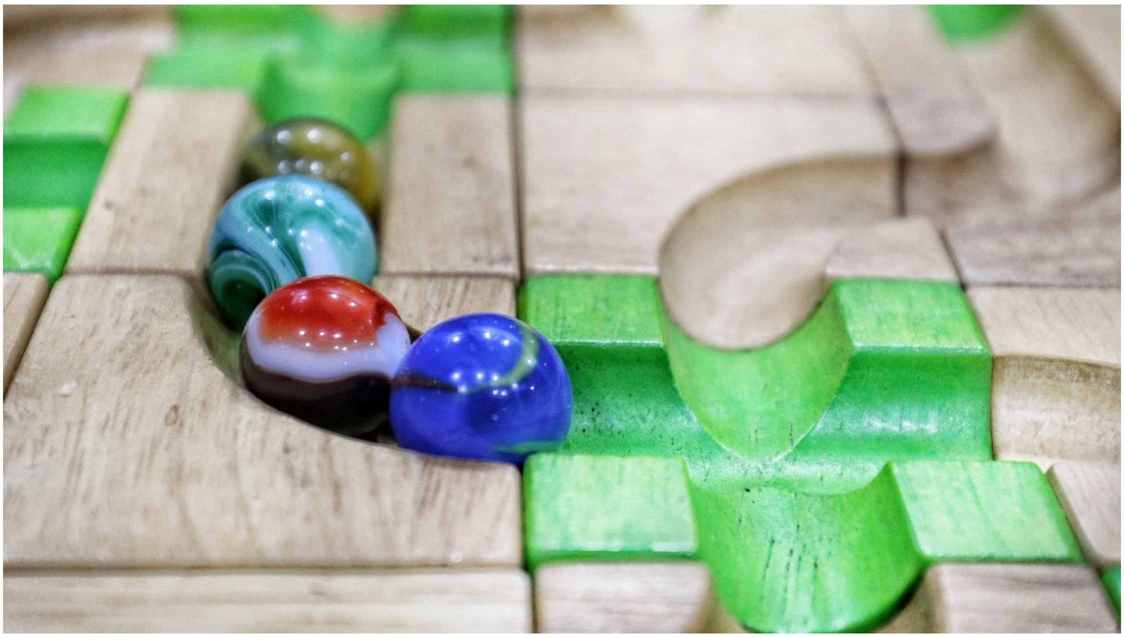
# Pensions – Estate Planning and Inheritance Tax



The goals of any inheritance tax planning are two fold – to shape how a legacy is available for beneficiaries and to maximise it where possible. Some assets in an estate will need more intricate planning such as trusts. Others, such as defined contribution (DC) pensions, are very straightforward and yet they are often overlooked in planning an inheritance.

DC pension holders and their advisers can act early to utilise the valuable planning opportunities. It is crucial, however, to ensure that the wishes of the pensionholder are clear and up to date. Without clear instruction, pension trustees may act on what they perceive to be reasonable, which won't necessarily be the most tax efficient or in the interests of the individual beneficiaries.

**Tax treatment of DC death benefits**

In April 2015, pension rules changed. Under the current regime a beneficiary of pension death benefits can take them as a tax free lump sum or income, if the pensionholder dies before age 75. If the pensionholder dies after the age of 75, the benefits will be taxed at the beneficiary's marginal income tax rates.

**Different types of beneficiary**

The rules now also allow the member to nominate almost anyone as a beneficiary of a DC pension, not just dependants. Beneficiaries are classed as either 'dependants', 'nominees' or 'successors' and death benefits can be paid to a as a lump sum or as a pension income.

6 Duke Street St James's, London, SW1Y 6BN, United Kingdom
+44 (0)20 7287 2225 hello@edisonwm.com edisonwm.com

A dependant is typically a spouse or civil partner of the pensionholder, or a child under the age of 23. A nominee is a beneficiary of the pensionholder who isn't a dependant. A nominee can be chosen by the pensionholder 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. This is just one reason why it's important to review nominations, especially from age 75.

This is perhaps best explained with an example.

**Jennifer and Chris**

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 (£12,500 for tax year 2019/20).

**Unforeseen consequences**

But here lies the complexity. 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.

**Pension trustees do not look for tax savings**

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 £12,500. Depending on the level of benefits, they could be taxed at up to the higher rate of tax in that one year.

**Importance of planning ahead**

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.

**Updating death benefit nominations**

Nominations can be updated at any time. Pension providers supply simple printable forms and will also accept supporting documentation. This is especially important where the policyholder's wishes do not fall neatly into a % split.

If the wishes are more subtle, then the pensionholder and their advisers should speak to a pension specialist. They will be able to advise on how the trustees might react as there are no simple rules when it comes to this. And a pension adviser should be able to access the pension trustees directly – they are often difficult to contact directly.

It is important to seek advice and check that the death benefit options match the needs, sooner rather than later.

**Not all pension plans are created equal**

Not all DC pension schemes can offer the full range of death benefit options. Finding this out on death would potentially render void the express wishes or prior planning. Those with DC pensions should seek advice on their suitability in light of what they want to achieve. Ultimately they may need to consider transferring to an alternative DC pension.

**Joining up the Will and the Pensions**

Reviewing death benefit nominations in tandem with drafting a Will makes sense from a planning perspective. This will include questions like:

1. Does this include defined contribution pension, for example, personal pension or SIPP?
2. When was the last time a death benefit nomination form was included?
3. Do the beneficiaries match the beneficiaries of the Will? And to what extent?
4. Does the death benefit nomination form reflect current wishes?
5. Does the existing pension plan provide all the flexibilities that needed to ensure the pension fund can be cascaded in accordance with wishes?

**How Edison can help you**

Simple planning now can avoid unexpected tax surprises later.

As pension specialists, we can help by:

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

To contact us, do not hesitate to call on 0207 287 225 or by email (help@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. It does not constitute advice. The views expressed above are subject to changes in legislation. The Financial Conduct Authority does not regulate tax advice.

Edison Wealth Management

6 Duke Street St James's, London, SW1Y 6BN, United Kingdom
+44 (0)20 7287 2225 hello@edisonwm.com edisonwm.com