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Pension death benefits – you can take it or leave it!

Those looking to pass on their pension fund received a boost when the Government confirmed they're following through on their promise to scrap the current 55% tax charge on death. This means the tax system will no longer penalise those who draw sensibly on their pension fund, making pensions a very attractive wealth transfer wrapper.

What's changing?

Your age at death will still determine how your pension death benefits are treated. The age 75 threshold remains, but with some very welcome amendments.

- **Death before 75** - The pension fund can be taken tax free, at any time, whether in instalments, or as a one-off lump sum. This will apply to both crystallised and uncrystallised funds, which means those in drawdown will see their potential tax charge on death cut from 55% to zero overnight. Using the fund to provide beneficiaries with a sustainable stream of income allows it to potentially grow tax free, while remaining outside their estate for IHT.

- **Death after 75** - Personal Pension / Money Purchase scheme savers will be able to nominate who ‘inherits' their remaining pension fund. This fund can then be taken under the new pension flexibility and will be taxed at the beneficiary's marginal rate as they draw income from it. Alternatively, they'll be able to take it as a lump sum less a 45% tax charge (this will become their marginal rate from 2016/17).

We understand these new rules will apply to payments made on or after 6 April 2015 rather than the date of death. So where payment of death benefits can be delayed until after 5 April 2015 (the scheme administrators have up to two years to make the payment if it the member dies before 75) the beneficiaries will be able to take advantage of the new rules.

The changes can be summarised as follows:

Death pre 75	Old rules	New rules
Lump sum	•Uncrystallised funds - tax free	•All tax free
	•Crystallised funds - 55% tax	
Income	•Option only available to dependants	•Tax free if taken via new flexible income
	•Taxed as income	•Option available to any beneficiary

Death post 75	Old rules	New rules
Lump sum	•Subject to 55% tax	•Subject to 45% tax (marginal rate from 2016/17).
Income	•Taxed as income •Option only available to dependants	•Taxed as income •Option available to any beneficiary.

Annuities

The changes will also apply to lump sums from value protected annuities, with payments made tax free if death is before age 75 and taxed at 45% (marginal rate from 2016/17) after this age. However, survivors' annuities will continue to be taxed at the survivor's marginal rate, regardless of the date the member died.

Defined Benefit (Final Salary) Schemes

A similar position applies to death benefits from DB schemes. Again, if the scheme allows lump sum death benefits to be paid from pensions in payment, these will be tax free before 75 and taxed at 45% (marginal from 2016/17) after this age. Any continuing dependant's pension will still be taxed at their marginal rate.

This leaves dependants' pensions from annuities and DB schemes at a disadvantage to someone who's receiving income from a beneficiary's drawdown. Where the original scheme member died before age 75, the drawdown beneficiary will receive tax free income, compared to income taxed at their marginal rate from an annuity or scheme pension.

What does this mean for advice?

Funding

Taken with all the other pension changes coming in April 2015, this creates a genuine incentive to save, knowing that family members can benefit from the remaining fund. It means that a pension will become a family savings plan, enabling one generation to support the next.

Drawing an income

The current 55% tax charge on death acts as a penalty for scheme members who take a sustainable income from their pension pot. The only way to delay this charge is for a surviving dependant to continue taking an income from the fund.

The option of taking a lump sum is often overlooked in favour of postponing the tax charge until the dependant's death.

The new rules will mean that beneficiaries other than dependants may now benefit from the remaining fund, without suffering a 55% penalty. With dependant's drawdown essentially becoming beneficiary's drawdown from next April.

Death before age 75 offers the option of a tax free lump sum. But it also allows the fund to remain within the pension wrapper which the beneficiaries would have flexible access to. And nominating a loved one to take over the flexible pension pot will also be a popular choice when death occurs after this age.