Flexible Pension Annuity

Technical Guide

For use by professional advisers and intermediaries only

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Introduction to our Flexible Pension Annuity ('FPA')

The FPA is a unit-linked lifetime annuity, issued by London & Colonial Assurance PCC Plc ('LCA') purchased using assets held within a registered pension scheme or an existing pension annuity. It is designed to provide an income to the annuitant for life and can be bought either in the member's (annuitant's) name or the trustee/scheme manager's name.

Being unit-linked annuities, you and your client can choose to invest from a wide range of permitted investments. For more information on permitted investments please see the 'Flexible Pension Annuity Permitted Investments.'

The investments that sit within the annuity belong to LCA. LCA, being a Gibraltar based company, pays no corporation tax on any income or growth, made within the investments. However, there may be withholding tax paid, which cannot be reclaimed, depending on the underlying investments that you or your client has chosen.

Any investment gains made as a result of switching between underlying investments does not give rise to a UK capital gains tax liability.

As the investments belong to LCA there is no potential UK income tax liability until your client decides to take an annuity payment.

Frequently Asked Questions

If your question is not covered below, please contact your business development manager who will be happy to help.

1. How is the level of annuity payments calculated at outset?

At outset, the level of annuity payments are calculated using the member's age and initial amount invested. Then using an appropriate mortality table and current gift yield we calculate the yearly annuity payment that the initial amount invested would support over the member's expected lifetime.

Where the premium paid is coming from a pre-6 April 2015 annuity the amount of annuity payments must be between a maximum of 120% and a minimum of 50% of a standard market annuity in line with HM Revenue & Customs ('HMRC') requirements.

2. Can additional premiums be paid into the FPA?

Yes, additional premiums can be paid into the annuity at any time. The minimum additional premium is £50,000; there is no maximum.

Where the FPA has been purchased in the name of the member any additional premiums must come from their pension benefits. However, if the FPA has been purchased in the pension scheme trustees' name additional premiums can only come from that particular pension scheme.

3. Can the FPA accept an in-specie transfer?

Yes, subject to the asset being a permitted investment.

4. Can the level of annuity payments be changed during the lifetime of the FPA?

Yes, your client can request to change the amount of annuity payments. The annuity payments can be any amount from zero upwards as long as the new annuity payment does not make the value of the FPA fall below 10% of the amounts invested.

LCA will require at least 60 working days' notice to change the amount of annuity payments.

Frequently Asked Questions (continued)

5. What happens at the three-year review under an FPA?

As this is a unit-linked annuity where the value of units can go up as well as down, we want to ensure that the level of annuity payments can continue to be supported for the member's life.

Therefore, every three years we will recalculate the level of annuity payments that could be purchased with the then value of the annuity using the member's new life expectancy.

6. How are the annuity payments taxed?

Where the FPA is purchased by the member, any annuity payments received from the FPA are treated as pension income in the hands of the member and taxable at their marginal rate of UK income tax. Therefore, we will pay the annuity payment net of UK income tax based on the member's tax code.

Where the FPA is purchased by the pension scheme, we will pay any annuity payments gross of UK income tax to the pension scheme trustees.

7. Can the FPA invest in commercial property?

As an anti-avoidance provision HMRC restrict the choice of available investments to the following:

- Property appropriated by the insurer to an internal linked fund,
- Units in an authorised unit trust,
- Shares in an approved investment trust, or an overseas equivalent,
- Shares in an open-ended investment company ('OEIC'),
- Cash (but not acquired for speculative purposes),
- Interests in collective investment schemes, which are units in non-UK unit trusts or any other arrangement that creates rights in the nature of co-ownership under the law of a territory outside the UK,
- Shares in a UK Real Estate Investment Trust ('REIT') or an overseas equivalent, and
- An interest in an authorised contractual scheme.

Provided the commercial property falls within one of the above permitted investments it can be included within the annuity.

If the commercial property does not fall within one of the permitted investments, it cannot be included within the annuity.

8. When a fund switch takes place, is CGT paid?

The funds that sit within the annuity belong to LCA. As LCA is a Gibraltar based company we pay no corporation tax on any income or growth, made within the funds. However, there may be withholding tax paid, which cannot be reclaimed, depending on the underlying funds.

Any investment gains made as a result of switching between underlying funds does not give rise to a UK capital gains tax liability.

9. Why buy a preference share?

When your client effects a FPA with us they also have the option to buy a preference share in the company.

LCA is a Protected Cell Company ('PCC'). This means that LCA will create legally recognised 'Cells' within the company to segregate and protect each policyholder's assets. Each Cell has its own designation (the FPA number).

In the event of the member's death the FPA will stop, and any remaining value will sit in the Cell. If your client buys a preference share, in LCA, as this is attached to their Cell, the remaining value can be paid to the person entitled to the preference share – this will be the member's estate or the pension scheme.

10. Can more than one preference share be bought?

Yes, with each preference share being linked to the Cell which is designated to your client's individual annuity.

Where more than one preference share is bought the value remaining in the Cell will be shared equally between all preference shares.

Frequently Asked Questions (continued)

11. Does another preference share need to be purchased if an additional premium is paid?

No, your client buys a preference share in the company. This preference share is linked to the Cell which is attached to the FPA.

12. Does the preference share have any value during the lifetime of the FPA?

No, the preference share merely holds an expectation of the value that may remain within the Cell on the member's death.

13. Can the preference share be gifted?

Yes, potentially the preference share can be gifted but as there may be tax implications, we would recommend that legal advice is sought.

14. Where the preference share is purchased by the member would it qualify for inheritance tax business relief?

Yes, where the member holds the preference share for at least two years and continues to hold it on their death it can be passed to their estate beneficiaries free of UK inheritance tax.

This is because LCA is a trading company, meaning that it qualifies for 100% business relief.

Please note that HMRC will only conduct a business relief assessment on the death of the member. Whilst business relief has been around since 1976 and over time governments have recognised the value of this relief LCA accept no responsibility for any changes in legislation.

15. Does inheritance tax business relief apply if the pension scheme has purchased the preference share?

No, business relief only applies to individuals.

Where the pension scheme holds the preference share on the member's death the value remaining in the Cell is paid to the pension scheme trustees. The preference share is a private equity investment separate to the FPA. Consequently, it would not be classed as an annuity protection lump sum death benefit so its value would not be limited to the amount of the purchase price less annuity income paid. This means any investment growth on the annuity is not lost but is instead retained by the pension scheme to be used to provide further benefits.

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