

# Death benefits

## Guidance Notes

This document is provided for use by professional advisers in conjunction with products provided by Talbot and Muir. The information in this document is based on our interpretation of the relevant HMRC guidelines, which are subject to change.

### Overview

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When a member of a registered pension scheme dies HM Revenue & Customs rules prescribe the ways in which it is possible to dispose of their remaining pension benefits. The options available will depend on a number of factors.

The guidance below sets out the position on the death of a member of a money purchase pension scheme (e.g. a SIPP or SSAS) on or after 6<sup>th</sup> April 2015.

Until an announcement on the 30<sup>th</sup> September 2014 the tax treatment of death benefits from money purchase pension schemes were mainly determined by reference to if the funds were crystallised or uncrystallised as well as if the member was pre or post age 75 at their date of death. This has now changed to only take account of the age at date of death to determine the tax treatment. There could be additional charges on uncrystallised funds if they take the members benefits over the lifetime allowance.

### Pre 75 benefit options – death of the member

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#### **Capped/Flexi-access Drawdown or uncrystallised funds**

The value of the pension fund at the date of death will be payable to the beneficiaries.

It is possible to nominate any beneficiary and the payments will be made free from income tax provided they are designated within two years of the member's death. If the designation is made after 2 years and from uncrystallised funds then any income or lump sum paid will be subject to income tax at the beneficiary's marginal rate.

Beneficiaries will either be a dependant or a nominee. A nominee is someone who is nominated but not actually dependant on the member. There is no limit on the number of beneficiaries who can be named to receive benefits.

The beneficiary can choose how they want to take the benefits, including:

- A lump sum payment from the scheme;
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- Flexi-access drawdown;
- An annuity; or
- A scheme pension.

Not all schemes will offer all benefits and you should check the scheme rules to ensure that your clients preferred options will be catered for.

### **Scheme pension**

Any benefit payable will depend upon the basis of the scheme pension and how long it has been in force. Any remaining fund can be used to provide benefits in just the same way as drawdown above.

### **Annuity (Lifetime, Fixed Term or Investment Linked)**

Whether there is any benefit entitlement will depend on the basis of how the annuity was set up, including how long the annuity was in force at the time of death. Annuities purchased after 5<sup>th</sup> April 2015 may be able to offer additional options when determining who the benefits can be paid to.

Only joint life and guarantee payments that start after the 5<sup>th</sup> April 2015 will be able to be paid tax free, any payments in force before that time will continue to be taxed at the beneficiary's marginal rate.

## **Post 75 benefit options – death of the member**

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The value of the pension fund at the date of death will be payable to the beneficiaries.

It is possible to nominate any beneficiary and the payments will be taxed according to the way in which they are paid. Beneficiaries will either be a dependant or a nominee. A nominee is someone who is nominated but not actually dependant on the member. There is no limit on the number of beneficiaries who can be named to receive benefits.

The beneficiary can choose how they want to take the benefits, including:

- A lump sum payment from the scheme, taxed at the beneficiary's marginal rate of income;
- Flexi-access drawdown, taxed at the beneficiary's marginal rate as income;
- An annuity, taxed at the beneficiary's marginal rate as income; or
- A scheme pension, taxed at the beneficiary's marginal rate as income.

Not all schemes will offer all benefits and you should check the scheme rules to ensure that your clients preferred options will be catered for.

### **Scheme pension**

Any benefit payable will depend upon the basis of the scheme pension and how long it has been in force. Any remaining fund can be used to provide benefits in just the same way as drawdown above.

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## **Annuity (Lifetime, Fixed Term or Investment Linked)**

Whether there is any benefit entitlement for the member will depend on the basis of how the annuity was set up, including how long the annuity was in force at the time of death. Annuities purchased after 5<sup>th</sup> April 2015 may be able to offer additional options when determining who the benefits can be paid to.

Any joint life and guarantee payments will be taxed at the beneficiary's marginal rate.

## **Death of a beneficiary**

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If a beneficiary has chosen to take flexi-access drawdown then on their death there may still be remaining funds in the pension. The beneficiary can name their beneficiaries to receive the remaining funds in much the same way as if they had been their funds originally. Their beneficiaries are called successors and need not be associated in any way with the original member. The tax treatment is determined by the current beneficiary's age when they die, refer to the section on pre and post 75 benefits above for full details.

This can continue indefinitely, with a successor leaving the fund to another successor as long as some funds remain

## **Lifetime Allowance**

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Funds that are not already crystallised before death will be tested against the lifetime allowance when the member dies, there is no test on the death of a beneficiary because they will already have been tested.

If the value of the death benefits takes them over the lifetime allowance then the beneficiary will need to pay the appropriate lifetime allowance charge. If there is more than one beneficiary the charge is apportioned across the fund they each receive so one beneficiary isn't lumbered with the whole charge.

The BCE tests applicable are BCE 7 - relevant lump sum death benefit and 5C - unused uncrystallised funds designated for drawdown following a death. There is proposed to be BCE 5D which will catch unused uncrystallised funds designated for annuity following a death.

These BCEs only apply if they benefits are designated within two years of the members death, but it should be noted that should the designation not occur within two years the other tax benefits that would be applicable will be lost and the beneficiary will pay income tax on the income or any lump sum.

BCE 7 is chargeable at 55% flat rate on the excess over the lifetime allowance; BCE 5C and 5D will be a flat rate of 25% of the excess over the lifetime allowance. The charge is payable directly by the beneficiary to HMRC and will not be deducted from the funds before payment by the scheme administrator.

## **Inheritance Tax**

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Pension death benefits will not normally be subject to Inheritance Tax (IHT) regardless of the age of the scheme member at death. However, if pension benefits have been paid from the scheme by way of a lump sum to the member's beneficiaries those funds form part of the recipient's estate for IHT purposes. If the

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beneficiary chooses to opt for flexi-access drawdown any funds not yet paid out to the beneficiary will remain part of the pension scheme and still outside their estate on their death

HM Revenue & Customs reserve the right to subject a pension fund to an IHT charge if they feel it has been used for tax avoidance purposes. From 6<sup>th</sup> April 2011, the failure of the member to exercise their right to draw benefits at their nominated retirement age will no longer result in an IHT charge.

## Expressions of Wishes

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Whilst the scheme member cannot make a binding request that the scheme trustees pay the benefits from their pension to a specified beneficiary or beneficiaries – there can be IHT implications where this is not the case – they can submit an indication of how they would like their remaining benefits disposed of on death, called an Expression of Wishes.

Legally pension scheme trustees retain absolute discretion when it comes to the payment of death benefits, however the wishes of the member will often be taken into consideration. They can be updated at any time before death of the current holder of the pension (member or beneficiary)

With the changes to the death benefit options it is essential that expression of wish forms are reviewed frequently and new forms are completed on the death of a member, dependant, nominee or successor to ensure there is always a valid form on file. Should there be no indication of who the scheme administrator should pay the benefits to, they are compelled to pay a dependant if possible.

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