The PENSIONS Advisory Service

Spotlight

Death and Taxes

"In this world nothing can be said to be certain, except ***death and taxes"****. Benjamin Franklin, 1789.*

The Taxation of Pensions Act 2014 changed the way in which taxes are payable on the death of someone with pension benefits. This note sets out what tax will apply to your pension after you die. This note applies to payments made on and after 6 April 2015 and none of the changes explained in this note apply to survivor pensions paid from defined benefit schemes.

The Pensions Advisory Service is unable to give individual specific advice and you should seek alternative tax or independent financial advice.

Summary

What are the main changes from April 2015?

The previous 55% charge that applied to most lump-sum death benefits for people with unused defined contribution (DC) pension benefits no longer applies. Changes have also been made to the way in which pension death benefits can be paid. The actual tax treatment will now depend on the age of the person at their death and the form in which benefits are paid. In general, if you die before you reach 75 then your beneficiaries will not pay tax. If you die after age 75 then tax will be payable, initially at a rate of 45%, although this is due to reduce to the marginal tax of tax paid by your beneficiary on their income. Similar tax treatment will apply for annuities paid to dependants as well as to recipients of guaranteed annuities.

What about Inheritance Tax (IHT)?

Unless you have cashed in your entire pension, any funds left in your pension fund at death will not form part of your estate for IHT purposes. Bear in mind that any assets left (such as cash or savings, even if they were originally part of your pension fund) will be part of your estate for IHT purposes, and to the extent they are not transferred to your spouse or civil partner at death, anything in excess of £325,000 is currently taxed at 40%.

Who do these changes affect?

The changes affect anyone who has a DC pension pot. If you use your pension pot to take income from (a drawdown policy) and there are funds still left in it, your beneficiaries will benefit from the change. Alternatively, if you use your pension pot to buy an annuity (a lifetime income from an insurance company), there will also be a change in tax treatment for your beneficiaries.

The changes do not however affect anyone who is currently in receipt of a pension from a defined benefit (DB) scheme. Nor will they affect anyone who had purchased a single life annuity. However the changes will affect dependants' annuities, i.e. where a surviving partner is due an income on the death of the annuitant.

What if I have cashed in my pension pot?

If you decide to cash in your pension pot before death, then any funds that you have withdrawn from the pot but have not spent before your death will form part of your estate and may be subject to

Tax rate payable on death

What happens if I die before I reach age 75?

If you die before you reach age 75, anyone who inherits your pension fund will not pay any tax. The beneficiary can choose to take the pension in a variety of ways and the position on each is as follows:

- If no money has been taken from the pension fund at the time of death, your beneficiary can take the whole fund tax free. Alternatively, if they take out a drawdown policy or an annuity with the proceeds they will not be taxed on any income received.
- If you are in drawdown at the time of death, then your beneficiary can take the remaining money left as a tax free lump sum. Alternatively, they can continue to draw an income and will not be taxed on income received.
- If you had a joint life annuity, then the income your beneficiary receives after you die will not be subject to income tax.

If you die before age 75, any pension proceeds inherited will be tested against the lifetime allowance. This is the maximum amount that an individual is permitted to save within a pension arrangement without incurring an additional (55%) tax charge. The LTA is currently set at £1.25m although this is due to reduce to £1m from April 2016.

What happens if I die after I reach age 75?

The beneficiary can choose to take the pension in a variety of ways and the position on each is as follows:

- If no money has been taken from the pension fund at the time of death, your beneficiary will receive a tax charge of 45% if they take the benefit as a lump sum, although from April 2016 onwards it is the Government's intention to reduce this to their marginal rate of tax (the highest rate at which they pay tax on their income), although this is not yet set out in law. Alternatively, if they take out a drawdown policy or an annuity with the proceeds they will be taxed on any income received at their marginal tax rate.
- If you are in drawdown at the time of death, then your beneficiary can take the remaining money left as a lump sum with a tax charge of 45% although from April 2016 onwards it is the Government's intention to reduce this to their marginal rate of tax Alternatively, they can continue to draw an income and they will be taxed at their marginal rate on income received.
- If you had a joint life annuity, then the income your beneficiary receives after you die will be taxed at their marginal rate.

How do my beneficiaries qualify for this tax treatment?

In order to benefit from the favourable tax treatment, it is necessary to designate funds to a beneficiary within two years of death. In practice, this period of two years starts from the date on which the pension administrator is notified of the death of an individual. This means that if your beneficiary wishes to take the benefits in the form of a lump sum, they need to take the money within two years. However, if they decide to draw down pension, they don't need to take the first payment within the two years, but they do need to notify the administrator of their intentions to draw an income.

Nominating dependants

Who can I leave my pension fund to?

Although many people will leave their pension fund to their spouse or partner it will also be possible to leave this to your children or grandchildren and they will benefit from the tax rates set out above.

How do I nominate the beneficiary for my pension fund?

Many pension schemes will ask you to nominate a beneficiary (often using what is called an Expression of Wish form) so it is important to advise them of who you want to leave your pension to, and to update this if circumstances change. It is up to the discretion of the company or trustees who look after the pension as to who it can be paid to. In some circumstances, where they decide not to pay out the proceeds any funds left will be paid, net of 45% tax charge, to the executors of your estate to distribute (although not as part of the estate for IHT purposes).

What if there is no "expression of wish"?

Nominations can also be made by pension trustees if there is no expression of wish; or in the absence of either of those, be based on what is provided in a will. However, this will always be subject to what is set out in the scheme rules, contract or arrangement. If in doubt, you should explore this issue with your provider, so you are able to understand if there are any restrictions in your current arrangements regarding nominating beneficiaries, so you can transfer elsewhere if need be. It is generally important to do something before it gets to the point of following a will, as this might lead to complications and a possible need to reclaim tax in the future.

When I die, who will receive the dependants' annuity?

For joint life annuities, the nomination of a dependant is integral to the setting up of the annuity, and will be reflected in the pricing. Therefore, providers will not generally allow nomination of someone else at a later date.

About Us

The Pensions Advisory Service (TPAS) works to make pensions accessible and understandable for everyone. We provide independent and impartial information and guidance about pensions, free of charge, to members of the public.

We help with all pension matters covering workplace, personal and stakeholder schemes and also the State Pension. We answer general questions, help with specific queries and offer guidance for people with complaints about their private pension scheme.

Contacting us

Pensions Helpline **(Monday-Friday 9:00am - 5:00pm)**	**0300 123 1047**
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