



Dash for cash

March 2009

Business owners are being squeezed by three main factors: falling demand resulting in lower sales; lack of access to borrowing from the banks constraining access to working capital and investment and rapidly falling property values reducing the options for raising cash from property disposals or secured borrowing against those assets. In some scenarios banks are reducing or withdrawing longstanding overdrafts or requesting reductions in secured loans to reflect the reductions in property values.

Inevitably for many business owners this will, eventually, lead to a reduction in remuneration, dividends and any 'lifestyle' benefits that the business provides. The most pressing problem, however, is likely to be a need to raise cash to meet short term business and personal needs in order to ride out the recession/depression. So in this article we will explain various ways, some conventional and others less so, that one can use different types of pension arrangement to raise cash.

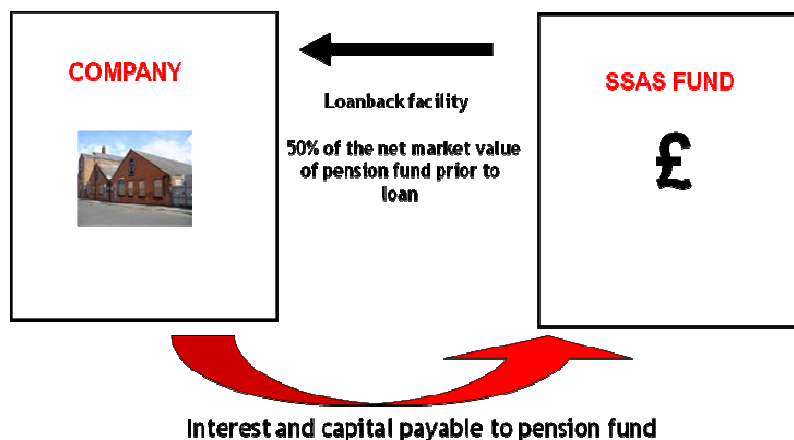
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Opportunities using UK registered pension schemes

There are two types of registered UK based pension schemes: personal and occupational. While it is not possible for a sponsoring business to borrow from a personal scheme it may do so from an occupational scheme. For most small businesses set up as limited companies, the occupational scheme usually takes the form of a small self-administered scheme (SSAS). A SSAS may lend up to 50% of its net assets to the sponsoring employer for qualifying purposes, if on normal commercial terms and repayable within five years. The loan does

not need to fund items of a capital nature but it does need to be for prudent business reasons and not purely for the purposes of keeping an ailing company afloat.

Figure 1



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In order to borrow from a SSAS it obviously needs to have sufficient funds in the first place. These can arise from either new contributions, transfers of previously accrued pension benefits or a mixture of the two. Putting aside for the time being the possibility of any new contributions, the simplest and easiest option is to 'unlock' existing pension funds. If, say, two business owners each had various pension plans worth £500,000 then this would create a SSAS fund of £1,000,000. The maximum borrowing would, therefore, be £500,000, subject to acceptable security.

Security must be a first charge on assets equal to the loan and can include a floating charge over the company's assets. The loan must be charged at a minimum of 1% over banks' base rate (an average of the base lending rate of the six leading high street banks) and repayable within five years in equal annual instalments of capital and interest. It would be possible to roll over the loan if the company were experiencing exceptional financial difficulties, in which case it would not be tested again against the 50% of fund limit. The trustees must act unanimously and take professional financial advice as to the consequences of making the loan, including factors such as liquidity for paying scheme pensions and security of assets. If the trustees do not take advice they potentially make themselves liable for any losses by the scheme.

But what if you operate through a limited liability partnership (LLP) or are a sole trader? While LLPs and sole traders are permitted to contribute to a SSAS, the scheme is not permitted to make loans to connected trustees, i.e. an LLP member or sole trader. The simplest solution, therefore, is to create a limited company and admit it as a member of the LLP, or a new LLP in the case of the sole trader. The limited company can then become the sponsoring employer of a SSAS and the SSAS can then lend to the limited company, which can in turn either lend or, more preferably, introduce the capital to the LLP. So this technique works whether you already operate through an LLP with a company as one of the members or you are considering doing so anyway for other tax planning reasons.

...the member company will receive cash from the pension to the value of the assets.

Asset swapping

Another possibility is for a pension scheme member to sell certain personally owned assets to his or her pension scheme, whether that is a SSAS or a self-invested personal pension (SIPP). Allowable assets include commercial property, land, quoted equities, gilts, collective funds, options and even copyrights. It is also possible for the company to sell property assets to the pension scheme.

Although the sale will be deemed a disposal for capital gains tax purposes, in the current environment it might well be that the asset has little or no latent gain or might even be showing a loss. Stamp duty will also be due if the asset is land or property. The pension scheme will therefore take ownership of the assets and the member or company will receive cash from the pension scheme to the value of the assets.

The pension scheme, whether SSAS or SIPP, may borrow up to 50% of the scheme assets to fund asset purchases so this could be useful if the scheme has insufficient assets to fund the purchase. For example, say that a pension scheme has £200,000 of cash and it is to purchase a property worth £250,000. After allowing for stamp duty of 1% and legal fees, the purchase costs will be £255,000. The scheme therefore borrows £55,000, which is well below the 50% of scheme assets limit. It is also only 20% of the property's value, so a wide choice of lenders is available. Any future income or capital gains will arise within the pension scheme tax-free.



Unlocking protected rights

Protected rights represent the value of invested national insurance rebates paid by the Department of Work & Pensions to a personal pension nominated by an individual who has contracted out of the state second pension (S2P - previously known as the state earnings related pension scheme (SERPS)). The largest protected rights funds could easily be worth over £200,000. In October 2008 new rules were introduced which permitted protected rights to be invested in a SIPP (they are still not permitted in a SSAS). This opens up further options to allow asset swapping using pension assets which were previously tied up in insurance company funds.

Tax relief

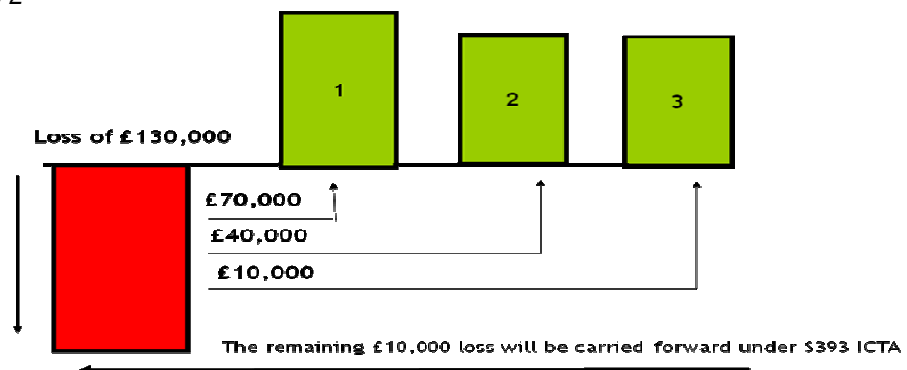
Where loan backs, asset swapping or a combination are being considered, depending on the business's cash position, it might make sense to make additional pension contributions and secure corporation tax relief in the current or previous accounting period. Current year relief will depend on the amount of profits being relieved and passing the 'wholly and exclusively' test (i.e. contributions must be paid for the purpose of the employer's trade).

It may also be possible to create a current year trading loss by virtue of a pension contribution and for this loss to be carried back to the previous trading period and thus trigger a repayment or avoidance of corporation tax. HMRC may want justification for the creation of a loss arising from the pension contribution but it is quite common for a business which has made good profits in a prior year to have to wait to receive the cash which arises from that activity. It should not, therefore, be difficult to put up a strong defence should this be needed.

Unlimited losses can be carried back to the previous accounting period. For companies with accounting periods that fall within 24/11/2008 - 23/11/2009 and unincorporated businesses for the tax year 2008/09, it is also possible to carry back losses of up to £50,000 in total to the two preceding years (subject to certain restrictions - <http://www.hmrc.gov.uk/pbr2008/loss-relief-583.pdf>). Any losses not relieved can be carried forward.

For example ABC Limited has a current year loss of £130,000 and prior year profits of £70,000, £40,000 and £40,000. This is shown graphically in Figure 2 below.

Figure 2



Source: HMRC

In this scenario the business will therefore be able to obtain a cash repayment on tax already paid.



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Capital allowances

Taking a loan from a SSAS can be combined with claiming capital allowances to improve the company's cash position by allowing a reclamation of corporation tax previously paid. In addition to the standard 20% annual reducing balance depreciation on most assets, capital allowances of 100% are allowed on certain research and development expenditure; business premises renovation and the first £50,000 annual expenditure on plant and machinery known as the Annual Investment Allowance (AIA).

Let's take the example of Phoenix Limited, which wants to invest £50,000 in new plant. The company pays corporation tax at the smaller companies' rate of 21% and has gross profits of £100,000. The company has the full £50,000 to invest and is investigating two options:

- Purchase of the plant out of company money for which the company would qualify for a 100% "Annual Investment Allowance";
- Using the company SSAS, which has a value of £50,000.

As illustrated in Figure 3, by including the SSAS in the transaction, the net cost to the company will fall by £10,500 less the interest due on the loan. The loan interest payable will also be tax deductible against profits. The growth of the pension fund is tax-free (subject to any non-reclaimable withholding tax, e.g. on UK dividends).

Figure 3

	Purchase out of company money	Purchase via SSAS
Gross profits	£100,000	£100,000
Pension contribution		(£50,000)
Capital Allowance	(£50,000)	(£50,000)
Taxable profits	£50,000	NIL
Corporation tax @ 21%	£10,500	NIL

The offshore angle

It is possible to take this approach a stage further by using offshore pension arrangements. We explained how offshore pensions worked in a recent article on overseas pensions, particularly the interaction of qualifying recognised overseas pension schemes (QROPS) and recognised overseas pension schemes (ROPS). A particularly interesting fact is that a QROPS may 'invest' in an associated ROPS, providing that it is a prudent investment. One could, therefore, effect a transfer of UK pension benefits to a QROPS which is associated with offshore employment and the QROPS could then subsequently 'invest' those funds in the ROPS.

Most robust ROPS will allow the member or the sponsoring employer to borrow up to **75% of the scheme's assets**. Although security is desirable, it is not always essential. In addition, the loan repayment terms are usually much less onerous than with an onshore scheme. The purpose of the loan is also much less restrictive than with an onshore scheme and personal use by the member is entirely a possibility.



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So taking our previous example of two business owners each with £500,000 of pension funds, this would equate to a £1,000,000 QROPS fund which could subsequently be invested in a ROPS. The ROPS could then lend £750,000 (i.e. 75%) to the member or his business; not a bad result. Clearly there will be costs involved in either the SSAS or QROPS/ROPS route, with the offshore route being considerably more expensive, but 'unlocking' between 50 and 75% of a pension fund to use it more productively could potentially repay those costs many, many times over.

No tax or financial planning route is risk-free or without costs. However, where the circumstances are right and one is aware of the potential downsides, UK or overseas pensions can offer a number of interesting opportunities for releasing cash, on which the well advised can capitalise.

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