Boal & Co

Actuaries & Consultants

Pensions News

October 2007

Pensions - New IOM Tax Rules

by Gary Boal, 16th October 2007

Following the consultation exercise earlier this year (to which Boal & Co responded), the Isle of Man Treasury / Income Tax Division have now published details of the proposed new tax rules governing IoM pensions.

The changes are wide-ranging and positive, and we warmly welcome them. Coming on top of the recent UK Pre-Budget Report measures to restore IHT-protection to overseas pension schemes (including IoM), October has been a good month for IoM pensions.

The Income Tax (Pensions) Bill 2007 to introduce the changes has also been published, and will start its passage through Tynwald in autumn 2007. We expect the changes to take effect in April 2008.

Importantly, for packaged pension products (eg insured personal pensions and group personal pensions), the tax changes do not over-ride scheme rules in some cases. So the new higher limits and increased flexibility will only apply if the insurer is willing to change its policy to permit them. **Individuals and companies should therefore review the merits of switching to self-administered pension scheme arrangements to maximise the opportunities from the new IoM regime.**

A full copy of the Bill and the accompanying Proposal Document can be accessed here.

A summary of the changes is given below:

1. Draw-down

Personal pensions previously had to be used to buy an annuity at retirement (though SIPPs by concession were exempt). The **annuity requirement is now dropped** so that it becomes an option, rather than a requirement (which is just as well as there are no mainstream annuity providers any more on the Island!).

Boal & Co SIPPs already operate in drawdown on an actuarial basis, where we advise the trustees on a range of possible pension amounts, bearing in mind each scheme's specific investment policy, the member's needs for income and the likely future pattern of drawdown. We are pleased to say that this actuarial basis continues.

For other personal pension schemes (where there is no actuarial involvement), a "formula" approach to drawdown will now be introduced by regulations. These regulations are expected to tie into the UK drawdown regime which uses fixed tables prepared by the Government Actuary's Department (GAD).

As before, drawdown has to begin by age 75 at the latest (and no earlier than age 50).

2. Investments

Proposed changes here will **liberalise the investment policy for our SSASs and SIPPs**.

Previously, policy in this area has operated on an informal principles basis, with Income Tax approval needed for unconventional investments.

It is now intended to define permitted and prohibited investments instead by means of 4 tests. An investment is judged permissible if it:

a. satisfies the *duty of care* on the part of the scheme administrator and does not contravene the "*sole purpose*" requirement (that the sole purpose of a pension scheme must be the provision, for its members, spouses and dependants, of benefits on retirement and death);

b. is commercial and demonstrably entered into on an "arms-length" basis

c. does not give members and connected persons further personal benefits (other than the sole purpose benefit) from the investment;

d. can readily be valued by independent third parties.

It is specifically noted in the Proposal Document that residential property is capable of meeting the four new tests. This for the first time **opens the possibility to residential property in a SIPP or SSAS**.

3. Tax-free lump sum

Previously, all IoM pension schemes had restrictions on the maximum tax-free lump sum at retirement. Personal pension schemes had a 25% limit (25% of the fund). Occupational pension schemes have a limit based on length of service. Both were subject to a ceiling of £150,000.

Two changes are now to be introduced:

- the **£150,000 limit is removed**
- for personal pensions, the **tax-free lump sum increases to 30% of the fund**.

This is a welcome increase in the tax-free lump sum. The changes maximise the limits now applied to QROPS schemes in respect of pension transfers from the UK. (Note, pension transfers from the UK to the IoM are no longer tied to a change in residence and taking up residence in IoM, following changes introduced in the UK in 2006.) IoM rules are now more generous than the UK, raising a number of interesting possibilities for transfers.

4. **Severance of timing link between lump sum and pension**

Previously, the taking of a retirement lump sum triggered a requirement to start drawing pension at the same time. That link is now broken, so that a lump sum can be taken at one date (being no earlier than the earliest possible date the pension could have been taken) and the pension deferred to a later date.

Contributions can also continue even after the taking of the lump sum (though only additional pension benefits can accrue from these, ie they cannot increase further the tax-free lump sum).

5. **Contribution Limits**

A new annual contribution allowance is introduced. The allowance includes member, company and DHSS contributions - which are now subject to a high **limit of £300,000 pa**.

Contributions less than this limit can be made **up to 100% of relevant earnings**, and members have a **new right to contribute up to £3,600 pa regardless of earnings**.

The previous "carry forward" and "carry back" methods for enhancing contributions to personal pension schemes are now removed. However, with the generous new annual limits, this is not a problem.

6. **Tax on Winding up**

Where a personal pension scheme (eg a SIPP) is in drawdown and the member dies, the remaining funds can be used either to provide a pension for the surviving spouse or other dependant beneficiaries, failing which the scheme is wound up and tax is payable. Tax can currently be levied @18% on such a wind-up.

Treasury propose to now **reduce the tax rate on winding-up to 7.5%**.

As before, there is no tax applicable on death before retirement.

7. **Trivial Commutation**

The Bill formalises the ability (currently provided by extra-statutory concession) to commute a pension fund entirely for a lump sum, where it is below a certain threshold (currently £16,000).

8. **Concurrency**

The Bill formalises the ability (currently provided by extra-statutory concession) to be a member of two pension schemes in respect of the same source of earnings. Hence, an employee could be a member of his employer's pension scheme and at the same time make contributions to a personal pension scheme.

9. **International Personal Pension Schemes**

We very much welcome the proposed introduction of new International Personal Pension Schemes legislation, providing for tax-free growth and tax-free benefits to non-residents. Previously, such schemes were only possible under "50B" legislation, which allowed for occupational pension schemes for international companies.

Copyright ©2007 Boal & Co All Rights Reserved (www.boal.co.uk)