

THE FAMILY SIPP AN ESSENTIAL ELEMENT OF INHERITANCE TAX PLANNING

What is a "Family SIPP"

Very simply, where different members of a family and/or their circle of friends each have a SIPP (Self-Invested Personal Pension) with the same provider eg they each have their own MW SIPP.

What's the relevance for IHT planning?

From 6th April 2006, any surplus under a member's SIPP on their death (after payment of any required death benefits) can be passed on to one or more other SIPPs eg to the SIPP of their child or grandchild. The only requirement is that all the SIPPs must be with the same provider eg each has an MW SIPP. There may be tax issues – see below.

What are the tax and other benefits and restrictions?

As yet, we don't know! HM Revenue and Customs consulted on this during the summer of 2005, and consultation ended on 30th September 2005. They have not said when they will issue the results of the consultation. HMRC recognise that in most cases there are strong grounds for allowing all the remaining assets to be passed to another Family SIPP (or SIPPs) tax free. But equally they recognise that there are potential IHT avoidance options – the extreme case being someone who has a pension pot equal to the Lifetime Allowance and who has no intention of ever drawing a penny from it. The problem is that the situation is not black or white. Each case has its own characteristics and is a different shade of grey!

Our own submission to HMRC is included in our October 2005 Newsletter. One point we made is that the "inheritor" cannot access the inherited assets until they reach age 55 (50 until 6th April 2010) and (other than the tax free cash sum) they will pay tax on the income when they draw benefits.

Many (grand)parents may like the idea of passing on wealth that can be used to provide secure income in their (grand)children's old age, and which the children cannot immediately "blow" on Ferraris and the like! The worst case scenario is that the whole of any inherited SIPP assets would be taxed at 40% i.e. IHT rate. Even so, many people might prefer this, given the only alternatives for those assets on their death are:

- Either (i) for the surplus to be passed to an insurance company i.e. buy an annuity before they die
- or (ii) for the surplus to go to a charity they nominate
- or (iii) for the surplus to go to the Duchy of Cornwall

Let us hope common sense prevails – our suggestion was that, on death, assets up to 20% of the Lifetime Allowance (i.e. in 2005/06 that would be £300,000 being 20% of £1.5M) could be passed on tax free, with the balance being taxed at 15%. See our October Newsletter for our reasoning.

How much could be passed on in this way?

Each person can have up to £1.5M tax free held within their own SIPP. They can take up to 25% of their fund as tax free cash sum at any time after age 55 (50 prior to 6th April 2010). They do not need to draw out any of the residual fund as income, if they don't want to – though if they don't have sufficient other personal wealth they may need to draw out more to meet their normal living expenses. When they die, the first call on the remaining assets of their SIPP is usually the spouse (or dependant child, if there is one) i.e. the original member's SIPP is used to provide income to the spouse or dependant ["dependency" is defined as up to age 23 unless they are physically or mentally handicapped]. However, the spouse/dependant in turn does not need to draw any income.

Note that if there are dependants as well as a spouse, "drawdown" of benefits must continue until the last of the spouse/dependants dies. Only then can the residual "lump sum" be passed on.

Three important points

1. All the SIPPs **must** be with the same SIPP provider eg all should have an MW SIPP.
2. The Trustee of the SIPP should have a "Nomination Form" from the member indicating which SIPP(s) they wish to receive their own SIPP assets on their death. This is not binding on the Trustee, but they will need guidance.
3. If the assets are not passed on with the "Family SIPP", the Trustee will have to pay the assets to a charity (which will have had to be nominated by the member in writing to the Trustee) or to the Duchy of Cornwall.

What about the need to buy an annuity at age 75?

That rule goes from 6th April 2006 – something that has had amazingly little publicity! Under the new Rules, once a member reaches age 75 they will not need to buy an annuity. Instead they will be able to continue what is effectively "drawdown" after they reach age 75, and continue using drawdown right up to their death (this will technically be known as an "Alternative Secured Pension"). If they die after age 75, the remaining fund on their death can be used to provide continuing income drawdown to their spouse. And what is more, it does not matter if the spouse is more or less than 75 – drawdown can continue after (s)he is 75 too. How this works in practice is explained fully overleaf.

Who should be included in a Family SIPP?

Basically, from 6th April 2006, anyone in the UK can have a SIPP. There are no minimum age restrictions – a SIPP can be set up for a child at birth! The SIPP needs to be set up legally and a contribution needs to be paid into it eg the parents could put a contribution into the SIPP for their newly born child. And they get tax relief on the contribution too! The maximum that can be paid for someone with no earnings of their own (eg a child) is £2808pa net, which is grossed up to £3600pa. There is no need for continuing contributions – a one-off payment is all that is required to set up a SIPP.

So SIPPs should be set up for IHT purposes for children, grandchildren, possibly even great or great-great grandchildren! The members of the “Family SIPP” need not be immediate family members – they could be friends or business colleagues: whomever it is that the member wants to pass their wealth on to.

Are there facilities to “top” up a member’s pension fund after his/her death?

Yes! The Revenue will allow (after 6th April 2006), the member’s pension fund i.e. their SIPP to be fully topped up **in the year of the member’s death** to the maximum of £1.5M, even if the required contribution is more than the normal maximum allowed of £215,000. For example, if the member had a fund of £500,000 at the date of death, the company could pay in up to £1M in the year of the member’s death, and obtain full tax relief on that amount (*tax relief may be subject to spreading*). This is a nice way of potentially tax efficiently extracting wealth out of the company to the member’s children, for example!

Is it possible to “top-up” a member’s pension fund in the year of retirement?

Yes, the same example applies as above. The member can top-up his/her SIPP to the permitted maximum of £1.5m with an employer’s contribution (post 6th April 2006). This in turn can, over time, similarly be passed on to the SIPPs of subsequent generations. This might makes deferring retirement post 6th April 2006 advantageous in some instances.

NB: For both of the previous examples, the rules regarding contributions are different for the Self-Employed. Take advice and see our relevant news sheet.

Which assets can be passed on outside of IHT using a SIPP?

Quite simply, any assets that can legally be held within a SIPP. From 6th April 2006, the means just about anything! After 6th April 2006, assets owned by the member themselves, or members of their family, can be transferred (at independently assessed market price) to their SIPP. This may well be relevant to IHT planning in many cases.

Will there be “surplus” funds if the member and (following their death) the spouse draws out the maximum amount each year?

Very probably. Sorry, but we have to get a bit technical here. The idea is that the income taken out via drawdown will last until death. The maximum that can be taken each year prior to age 75 will be 120% of what is deemed (using tables provided by the Government Actuary’s Department) to be the amount of “pension” that would be provided for life from the existing funds. This mean that at age 75 there will still be funds left even if, prior to age 75, the member took income at the maximum 120% limit each year. After age 75, the calculation changes and the maximum that can be taken is calculated each year as 70% of the “single life annuity” that could be bought in the insurance market assuming the member was still aged 75. So, even if the member is 80 or 90, they are assumed to be 75 for this purpose. The result of this age assumption, coupled with the 70% maximum, is that whenever they die there are bound to be assets remaining. These can be passed on outside of IHT, if the planning is correct and the right action has been taken.

Fees

Our fees for Family SIPPs will be finalised when we have the final details from HMRC, but we expect them to be lower than for full SIPPs

ACTION

Advantage can only be taken on this if all the relevant SIPPs are set up. So, decide who needs a SIPP and **set up an MW SIPP for them all now**. SIPPs for adults can be set up before 6th April 2006. For children, you have to wait until 6th April 2006. Advice needs to be co-ordinated, so typically the IFA, solicitor and accountant need to provide “joined up” advice to the member and their family.

And remember – if there is not another Family SIPP in place at the date of death, the Trustee will be required to pass on any remaining assets of the SIPP to charity.

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