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FINANCIAL

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Collective pension plans

Forever anxious to make pension savings more attractive, the Government is investigating the merits of the Collective Defined Contribution schemes which are available in some other countries.

Most private sector companies have ceased offering defined benefit schemes, which promise to pay a pension whose value is defined by reference to the employee's final salary, and are offering instead defined contribution ('DC') schemes under which the value of the pension depends on the performance of the investments into which contributions are placed.

Like DC schemes, Collective Defined Contribution ('CDC') schemes receive contributions from both employers and employees but they go much further than simply pooling investments in order to achieve cost savings and a wider range of investment opportunities. They also pay retirement benefits to the members.

In this respect they operate rather like a With Profits insurance policy, by smoothing the investment returns in such a way as to reduce the impact of downturns in the stock market. For example, the value of Dutch schemes fell by only between 2% and 6% in 2008, when the stock market fell much further as a result of the global economic crisis.

In the Dutch example, investment decisions are taken by appointed managers, with input from trades unions, and members are given a target retirement income but may be asked to make additional contributions in order to achieve this.

As a middle road between defined benefit and DC schemes, CDCs appear to have merit. However, it is difficult to imagine how such schemes could accommodate the flexibility which savers in DC schemes will enjoy as from April 2014, to draw their benefits in cash at any time after the age of 55.

If the Government decides to introduce CDC schemes in the UK, they could become available as early as 2016. However, their success would depend on the willingness of employers to switch from traditional DC schemes.

Relevant life plans

Higher-paid employees might be affected in an unexpected way by the reduction in the Lifetime pension allowance which came into effect in April 2014. This reduces from £1.5 million to £1.25 million the total fund which can be accumulated by or on behalf of an individual without incurring a tax charge, which would be levied at the rate of 55%.

The problem arises in relation to death-in-service benefits which are provided through a registered pension scheme. These can normally be paid to beneficiaries of a deceased scheme member free of tax, but when added to the value of the accrued fund they could push the total over the limit and result in the 55% tax charge.

This situation could be avoided if the benefits were instead provided by a 'relevant life plan'. This is basically an individual life policy providing death-in-service benefits in the form of a lump sum payment which is made in the event of the individual dying or being diagnosed with a terminal illness during the period of their employment.

A particular advantage of relevant life plans is that they qualify for special tax treatment. The premiums paid by the employer usually qualify to be treated as a deductible expense for corporation tax purposes.

Furthermore, they are not regarded as benefits in kind, so do not trigger a tax charge on the employee or a liability to National Insurance charges on either the employer or the employee.

Nor are they regarded as pension contributions for the purpose of the £40,000 annual allowance for pension contributions. The policy proceeds are normally paid as a lump sum in trust for named beneficiaries.

These benefits substantially reduce the cost to employers of providing the required cover. It should be noted, however, that these plans are available only for the benefit of employees. So the self-employed do not qualify. Nor is it possible to arrange joint cover for spouses or civil partners.

Companies which have a number of employees for whom the treatment of scheme-based death-in-service benefits is an issue can set up a group scheme and achieve further cost savings.

Tax planning with an ISA

After pensions, ISAs and before them PEPs, have for long been the most tax-efficient forms of investment, offering freedom from both income and capital gains tax. As from August 2013, however, some ISAs can also offer relief against inheritance tax.

The ISAs in question are those which invest in shares which are quoted on the Alternative Investment Market ('AIM') and which qualify for Business Property Relief ('BPR'). Not all AIM shares qualify for BPR

After just two years (compared with seven years for transfers by way of gift or into trust), such shares become exempt from inheritance tax, provided that they are still held at the date of death.

The AIM market caters for smaller and growing companies which by definition present a higher investment risk. Also, they can sometimes be difficult to sell.

It should be noted that following the 2014 Budget changes, which introduced additional flexibility for ISA holders, including the right to switch between cash and share holdings, ISAs have been re-named NISAs (New ISAs).

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