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PENSION TRUSTEES

Retirement Annuity Contract & Self-Invested Personal Pension ('SIPP') Company

Guidance Notes & Key Features

Background

The Income Tax (Jersey) Law 1961 allows individuals to look after their own pension arrangements, which gives significant flexibility regarding investment choice and responsibility. The arrangement is commonly known as a Self-Invested Personal Pension ('**SIPP**') Company.

Setting up a SIPP Company

The basic procedure involves forming a Jersey company into which an individual (the 'Annuitant') will be able to make payments as either pension contributions or transfers from other approved pension schemes. The company will then purchase investments, this forming the pension fund. To qualify for recognition by the Comptroller of Taxes, the Annuitant must enter into a formal contract with the company, called a Retirement Annuity Contract ('**RAC**'), which sets out the essential terms. It is this RAC that is formally approved by the Comptroller of Taxes.

Eligible Investments

The Comptroller of Taxes has issued guidance, binding on Annuitants, setting out the investments that a SIPP is permitted to hold. There still exists the ability to make investments by way of loans on commercial terms and private company investments, alongside more traditional investments such as publicly listed equities or funds, and therefore an Annuitant contributing to their RAC, should bear in mind the following sensible guidelines:

1. that the investment can be realised in a timeframe to enable the purchase of an annuity or the transfer into a Retirement Trust Scheme ('**RTS**') or an Approved Drawdown Contract ('**ADC**') at retirement;
2. that the contributions are being invested in appropriate investments i.e. earning an income and/or capital return; and
3. that the investments are well diversified i.e. do not have 'all your eggs in one basket'.

The majority of people are likely to invest in equities and bonds either directly or via funds (e.g. investment trusts and unit trusts). However, there is no reason why a reasonable proportion cannot be invested in commercial loans or private company investments, but the investor should always bear in mind the strict restrictions on transactions with 'connected' individuals and the personal enjoyment of pension assets, as stated in the Comptroller of Taxes' guidance.

Main Contract Terms

The law sets out a number of specific terms that have to be complied with in order for the contract to receive approval by the Comptroller of Taxes. The main terms are:

1. The company will not loan funds from the pension fund to the individual, or to any person connected with the individual or any other person having control of the pension fund. The company cannot allow pension fund assets to be used for the personal benefit or enjoyment of the individual or any other person connected with the individual or any other person having control of the pension fund.

2. The company cannot borrow money under any circumstances.

3. The company cannot make traditional annuity or Annuity Equivalent payments from the pension fund. Thus, if the individual wishes to receive an annuity on retirement this has to be purchased from an approved annuity provider. The far more popular choice now available is to transfer the pension fund to a RTS and take Annuity Equivalent payments out of the pension fund, thereby retaining an element of control over the fund.

4. The company will not enter the pension fund into any investment transaction with the individual or any person connected to the individual or any other person having control of the pension fund. This includes prohibiting an individual from making a loan to the pension fund.

5. In the event of the death of the individual prior to retirement, the pension fund will be transferred to the general funds of the company and freed from the terms of the RAC. The funds remain held for the benefit of the estate of the individual or for any nominated beneficiaries, if applicable.

Tax Position of the Individual

Contributions paid into the SIPP Company by an individual are tax deductible in the individual's tax assessment but limited to the amount set out in law. The annual limit (with effect from 1 January 2009) is the lower of:

a) 100% of the Individual's relevant earnings; or
b) £50,000.

It should be noted that the limit above covers all of an individual's pension arrangements. Thus, if an individual was already making employee contributions into a company scheme or another personal scheme, the contributions payable to the SIPP Company must be aggregated with all other personal contributions.

Important Note: An amendment to the Income Tax (Jersey) Law in January 2013 restricts the amount of personal tax relief available on pension contributions for individuals whose 'total income' exceeds £150k. Employer contributions are unaffected by this change in law.

Pension Transfers

It is also possible to transfer pension funds in from other existing approved schemes (including from a UK scheme – see below) into a SIPP Company, in order to consolidate them under one administrative arrangement. Please note that pension transfers can be quite technical and it is always highly recommend that an individual seeks specialist pension transfer advice, before proceeding.

UK Pension Transfers

A SIPP Company can accept transfers from a UK Registered Pension Scheme, provided that it has registered as a Qualified Recognised Overseas Pension Scheme (‘QROPS’). QROPS registration is achieved via direct correspondence with HMRC in the UK.

Employer Contributions

Since 1st January 2009, an individual’s employer is also allowed to make contributions directly to a SIPP Company and the employing company making the contributions can claim 100% of the payments as an allowable expense in the tax year in which the contributions are made.

Tax Position of the SIPP Company

When the Comptroller of Taxes approves the RAC between the individual and the SIPP Company, the SIPP Company is able to claim exemption from income tax on its investment income, under Article 115(fa) of the Income Tax (Jersey) Law. Furthermore, should the pension fund be in receipt of dividends from Jersey companies, the tax deducted can be reclaimed by the company. UK dividends deducted at source will not be able to be reclaimed.

Husband and Wife

A single SIPP Company can be used by married couples, but each individual must establish their own approved RAC with the SIPP Company. The individual pension funds need to be identified within the SIPP Company, but this does not mean they could not invest jointly into a portfolio, as long as the proportions are clearly stated in the accounts.

Annual Requirements

The SIPP Company has to prepare financial statements each year and provide these, by 31st March of the following year, to the Comptroller of Taxes in order to maintain its approved status. The financial statements are required to be approved by a qualified Accountant, who is acceptable to the Comptroller of Taxes.

The company will also have to pay an annual return fee to the Companies Registry, currently £150.

Options on Retirement

1. ***Purchase of an annuity*** – An annuity may be purchased from an approved provider, with the opportunity of taking a tax free cash lump sum of up to 30% of the total fund value. On death, subject to any guarantee purchased at outset, there will be no funds available to an individual's estate.

2. ***Transfer to a Retirement Trust Scheme ('RTS')*** – With effect from 2008, it is now possible to establish a RTS in order to receive retirement benefits. The annual payment (Annuity Equivalent) to the pensioner is, however, limited to an annual maximum, set by reference to UK Government annuity rates. In addition, up to 30% of the total fund may be taken as a tax-free lump sum. Further guidance notes on RTS are available on request.

3. ***Transfer to an Approved Drawdown Contract ('ADC')*** – This option allows the SIPP Company pension fund to be transferred to an ADC, from which a pension income can be derived. The main advantage of an ADC, as opposed to using a RTS, is that there is no annual limit to the amount of income that can be drawn down.

   Please note that there is a minimum guaranteed income criteria that needs to be satisfied before an ADC will be approved, as per the guidance published by the Comptroller of Taxes.

It is highly recommend that individuals seek specialist advice at retirement, in order to ensure that the most suitable option, or combination of options, is/are chosen.

Summary of Key Points

The main advantages in using a RAC/SIPP company are:-

1. The investment portfolio may be wholly under the individual's control;

2. Individual contributions are deductible from the individual's taxable income (subject to limitations).

3. Employer contributions are deductible as an allowable expense in the year of payment (subject to limitations).

4. The company is effectively tax exempt.

5. The company is not tied to any employer, and is therefore completely portable.

6. It is possible to transfer-in existing personal pension funds and previous employer's pension funds (subject to the specific rules of those schemes).

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There are several important disadvantages in using a SIPP company:

1. **The contract should be regarded as a long-term commitment up to retirement age**. There are also annual expenses payable, which could make the use of a SIPP Company uneconomical. If the use of a SIPP Company was not economically viable it would be possible, however, to transfer the SIPP Company pension fund to another approved pension plan e.g. a Retirement Trust Scheme.

2. **Should the individual break the terms of the contract, the Comptroller of Taxes can charge the company taxation based on the higher of the contributions made into the company or the fund value, at a maximum tax rate of 50%**. The significant point is that once a payment is made into the SIPP Company, it would under normal circumstances, be locked into the company until retirement i.e. the SIPP Company could not repay it to the individual.

3. The individual will, unless they have sub-contracted the role, be in control of investment decisions and therefore will be responsible for the pension fund and thus its performance. Should the individual make poor investment decisions it is possible they will lose their entire pension fund. **A SIPP Company is therefore only appropriate for 'expert' investors or those using the services of an investment adviser**.

4. **Individuals should understand that a SIPP Company is a specialised investment vehicle that has annual obligations**. Should the obligations not be complied with, this could render the company non-compliant with tax and company law, subjecting it to the associated penalties.