FG | INSIGHT

INTELLIGENCE GUIDE: PENSION PLANNING

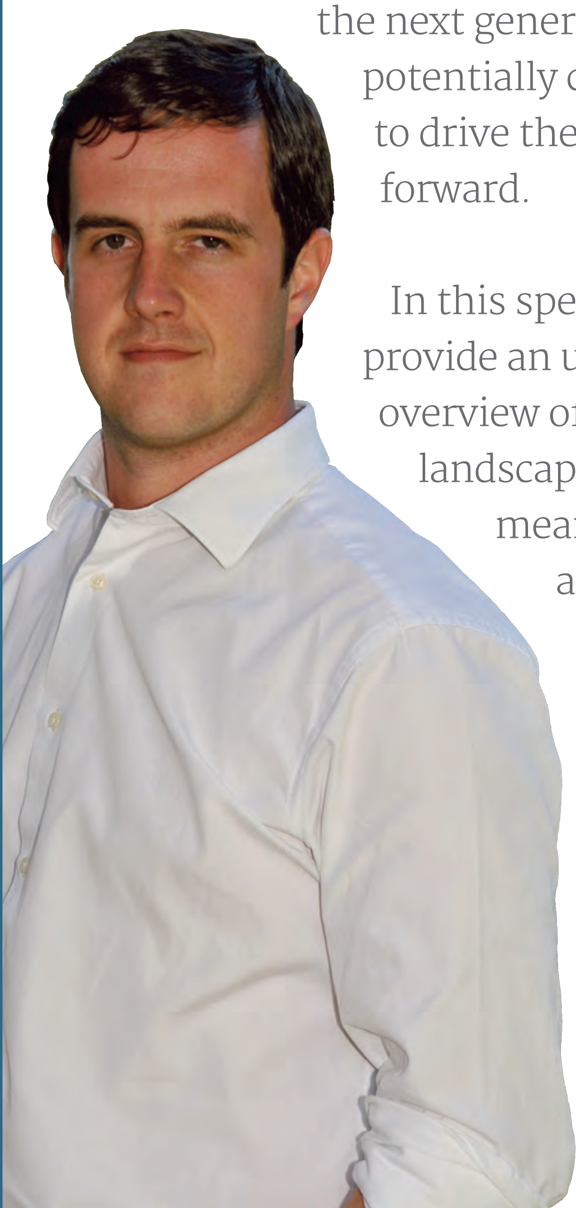
YOUR GUIDE TO

Making sure your pension works for you when it comes time to step back from the farm and how it can aid on-farm succession

INTRODUCTION

For many in farming there is a notion that you work until you drop. But this needn't be the case. With a range of easy and often tax-efficient pension options available, there are many ways to make the transition into retirement as smooth as possible.

One of the key considerations, however, is ensuring you think about your retirement plans sooner rather than later, therefore making life easier for the individual, but also the next generation of farmers potentially coming through to drive the business forward.



In this special guide, we provide an unrivalled overview of the pension landscape and what it means for farmers across the UK.

BEN BRIGGS
NEWS AND BUSINESS EDITOR

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BIG CHANGES MAKE PLANNING CRUCIAL

In his Budget statement in March 2014, Chancellor George Osborne announced one of the most radical reforms of retirement options for many years, taking the UK's highly restrictive pension regime to an extremely flexible one.

During his speech, he made the bold statement there would be 'no caps, no drawdown limits, let me be clear, no one will have to buy an annuity'.

Ben Harrison, of chartered accountants and business advisors Moore and Smalley, said from age 55, an individual can take benefits from their authorised pension plans.

"These plans can generally provide the option to take up to 25 per cent as a tax-free lump sum, called in the industry a pension commencement lump sum [PCLS]," he said. "The remaining fund then provides an income for the rest of your life."

But he also scrutinised the pension landscape and what it meant for farmers.

THE PROBLEM WITH ANNUITIES

Historically, individuals were unable to withdraw the entire remaining fund as they would not know how long they would live, but needed to guarantee an income until they died. As a solution, the remaining fund would have to be used to buy an annuity, which would solve this issue.

The problem is if you die early, your family may feel cheated because the capital which had been used to buy the income in the first place has been lost. As life expectancy has increased significantly over the recent past and low-risk interest rates have fallen to all-time lows, annuity rates have never looked such poor value.

EXISTING ALTERNATIVE SOLUTIONS

Solutions were subsequently introduced to allow individuals to keep their funds invested and, if the fund grew, this could provide for an increasing pension over time, in order to combat inflation.

On death, there could be a return of fund to the estate or spouse, albeit with a tax deduction of 55 per cent. These solutions were commonly called drawdown plans and they had annual withdrawal restrictions to prevent funds running out.

More recently, flexible drawdown was introduced. This allowed individuals over 55, with a retirement income exceeding £20,000, to potentially draw their entire remaining fund, subject to income tax at their marginal rate. However, many individuals could not meet the scheme's criteria and therefore the income they could draw was restricted.

THE NEW RULES

The new rules promise from mid-2015 everyone will have the ability to participate in flexible drawdown. This means the

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>
> Ben Harrison

minimum income requirement of £20,000 per annum, and for the remainder of this year, £12,000 per annum, will be removed, allowing all individuals to take their PCLS and potentially draw the remainder of their fund as income, subject to tax at their marginal rate.

Assuming new legislation is passed, anyone facing retirement will have major decisions to make. Investing in pensions for retirement planning and other investment-linked purposes has become a very interesting option.

For those going into retirement with debt, it provides the option to draw the pension as a lump sum and pay down this debt, thus saving crippling interest payments in retirement. While it reduces the future income payable, it may make retirement, at least in the early years, much more comfortable. This is never truer than when you consider many credit card providers charge interest rates of more than 30 per cent per annum.

For wealthier individuals, it provides a significant degree of flexibility in the planning of retirement income and also the Inheritance Tax planning which can be affected with other assets which would have otherwise been needed.

PLANNING FOR YOUR RETIREMENT

It is important to understand at retirement it is the same sum of money which needs to provide for your lifetime in retirement, but the options have expanded.

While some will rush out and 'buy a Lamborghini', most will understand their retirement needs and will take planning seriously.

What is clear, however, is picking the right solution, which in some cases may still be an annuity, will be a more complex task to understand and therefore high quality financial advice will be essential.

UNDERSTANDING TAX

Retirement and succession planning are sensitive and challenging issues for farming families. However, according to Catherine Desmond, partner at chartered accountants Saffery Champness, long-term planning is crucial to ensure the smooth and sustainable transition from one generation of the family to the next.

Part of this involves giving vital consideration to what constitutes an adequate income following withdrawal from the farming business, with pensions likely to form one source of retirement income.

Ms Desmond said: "Following [the 2014] Budget, the landscape has changed. It is important farmers appreciate how these changes affect pension saving and the new opportunities now offered to assist with planning for retirement."

UNTIL SPRING THIS YEAR, THE PENSION WITHDRAWAL RULES WERE:

➔Members of defined contribution schemes can withdraw up to 25 per cent of their pension fund as a tax-free lump sum on retirement with the balance used to purchase an annuity.

➔Alternatively, the individual can choose to remain in drawdown, allowing withdrawal of an income of up to 120 per cent of an equivalent annuity each year, or make withdrawals without a yearly limit, provided the individual has a guaranteed income of at least £20,000 from other sources.

➔A full withdrawal of the pension fund above the tax-free lump sum incurs a punitive 55 per cent tax charge – be warned!

The change comes about when you look to next year.

Ms Desmond said: "From April 6 [2015], it is proposed individuals aged 55 and over will be able to take their contribution pension pot how they want, without any limitation and subject only to their marginal rate.

"The proposals represent far-reaching changes to pensions and consultation is underway on the details before the implementation of the changes in April 2015."

However, for the past five months these withdrawal rules have been changed.

THE AMENDMENTS ARE:

➔Individuals aged 60 and over with pension savings of less than £30,000 could take everything in one lump sum. This was an increase on the previous limit for trivial commutation of £18,000.

➔The maximum capped drawdown permitted increased from 120 per cent to 150 per cent of an equivalent annuity.

➔The guaranteed income requirement for flexible drawdown has been reduced from £20,000 to £12,000 per annum.

"In addition, the size of a small pension pot which can be taken as a lump sum, regardless of an individual's total pension savings, has increased from £2,000 to £10,000 and the number of such pots which can be taken under the small pots rules has increased from two to three," added Ms Desmond.

PENSION TAX CONSIDERATIONS

PENSION contributions continue to attract relief at a taxpayer's marginal rate of Income Tax.

For a higher rate (40 per cent) taxpayer, for example, this means the net cost of making a £1,000 contribution to a pension fund is only £600. Part of the relief for this is given by the pension fund reclaiming tax from HM Revenue and Customs, with the balance given through the saver's tax return.

The annual limit for pension contributions has been reduced from £50,000 to £40,000 for the 2014/15 tax year onwards.

However, it is still possible to make use of unused allowances from the previous three years, meaning contributions of up to £190,000 could be made in the 2014/15 tax year. The lifetime limit for contributions is £1.25 million from April 6, 2014.

These latest proposals potentially offer freedom and flexibility for pension savers and, combined with significantly more generous ISA allowances, provide greater scope for farmers and others in rural business to be proactive and plan for their own retirement as well as organising succession for the next generation.

USING CASH WISELY

Planning for the time when you no longer draw your main wage from the farm is as important as the time you give to rearing cattle or planting crops.

This was the message from Nigel Evans, a Pembrokeshire dairy farmer who is one-third of the driving force behind investment fund Evanridge Properties.

Having begun in 2006, the investment portfolio owns more than 600 apartments in Sweden worth tens of millions of pounds.

By reaping rental income dividends as well as growing equity in the properties, the fund is reaping a 12 per cent return on investment for those who put their cash in.

Mr Evans said: "Personally, I think farmers should pay as much attention to their own financial future as they do to running their farm because they are intrinsically linked.

CAPITAL VALUE

"They have a capital value in their farm and they need to manage this during their working lives and be prepared for how they pass it on and the impact it will have.

"We do not think enough about things beyond milking, or our livestock or crops. But the further back you start planning and the younger you are, the greater the choices you leave yourself later on."

To buy into the scheme, which is currently running its third

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> Nigel Evans

investment pot, you will need to invest at least £25,000. The previous schemes had a £50,000 minimum investment, but changes to the rules mean the limit has been lowered.

Mr Evans said: "If you are coming in you need to be in it for five years. If you cannot do that, you should not be in it for five minutes. By growing the capital value of your cash you are making the most out of it.

GENERATING INCOME

"We are not speculators. It is about how much income we can generate and growing the equity at the same time."

Returns from the Swedish property markets are so secure, Mr Evans said, because there is not the same obsession with home ownership as there is in the UK, meaning 65 per cent of the population rent their homes.

He added: "The market is very regulated which makes it secure. Rents in Sweden are set locally and, being inflation linked, deliver year-on-year tangible, transparent and reliable returns protected from boom and bust."

EVANRIDGE PROPERTIES

- ➔The fund began in 2006 following discussions between farmer and First Milk board member Nigel Evans, fellow farmer Bill Ridge and tax accountant Huw Evans
- ➔Mr Evans farms 320 dairy cows on 200 hectares (500 acres), while Mr Ridge has 600 cows on 280ha (700 acres)
- ➔The two farmers wanted to provide for their future financial needs by building their capital and future earning capacity without taking away from their farm businesses or putting pressure on their successors
- ➔With the housing bubble about to burst and some experience of letting out properties, they looked further afield, to Sweden in fact
- ➔They bought whole blocks of flats, managing them just like 'vertical farms', delivering optimum yields and boosting profitability by nurturing growth
- ➔They now have a full-time Swedish property management team in place

PENSION PLANNING THOUGHTS

WHEN PLANNING YOUR NEST EGG FOR THE TIME YOU FINALLY HANG UP YOUR WELLIES, IT IS IMPORTANT TO POINT OUT A SIMPLE PENSION IS NOT THE ONLY OPTION.

Other considerations could include:

➔Is there any inheritance likely to come your way?
➔Do you have other properties which could be sold?
➔Do you have other investments which can be drawn down at retirement?
➔Are there stocks and shares you can cash in?

You may have some of these alongside a defined pension pot, but they all give you options when it comes time to retire from the farm.

MAKE THE MOST OF SIPPS OPTIONS

Think of a pension and what do you see? A pot of cash squirrelled away in a conventional plan which can be called on when retirement comes? Reliance on the state pension when you turned 60 or 65, although these ages seem to change with every passing year?

Or, as is the case for many, maybe there is no intention to retire or the subject has never been given proper thought?

But with 2015's changes making it easier to access your pension pot, even sceptics are reconsidering the worth of pensions, said Peter Wallin, chartered financial planner at NFU Mutual.

INTEREST

Of particular interest for Mr Wallin was how farmers can make self-invested personal pension schemes (SIPPs) work for them.

He said: "SIPPs are specialist pension products which allow greater flexibility and control over investment choices. They offer the same tax benefits as traditional pension plans, but also allow investment in a wide range of assets including shares, commercial property and land. They will also provide a range of options on how retirement benefits can be drawn.

"Many farmers are increasingly aware of potential SIPP planning opportunities in relation to their own land, typically where they have significant existing pension funds at their disposal.

"Farmers can sell farmland or commercial buildings to their SIPP at a market value [subject to stamp duty and potential capital gains tax]. The sale proceeds could provide the business working capital while rental for the land would be payable back into their tax efficient pension. The rent itself [payable at market rate] would be an allowable expense for the business.

> MANY FARMERS ARE INCREASINGLY AWARE OF POTENTIAL SIPP PLANNING OPPORTUNITIES
>
> **Peter Wallin**

"Following on from the business succession theme, if a farming son or daughter can use their SIPP to purchase land from their father [or grandfather], this not only represents excellent tax planning for the child, but also frees up capital for the father or grandfather and once again helps address the problem of the farm supporting too many generations.

"It should be stressed SIPPs are not right for everyone. Costs will typically be higher and they will usually suit a more sophisticated type of investor."

PENSION ADVICE: TRADITIONAL PENSION FUND

"More so than most businesses, farming incomes fluctuate from year to year. If you have not been able to make full use of your pension contribution in previous years, you can carry forward any unused allowance for up to three years.

"Carrying forward your allowance until a year when you are paying a higher rate of tax can also be an effective way of reducing your overall tax bill.

"From April 2015, it is proposed people will be able to access their pension pot how they want, subject to their marginal rate of income tax in that year.

"A quarter of the fund will remain tax-free. This provides flexibility for those who have resisted the tax benefits of pension planning because of concerns about being locked in to poor annuity rates."

SOURCE: PETER WALLIN, NFU MUTUAL

PENSION ADVICE: HELPING WITH SUCCESSION

"Often, farmers will not have thought about how much they will need to earn in retirement – in fact, many will expect to never give up working on-farm.

"The key to a smooth farm succession is recognising and planning for the level of income required in retirement.

"Where plans are put in place early enough, a good financial adviser should be able to help them plan realistically for the retirement they want and make best use of tax advantages from pension planning to do so.

"Where older generations have good pension provision in place, this can reduce the need for them to take any money from the business and be a good way to relieve the financial pressure on younger family members."

SOURCE: PETER WALLIN, NFU MUTUAL