may be subject to change in the future. The tax treatment depends on the individual circumstances of each client.

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Risk Warning: Hargreave Hale services may not be suitable for everyone. Before investing in the stock market, please bear in mind that the value of investments and the income generated from them can fall as well as rise. Investing in the stock market should be done for the medium or longer term, and should be a part of personal financial planning which may also involve considering levels of debt and cash resources as well as pension provision and tax planning.

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