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EURO-AMERICAN LAWYERS GROUP

UK: SIPPS

A DISCUSSION OF THE NEWLY POPULAR PENSION PLAN

AN EURO-AMERICAN LAWYERS GROUP BRIEFING ARTICLE

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Since the passing of the Pensions Act 2004 and the unveiling of the new pensions regime, enforceable from 6 April 2006 (known as “A Day”), much of the hype surrounding the changes has been related to the increased desirability they have afforded to self-invested personal pensions (Sipps). Companies have been actively promoting the setting up of Sipps due to the fact that, from A Day, the restrictions on what can be held in a pension fund will disappear, leading many commentators to speculate that demand for Sipps will go through the roof. The main advantage of Sipps over standard pensions at the moment is that they offer substantially more investment freedom. This freedom will only increase from A Day when the list of permitted investments will expand to include everything from holiday homes and buy-to-lets to artwork and classic cars.

A note of caution should be sounded, however, amidst all this positive promotion. Both advisers and providers of Sipps are pointing out that there may, in fact, be no advantage to holding some of the newly qualifying investments which have so captured the public’s imagination e.g. a holiday home, in a pension scheme and indeed that, in many cases, it would still be better to hold such assets outside of your pension scheme. However, according to the Affordable Rural Housing Commission, this will still not deter people from the idea of holding a home as an investment of their pension fund and they have warned that demand for homes in the country could soar after A Day, pricing local people out of the housing market.

The main attraction to Sipps, following implementation of the new regime, is the tax relief offered by the government. For example, if a higher-rate taxpayer wanted to buy a property with a pension fund worth £500,000, he or she would only need to contribute £300,000, with a basic-rate taxpayer paying £390,000. Furthermore, the investment returns from the pensions are also tax-free. It is these tax breaks that advisers say make a UK buy-to-let a sound investment of your pension fund although this would require a fairly substantial pension fund in the first place as the new rules only allow investors to borrow half of their fund value to buy an investment property. One drawback to holding a main residence in a pension is that you will be required, under the new regime, to pay a commercial rent to your pension fund if you or your family stay in the property for all or part of the year. This could prove extremely costly if the property is your main residence. An alternative to the payment of commercial rent is the payment of a benefit-in-kind



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to the Revenue. This is 40% of the market rent, however, the proceeds will go straight to the taxman rather than to your pension fund. Buying an overseas buy-to-let only further complicates matters as you will be taxed on your returns in the foreign country.

The new rules are even more stringent when it comes to the more exotic variety of investments such as yachts or artwork. If you derive any personal gain from these types of investments, for example by hanging a painting on your living room wall, you will immediately fall foul of the benefit-in-kind rules. The market rent for non-property investments is a fifth of the purchase price. In addition, even though the alternative benefit-in-kind charge remains 40% of the rent, extra tax is paid where the investment is a wasting one, i.e. deemed to have a useful life of less than 50 years. Examples of wasting assets are boats, cars and antique clocks. Where an investment falls into this category, a further 15% must be paid to the Revenue by the pension fund.

To conclude, although at first glance the new tax regime appears to bathe Sipp in a very advantageous light, on closer inspection it may make more sense to maintain the status quo and continue holding investments such as residences or yachts outside of your pension scheme. Careful consideration and prudent planning is recommended before deciding to place one of the new qualifying investments in a Sipp. It remains to be seen how the public will react to the removal of restrictions on the more opulent investments that can be held in Sipp but one would hope that a degree of common sense and perspective shall prevail.

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