For financial advisers only

Death Benefit Freedom and Choice - Case Study

John, 70, and Paul, 76, are brothers

They are both married with children and grandchildren and have worked in the successful family business.

They have each built up sizeable pension pots and reasonable savings in ISAs, Collectives and Offshore Bonds.

John and Paul are both keen to ensure that their families receive as much of their savings as possible in the event of their death.

John – passing on to the next generation

John has an uncrystallised pension of £400,000. He also has £250,000 in capped drawdown. He decided to take these benefits in the 2010/11 tax year, crystallising £400,000 and taking £100,000 PCLS and investing the balance of £300,000 in capped drawdown. This used up 22.22% of his available Lifetime Allowance.

Following the far-reaching changes to pension death benefits, John decided to review his existing nominations with his family and his financial adviser to ensure that they are still fit for purpose.

John's adviser informs him that he can nominate whoever he wants to receive his pension benefits and that the tax treatment will depend on the date of his death.

John discusses the options with his wife and children. As his wife, Joan, who is also 70, will inherit a significant number of other assets and investments when John dies, they have decided that they will nominate his crystallised and uncrystallised pension funds to pass to his two children directly.

John knows that this nomination can be reviewed at any time and that he should consider this especially as he approaches age 75.

If John were to die before his 75th birthday

- His children would be able to take the value of his pension savings within his Lifetime Allowance as a tax-free lump sum.
- His children would be able to take the remaining savings in the form of beneficiary drawdown, if he has a contract which provides this option, such as the Collective Retirement Account. They will be able to draw capital from these savings tax free, regardless of their age, for their lifetime. The funds will remain invested in a pension environment and will be outside their respective estates for Inheritance Tax purposes. The funds will not count against their Annual Allowance and Lifetime Allowance.
- John (via his adviser) has also sought confirmation that his existing pension scheme will offer this death benefit flexibility.

Unfortunately John dies on 1 May 2020. His sons each receive 50% of his respective pension funds, which equates to £325,000 each. £200,000 of these monies are uncrystallised and £125,000 is from the monies in capped drawdown.

There is a test against the Lifetime Allowance for the uncrystallised funds. Based on the current Lifetime Allowance of £1.0731 million and the previous crystallising event, there will be no Lifetime Allowance tax charge on John's remaining fund value.

What do they decide to do with the pension monies?

John's first son George who is 45 decides to take benefits using beneficiary drawdown. He is aware that he can draw these monies tax-free at any time and that these monies can be passed on if he dies to whoever he nominates.

George is also aware, following a previous meeting with the family financial adviser, that he can make personal pension contributions of up to 100% of his relevant earnings and receive tax relief at his highest marginal rate. George has available Annual Allowance so he decides to withdraw some monies from his beneficiary drawdown account to replace the money that he is going to use to fund his additional pension contributions.

John's second son Oliver who is 40 decides to take £100,000 in the form of a lump sum tax-free payment so that he can pay off his outstanding mortgage and credit card debts. He decides to take the remaining monies in the form of a beneficiary drawdown. He is aware that he can draw these monies at any time in the future.

The family are happy in the knowledge that George and Oliver can withdraw John's pension monies tax free at any time to meet their needs and that these monies can be passed on in the event of their death.

They decided not to nominate John's wife Joan as she would inherit the majority of the other assets. If she had been nominated, given that John passed away before his 75th birthday, she would also have been able to take benefits in the form of a tax-free lump sum and/or a tax-free income as beneficiary drawdown. However, any monies withdrawn by Joan would be within her estate (which could potentially compound the IHT problems she will face).

Additionally, if she inherited these funds **and** did not pass away until she was over 75 then the tax position for their children (who would have been nominated to receive John's pension fund on her subsequent death) would be less attractive. Any lump sum and withdrawals from beneficiary drawdown would be subject to income tax at a recipient's highest marginal rate.

Paul – passing some of the pension on to the grandchildren

Paul, who is over 75, has already crystallised his entire pension fund. He has £600,000 in capped drawdown. Paul has also decided to review his pension plans and nominations with his financial adviser in light of the additional flexibility.

Paul is aware of the tax position that will apply in the event of his death, and that this is different to his brother, given that he is over 75. Similar to John and his wife Joan, Paul's wife Linda will not require his pension fund to maintain her standard of living in the event of his death. The family discuss how best to meet their objectives of tax efficiency and passing on as much of his pension fund as possible.

Paul has one non-dependent child (Simon) and two grandchildren who are currently of school age.

Simon, who is currently a higher rate tax payer (and expects to be for the foreseeable future) suggests that his father nominates part of his pension fund to him, part to his wife Claire (who is currently a basic rate tax payer) and part to their two children.

Unfortunately, Paul dies shortly before his brother in February 2020.

He had made a valid nomination and his pension scheme offers the full death benefit flexibility available since April 2015.

What do they decide to do with the pension monies?

Simon decides to place the monies into beneficiary drawdown. He doesn't anticipate taking any withdrawals at this time as they will be taxed at his highest marginal rate. He is happy to leave these monies invested at this time and he plans to take them to supplement his retirement income at a later date when he expects to be a basic rate tax payer.

Simon's wife decides to place the monies into beneficiary drawdown. She plans to make modest ad hoc withdrawals to fund family holidays but will ensure that any monies taken are within her basic rate threshold of income so that she avoids higher rate tax.

The monies given to their children (Paul's grandchildren) are taken in the form of beneficiary drawdown. Simon and Claire plan to utilise their children's personal allowances to take withdrawals from the pension to pay for their private school fees. Any withdrawals are subject to tax at the nominees' marginal rate but for their children this is currently zero.

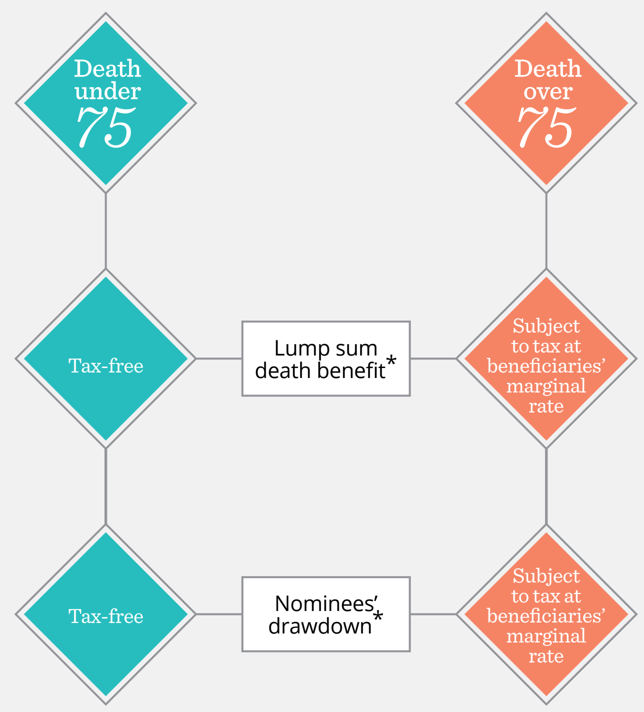
In the case of Simon, Claire, and their children, any residual monies can again be passed on to whoever they nominate in the event of their death.

The different tax position in the event of death meant that John and Paul made different nominations. This is something that should be reviewed on an ongoing basis to ensure that they continue to be fit for purpose. An up to date nomination will also aid the scheme administrator in determining to whom the death benefit is paid.

Before making recommendations relating to John's and Paul's potential beneficiaries and the different solutions that would be open to them; the financial adviser had sought and received confirmation that the existing pension scheme offered the death benefit flexibility of beneficiary drawdown.

Ongoing advice - anticipating the future...

Where death occurs pre 75, the chart below shows the position with respect to the benefit value within a client's Lifetime Allowance, regardless of whether funds are crystallised or uncrystallised. Any benefit taken from uncrystallised funds within 2 years of death will be tested against the lifetime allowance. If there is an excess, there is no charge if designated to drawdown or used to purchase an annuity. However, any excess taken as a lump sum will be liable for income tax.



Your clients' investments may fall or rise in value and they may not get back what they put in.

The tax treatment and efficiency of these options will depend on the individual circumstances of each customer. Tax rules and their application may change in the future.

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