PURCHASED LIFE ANNUITIES (PLA)

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A Purchased Life Annuity can be bought by anyone, and effectively exchanges **capital** for an **income stream for life**.

There is limited demand for these, and consequently a fairly **limited market**. However, **the tax treatment of these types of annuities can mean they are worth considering**, particularly as an alternative to a pension annuity, assuming sufficient non-pension and pension assets to enable the choice.

We look briefly here at how PLAs work, and how they are taxed. For a fuller consideration of the broader pros and cons of annuities in general, please see our note on Pension Annuities, as the much the same considerations apply here.

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SUMMARY

A Purchased Life Annuity (PLA) is a straightforward concept - a way of converting **capital** into a future **income** stream, which is then **paid for life**.

A PLA should **not be confused with a pension annuity** (called a compulsory purchase annuity), which is paid in respect of monies held within a tax approved pension environment only. A PLA can be bought by anyone. Simply, an investor buys an annuity from an insurance company with a lump sum payment and in return will receive a fixed payment for the remainder of their life. PLAs are covered by the Pension Protection Fund in the same way as pension annuities.

Although purchase of an annuity provides a **secure and guaranteed level of income**, it also means **loss of control** over the purchase capital.

The **ultimate value of the PLA depends on the eventual lifespan of the investor** – it can be poor value if the investor does not live to the expected age, or correspondingly can be good value if the investor lives longer than the average expected age. This clearly is not known in advance, and so the investor needs to decide which scenario they prefer the balance of risk to fall in favour of.

TAXATION BASIS

INCOME TAX

One of the attractions of PLAs is that, **for taxation purposes, part of the payment received by the investor is treated as a return of capital, not income and is therefore non- taxable**. The appropriate percentage is generally agreed with the Inland Revenue in advance and will be higher the lower the life expectancy of the individual concerned, i.e. the older the investor.

The proportion of the payment received that is treated as income is taxed as interest income, rather than earned income as in the case of pension annuities.

This means that, to enable an effective comparison of the PLA and pension annuity rates on offer, the investor must calculate the particular net of income tax rate applicable to them.

INHERITANCE TAX AND CAPITAL GAINS TAX MITIGATION

For those with both sufficient non-pension and pension assets, and who want to buy an annuity, a PLA can be considered in place of a pension annuity.

The PLA may, depending upon the individual tax position, offer a competitive annuity rate once income tax has been accounted for.

In addition, the conversion of non-pension capital to income, in place of pension capital, may reduce the size of the estate potentially taxable to IHT, and also help maintain a larger pot of funds in the tax-free growth environment of the pension wrapper. The decision will depend upon the levels of capital in each pot, and the particular tax position and circumstances of the investor.

PLAs can be set up to pay monthly, quarterly or annual income and can be established on a joint life basis as between husband and wife. Increasing annuities (e.g. by 3% or 5% per annum) are also available, as are a range of guarantee periods which promise to pay for a minimum of the guarantee period. Clearly, the more options selected, the lower the initial annuity rate paid will be. Please see our note on Pension Annuities for a full overview of the considerations and options involved in annuity purchase, whether via a pension or non-pension route.

Important information: Our views are based upon our understanding of current legislation in England, unless stated otherwise. Levels and bases of, and reliefs from, taxation are subject to change and their value to you will depend upon your personal circumstances.

Risk Warning: The past is not necessarily a guide to future performance. The value of your investment and the income from it can fall as well as rise and is not guaranteed. You may not get back the full amount invested. This document is provided for information only and does not constitute advice. You should not act on any of the information without seeking professional advice.