



Flexible Retirement Plan adviser opportunities

April 2010

We all know the story about the business that invested company monies into an offshore bond and then paid big pension contributions to artificially create a loss, before surrendering the bond and offsetting the bond gain with the "loss", thus reducing the tax on the gain.

Well here is a variation on that theme that could reduce or even completely negate the gain from onshore bond surrenders. Interested? Then read on!

Example case study

Take our 3rd generation Russian businessman Yelnats Llessur. 10 years ago on 6 April 2000, Yelnats inherited £100,000 and was advised to invest the money into a Unit Linked Bond. Yelnats made no withdrawals from his bond and in year ten the value has grown to £175,000. He now needs access to the monies for his business and has spoken to his adviser about surrendering the bond. Yelnats has gross income of £45,000 pa. The tax situation on surrender of the bond is not looking good!

Now Yelnats has a switched-on Adviser who knows that payment of a **single premium pension contribution** could reduce or eliminate the tax on the bond.

He suggests making a gross pension contribution of £8,625 (net £6,900) in to his FRP. This contribution has to be made in the same tax year the bond is surrendered. This premium equates to £7,500 (the bond slice), plus £1,125 (the element of Yelnat's income that falls into higher rate tax), and has the effect of increasing Yelnat's Basic Rate Tax threshold to £46,025.

Tax on Bond Surrender

UL bond Investment	£100,000 – 06/04/2000
Bond Value as at 06/04/2010	£175,000
Gross Income	£45,000 (tax year 2010/11)
Gain on bond	£75,000
Slice	£7,500
Tax on Slice	£1,500
Total Tax on gain	£15,000

Top-slicing relief does not apply as the gain on the slice is added to Yelnat's taxable income and as this is already in the 40% bracket the slice is taxed at 20% (x 10 slices) ie gain taxed at 40% but with credit at basic rate of tax for tax already paid.

Overall Tax position of Yelnats

Client's income	£45,000.00
Less personal allowance	£6,475.00
Taxable Income	£38,525.00
Split of Total Income Tax Liability	
£37,400.00	taxed @ 20% £7,480.00
£1,125.00	taxed @ 40% £450.00
£38,525.00	Total tax £7,930.00
Plus tax on total gain	£15,000.00
Total Income Tax liability	£22,930.00

Yelnats has now saved £15,000 tax on the bond and with Basic Rate Tax relief of £1,725 on the pension contribution (£8,625 x 20% = £1,725). He also received Higher Rate Tax relief of £225 (£7,930 – £7,705) which means the effective rate of tax relief on the FRP contribution is 196.5% (£16,950* /£8,625)

* The £16,950 comes from the £15,000 tax saved on the bond plus the BRT relief of £1,725 on the FRP plus the HRT relief of £225.

** For "net pay arrangements" the taxable income is reduced and the tax bands remain unchanged. The gross contribution above paid to a net pay arrangement would have the same overall affect. The contribution would be higher but the tax paid would be lower than the net relief at source contribution.

Tax position after payment of pension premium**

Client's income		£45,000.00
Less personal allowance		£6,475.00
Taxable Income		£38,525.00
Split of total Income Tax liability		
£38,525.00	taxed @ 20%	£7,705.00
£0.00	taxed @ 40%	£0.00
£38,525.00	Income Tax	£7,705.00
Plus tax on Bond gain		£0.00
Total Income Tax liability		£7,705.00

Summary

- There are various reasons to review/rewrite bonds, which may include:
 - Charges
 - Treating Customers Fairly considerations
 - With-Profit funds – weakened asset allocation models, MVRs
 - Financial strength issues constrain investment decision making
 - Company financial strength concerns
 - Take over or mergers of life company and fund management groups prompting uncertainty over future

- Performance (historic or prospective)/asset allocation
- Fund choice

Tools such as Barrie and Hibbert aim to assist here.

- Relatively simple pension application but allows you to demonstrate value-added in tax mitigation.
- May leverage further pension discussions notably around flexible commission!
- Prudential has a useful guide which covers Bond encashments, tax treatment and top-slicing – 'A guide to tax on your investment' (INVS0002).

Yelnats is happy and you are able to use the FRP flexible commission menu to ensure you are adequately rewarded for your holistic advice.

NB this assumes Yelnats is entitled to tax relief on the pension contribution and that the pension contribution is made in the same tax year that the bond is surrendered.

For more information on this subject contact Stan Russell at Stan.Russell@prudential.co.uk or your Account Manager.

Sheet for bond gains/pension contribution

For Advisers to use with clients who pay tax above the basic rate.

Income

Less personal allowance

Net Taxable Income

Tax

	Income in band		Tax Payable
20% band	<input type="text"/>	x 20% =	<input type="text"/>
40% band (A)	<input type="text"/>	x 40% =	<input type="text"/>
Slice (B)	<input type="text"/>	Tax bands for 2010/11	
A + B	<input type="text"/>	£0 – £37,400 taxed at 20%	
		£37,401 – £150,000 taxed at 40%	
		£150,001 and above taxed at 50%	

Add (A) and (B) together and enter the total in the relevant box. This is the gross pension contribution that you will have to arrange to be paid to ensure the client becomes (or remains as) a basic rate taxpayer and therefore means the tax on the bond gain is eliminated.

Please note where the client is a basic rate taxpayer but the addition of the slice takes them above the basic rate tax threshold, the gross pension premium required is the difference between the income* and the basic rate tax threshold.

From April 2010 the government introduced an additional rate tax of 50% for income over £150,000. For additional rate taxpayers, it is unlikely that a bond gain could become tax free. It is unlikely that a person would have the relevant earnings to support a pension contribution large enough to move all 40% and 50% taxed income, along with the slice, into the basic rate band.

However, the same principles above could apply to mitigate the tax on bond gains for additional rate taxpayers, by moving the slice out of the 50% tax bracket and into the 40% tax band.

From the 2010/11 tax year individuals whose income exceeds £100,000 will see a reduction in their personal allowance of £1 for every £2 of income above that limit. Currently this means that where income, including any sliced gain, is at least £112,950, the personal allowance is reduced to nil. This will increase the taxable income.

* For this purpose, the 'income' refers to the income within the 20% band plus the slice.

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