Edison
Wealth
Management

Passing on wealth with pensions

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Passing on wealth with pensions

Defined Contribution (DC) pension funds now play a much greater role in transferring wealth between generations. Changes introduced in April 2015 mean pension death benefits are now normally free from tax if the policyholder dies before age 75. Above the age of 75 pension death benefits will usually be subject to tax at the beneficiary's marginal rate. This presents policyholders and their advisers with some valuable legacy planning opportunities.

This is one aspect of how retirement planning is changing. At retirement, DC pension funds are now often preserved with income taken from other sources first, a reversal of the previous rule of thumb. This contemporary approach to income and legacy planning will mean more pension wealth will remain available to be shared as a family asset.

It's therefore crucial that your wishes on the treatment of your pension funds on your death are identified and everything is in place to get your money to the right people with the least amount of tax payable.

What has changed?

It's now possible to nominate almost anyone as beneficiaries of a DC pension, not just dependants. Death benefits can be paid as a lump sum or as a pension. Beneficiaries are classed as either 'dependants', 'nominees' or 'successors'.

A dependant is typically a spouse or civil partner of the member or a child under the age of 23. A nominee is a beneficiary of the original member who isn't a dependant (a nominee can be chosen by the member on the nomination form or, in some circumstances, by the pension provider or scheme trustees). A successor is a beneficiary who inherits from a previous beneficiary (dependant or nominee).

In some cases, it can be more tax-efficient for a beneficiary to receive a pension rather than a lump sum, and this is one reason why it's important to review your nominations, especially from age 75.

This is perhaps best explained with an example.

Example

Jennifer has a pension and dies age 80. She is survived by her husband, Chris, who is age 79. They have two adult children, Matt and James. Matt has two teenage children and James has one. Jennifer's nomination with her pension provider states: Chris 50%, Matt 25% and James 25%.

Jennifer was over 75 so the death benefits will be taxable. Chris and James are higher rate taxpayers and Matt is a basic rate taxpayer. Chris qualifies as a dependant as he was married to Jennifer. Matt and James qualify as nominees given they were on the death benefit nomination form.

When it comes to distributing the death benefits, the pension provider speaks to Jennifer's personal representatives. Chris has a pension of his own and is receiving most of Jennifer's estate, so he is well catered for. Matt and James both have good jobs. Chris, Matt and James agree that they would like most of Jennifer's pension to go to her grandchildren in the form of pensions. In this scenario, funds remain within the pension plan with an option for flexible pension income.

They would not want that much money passed down as a lump sum and from a tax planning perspective, this makes sense. The grandchildren are currently non-taxpayers and could receive income tax-free from the pension up to the personal allowance (£11,850 for tax year 2018/19).

But here lies the complexity as unfortunately the pension income option is not available to the grandchildren; Jennifer was survived by a dependant and had nominated people other than her grandchildren on the nomination form.

The pension provider could still opt to pay a lump sum but each grandchild would be subject to income tax on benefits in excess of £11,850. Depending on the level of benefits, they could be taxed at up to the higher rate of tax in that one year.

With hindsight and good advice, Jennifer could have updated her nomination form by adding her grandchildren to receive a nominal amount of, for example, 1%. This would have been sufficient to bring them into the definition of a nominee. They would have received a pension effectively tax free insofar as pension withdrawals could be kept within their personal allowances each year.

How to update your death benefit nominations

Nominations can be updated at any time by contacting your pension provider.

You should seek advice and check that the death benefit options match your needs, sooner rather than later.

Review your pension plan

Not all DC pension schemes can offer the full range of death benefit options. Finding this out on death would potentially render void your wishes or prior planning. You/ or your adviser, should discuss this with the pension provider. You may need to consider transferring to an alternative DC pension to ensure your wishes can be met.

Reviewing your death benefit nominations in tandem with drafting your will makes sense from a planning perspective.

We've included below some questions you may wish to consider:

1. Do you have a defined contribution pension, for example, personal pension or SIPP?
2. When was the last time you completed a death benefit nomination form?
3. To what extent and who have you named on the form?
4. Does the death benefit nomination form reflect your current wishes?
5. Does your existing pension plan provide all the flexibilities that you need to ensure your pension fund would be cascaded in accordance with your wishes?

How Edison can help you

We can help you by:

- Advising on your death benefit and retirement income options
- Understanding the tax implications for your beneficiaries
- Reviewing the suitability of your current plans

To contact us, do not hesitate to call on 0207 287 2225, or by email (scott@edisonwm.com).

You can read this Briefing Note on our website. To download it or view other updates please visit our Insights page.

Important Information

The above is a simplification of the legislation and does not constitute advice. The Financial Conduct Authority does not regulate inheritance tax planning.

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