



Pensions, death and taxes

The new pension rules effective from 6 April 2015 do not change the fundamental tax treatment of pension payments, fund accrual or retirement benefits; although the tax treatment of pension funds on death is much improved. However, the new flexibility removes concerns about access to those funds.

Key points

- Pension funds can now be passed on and continued by any beneficiary (not just narrowly defined dependants);
- The headline 55% death tax is abolished;
- Where the individual dies before age 75 and the pension fund is designated to beneficiaries within 2 years of death, any benefits (lump sum or income drawdown) are tax free;
- Where the deceased is age 75 or over, or the death benefits are not designated within 2 years of death, the benefits will be subject to tax at marginal rates of income.
- On death of a beneficiary, the remaining income drawdown fund can be passed on again, the age at death of that beneficiary (under/over 75) determining the tax treatment for the next in line. And so on.
- Existing nominations, trust arrangements, pension provider rules and pension product terms must all be reviewed if you want to take full advantage; revised intentions may be easily thwarted by existing arrangements.

Passing on a pension fund – the possibilities

Until April 2015, pension rules meant that an individual's pension fund had to last for their lifetime and, if desired, might continue to provide lifetime support to the individual's dependants. However, the death of the individual and their spouse/civil partner almost always led to the pension arrangement coming to an end and the funds being distributed at up to 55% tax.

From April 2015, the deceased's pension fund can be used to provide any of the following:

- a lump sum to any person
- a dependant's drawdown
- a nominee's drawdown
- a successor's drawdown

A *dependant* is usually a spouse, civil partner, child under the

age of 23 or a person financially dependent on the original individual.

A *nominee* is any other non-dependent beneficiary nominated by the original individual.

A *successor* is any subsequent beneficiary of a dependant, nominee or other successor.

It is important to understand that while pension scheme administrators have complete discretion over the recipients of a lump sum, their hands may be tied when it comes to offering part of the pension fund as an ongoing drawdown. Scheme administrators can only exercise discretion over beneficiaries of drawdown if the individual leaves no dependants or nominees.

So, if you want the option for some of your pension funds to pass on as a pension fund to anyone other than your spouse or civil partner, you must tell the pension provider who you want to nominate. Legislation prevents scheme administrators acting otherwise.

In a similar vein, the constitutional rules of a pension plan will reflect pre 2015 options and practice, and the wording may limit scope for manoeuvre. For example, it is common for individuals to set up a "bypass trust" in conjunction with a specific pension plan with the intention that the pension fund pass as a lump sum into a trust. Pension providers may feel that having gone to the trouble of setting up the trust, in the absence of a clear expression of wishes, the sole desire was payment into the trust.

While existing "SIPPs" and "flexible drawdown" plans might be adaptable, older pension plans may prove less flexible and unable to offer dependant's or nominee's drawdown. Indeed, retirement annuity policies (pre 1988 personal pension plans) and "section 32" buy out policies are not trust arrangements and are unlikely to be able to take advantage of the new flexibility.

The tax benefits of an ongoing drawdown pension fund

The new rules provide pension funds with a real boost, especially when death occurs before age 75: the tax free transfer of a fund that continues to grow tax free from which any withdrawals are tax free.

If death occurs after age 75, beneficiaries will be able to manage their taxable drawings within annual income tax allowances and tax bands. Nominating a non or low rate tax payer may be appropriate.

If beneficiaries receive their pension inheritance as a lump sum they might be faced with a large and immediate income tax bill, find that the subsequent growth is taxed and there may be inheritance tax charged on death.

The tax treatment of the various options is summarised in Table 1 below.

Case study

Carol died in her early 70s and is survived by her husband George and daughter Jane. Carol had previously completed an expression of wishes asking her SIPP provider to consider applying the pension fund for Jane's benefit. George has his own pension arrangements and, being financially secure, has

no need of Carol's pension fund.

The fund (some £1m) passes to Jane who chooses to draw occasional income as and when required; this income is tax free as Carol died before age 75. Jane could have elected to take the fund as a tax free lump sum but she works, is a 40% tax payer and has no immediate need for such a substantial sum. She much prefers to let it roll up within the tax free pension fund.

If Carol had not nominated Jane, the SIPP provider could only have offered the drawdown option to George; any payment to Jane would have been as a lump sum and the opportunity to roll up tax free would be lost.

Jane has a young son James and uses her tax free income to fund his school and university fees.

Had Carol died in her 80s, Jane's drawdown income would be taxable but she could draw more so that the income, after tax, covers her son's education fees. In anticipation of this it would have been prudent for Carol to nominate James to receive some of Carol's pension fund as his own drawdown. Although James's income would be taxable, as a non-taxpayer he would pay little or no tax and certainly less than the 40% his mother pays. If James is not nominated and Carol is survived by either George (as a dependant) or Jane (as a nominee), he cannot be offered drawdown, only a taxable lump sum.

Table 1

Age at death	Lump sum to individual		Lump sum to trust		Drawdown plan	
	On transfer	On subsequent income and growth	On transfer	On subsequent income and growth	On transfer	On subsequent income and growth
Under 75	Free of tax	Income tax: 0% to 45% CGT: 10% or 20%	Free of tax	Income tax: 45% CGT: 20% Periodic IHT: 6%	Free of tax	Free of tax
75 and over	Income tax: 0% to 45%	Income tax: 0% to 45% CGT: 10% or 20%	45% tax	Income tax: 45% CGT: 20% Periodic IHT: 6%	Free of tax	Free of tax but withdrawals taxed: 0% - 45%

If you wish to discuss the new provisions, please speak to your usual contact at Blick Rothenberg or:

Martin Reynard

Manager

+44 (0)20 7544 8804

martin.reynard@blickrothenberg.com

16 Great Queen Street
Covent Garden
London WC2B 5AH

+44 (0)20 7486 0111

www.blickrothenberg.com