PENSION DEATH BENEFITS: AVOIDING RISK

Jamie Clark | Pension Specialist

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WHEN A CLIENT DIES, MAKE SURE THEIR PENSION DOESN'T DIE WITH THEM

Significant changes have been made to pension death benefits in recent years. Pensions are now central to intergenerational financial planning.

Ensure you have the foresight to put the right plans in place for your clients.

Today you will learn about:

- The importance of nominations and why nominee drawdown could be the default position
- The tax-efficiency of the family cascade
- The risks that an adviser faces and the opportunities that exist

DEFINED CONTRIBUTION DEATH BENEFIT TAXATION

UNCRYSTALLISED AND OR CRYSTALLISED	**-75** DEATH PRE 75	**75+** DEATH POST 75
LUMP SUM DEATH BENEFIT	**Tax-free***	**Tax at beneficiaries' marginal rate****
BENEFICIARY FLEXI ACCESS DRAWDOWN	**Tax-free***	**Tax at beneficiaries' marginal rate**

* Subject to Lifetime Allowance and where benefit is provided with a relevant two year period following death
** For a trust (45%) / Charity (tax-free) subject to conditions

TERMINOLOGY: IMPORTANT DIFFERENCES

Term	Description
Beneficiary	Generic term that can mean dependant, nominee or successor
Dependant	Someone who is dependent on the member (e.g. spouse or child under 23)
Nominee	Anyone who is nominated on the member’s Expression of Wish (i.e. non-dependent child, grandchild, friend, local landlord etc)
Successor	Anyone who succeeds a dependant or nominee

A scheme administrator cannot use their discretion to give flexi access drawdown to anyone else if there is a nomination on file OR a Dependant exists.

DEATH CLAIMS EXPERIENCE

Over
1 in 5

Delays and full flexibility squandered

2016 – 28%

2017 – 28%

2018 – 38%

2019 – 23%

No nomination, ambiguity or challenge from beneficiaries

CASE STUDIES

CASE STUDY ONE: JACK AND DIANE

- Jack and Diane run a successful farming business
- They are both age 60 and have pensions worth £500,000 each
- They have a nephew Ben, age 35, who is gradually taking over the running of the farm
- Jack dies in a farming accident

The adviser requests that Jack's death benefits should be paid to Ben as Diane doesn't need it due to her own pension wealth and the income from the farm.

CRUCIALLY, THE ADVISER ONLY SUGGESTED NOMINATING DIANE AS A BENEFICIARY WHEN JACK'S PLAN WAS SET UP

CASE STUDY ONE: JACK AND DIANE

The adviser calls the provider and asks for nominee drawdown to be set up for Ben

Trustees check the nomination form - Ben isn't on it so nominee drawdown can't be set up for him

The trustees could pay a lump sum death benefit to Ben using their discretionary powers

CASE STUDY ONE: JACK AND DIANE

IF BEN **DOESN'T NEED** EXTRA INCOME

- Ask trustees to make a discretionary death benefits lump sum payment to Ben so it is tax-free
- Invest this in a tax-efficient investment (e.g. offshore bond)
- Future income can be taken if needed
- There is potential to place in trust to provide income for Ben's children while retaining control
- Depending on set up, could be IHT free on Ben's death
- Ben has full control

IF BEN **DOES** NEED EXTRA INCOME

- Diane can extract income from dependant's FAD tax-free
- This can then be passed to Ben under the surplus income rules (so no IHT)
- Ben can choose to spend or save the extra income
- Ben could save any surplus income in a tax-efficient wrapper
- Ben has no control until he gets the money

CASE STUDY ONE: JACK AND DIANE

After detailed discussions it is decided that Diane will receive Jack's pension as a dependant's flexi-access drawdown plan and pay regular income to Ben.

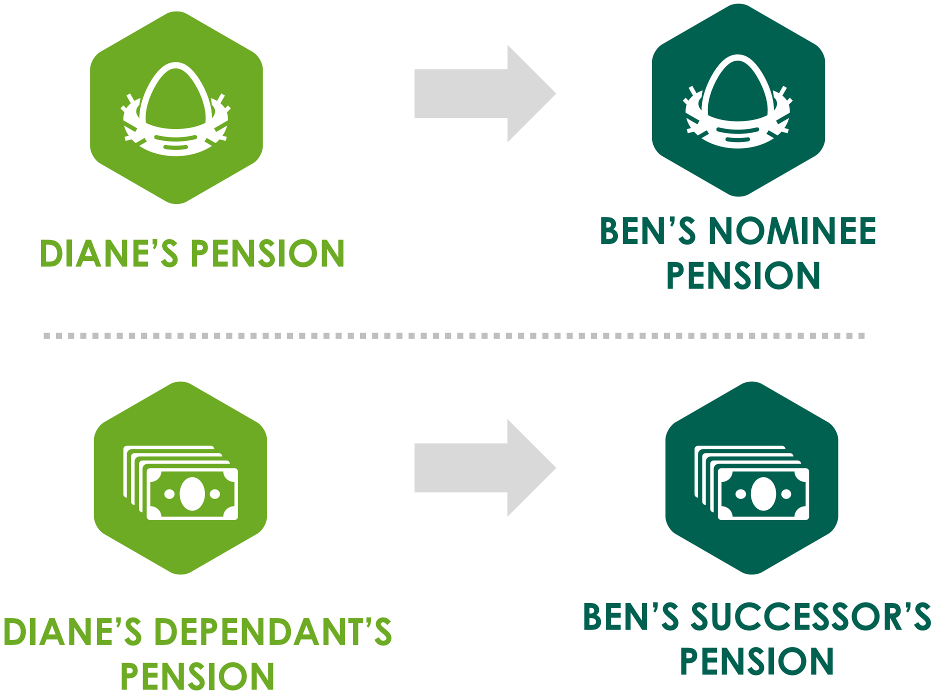
DIANE'S PENSION + DIANE'S DEPENDANT'S PENSION = £1m

THE ADVISER MAKES SURE BEN IS NOW ON DIANE'S NOMINATION FOR BOTH HER PENSIONS.

CASE STUDY ONE: JACK AND DIANE

16 years later, Diane passes away

- Ben can choose lump sums or flexi-access drawdown from Diane's pensions
- However as Diane was over age 75, **all** will be **taxed at Ben's marginal rate**
- Ben could have received income and retained complete control of Jack's pension **tax-free** had he been nominated



THE IDEAL SCENARIO

2 BENEFICIARIES' DETAILS

Use this section to nominate your preferred beneficiary(ies); the percentages allocated must total 100%.

▶ *Tick whether the beneficiary is an individual, a trust or a charity and complete the details as appropriate:*

1. Full name of beneficiary Diane Smith — Proportion: 100 %

Their address: 14 Anystreet, Anytown

Postcode: AA1 1AA

☐ Individual — Date of birth *(ddmmyyyy)*: 0 2 0 2 1 9 5 9

Relationship to you: Wife

☐ Trust — Date of trust *(ddmmyyyy)*:

Name of lead trustee:

☐ Charity — Registered charity number:

Nomination priority†: In the event that Diane does not need all, or some of the money, please consider my nephew, Ben Jones.

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CASE STUDY TWO: BRENDA & EDDIE

- Brenda is 46 and an active member of her employer's defined benefits scheme – current CETV £546,000
- Brenda is divorced from Eddie and has a 15 year-old daughter, Emma
- Brenda is diagnosed with terminal cancer with a life expectancy of less than a year.
- On Brenda's death, Emma's guardians will be her Grandmother and her Aunt.

WHAT WOULD YOU DO?

CASE STUDY TWO: BRENDA

Brenda seeks advice as to whether she should opt-out then transfer out of the scheme

The employer offers separate Death-In Service cover

Advice is to transfer out even though there could be an IHT charge

CASE STUDY TWO: BRENDA

If Brenda DOES NOT transfer the benefits from the scheme:

OPTION ONE	OPTION TWO
• Four times salary death-in-service lump sump death benefit **= £200,000** ***PLUS*** • **1/3rd children's pension of £5,700 p.a.** payable until age 18 or 23* ***PLUS*** • Return of contributions of **£25,000**	• Four times salary death-in-service lump sump death benefit **= £200,000** ***PLUS*** • Serious ill-health lump sum -15 x the member's pension of £17,100 p.a. - **£256,500** (this would be paid tax-free while she is alive)

*Children with mental/physical disabilities can receive a pension beyond age 23

CASE STUDY TWO: BRENDA

If Brenda DOES transfer the benefits from the scheme:

OPTION THREE

- Four times salary death-in-service lump sump death benefit **= £200,000**

PLUS, EITHER

- **£546,000** tax free as either a lump sum or a flexi-access dependant's drawdown on her death

OR

- All of the **£546,000** tax free as a withdrawal (early access before age 55 possible because of serious ill-health).

*Children with mental/physical disabilities can receive a pension beyond age 23

CASE STUDY TWO: BRENDA

As Brenda died within 2 years of the transfer, this must be reported to HMRC on IHT form IHT409. This might result in an IHT charge:

HMRC will seek to place a value on the **loss to the estate**, based on:

1. The value which **could have** been directed to the estate, taking account of growth/discount rates from date of transfer to date of death

MINUS

2. The value of the rights **retained** by the member immediately before death - essentially on a UFPLS basis.

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CASE STUDY TWO: BRENDA

VALUE OF DEATH BENEFITS

Assume:

- 4% growth rate from date of transfer to assumed life expectancy (1 year)
- 13% discount rate to reflect investment growth

VALUE OF DEATH BENEFITS

(£546,000 x 1.04)/1.13 = **£502,513**

VALUE OF RETAINED RIGHTS

PCLS = £546,000/4 = £136,500

Remaining fund = £409,500

Tax on £409,500 = £169,271

Balance after tax = £240,229

VALUE OF RETAINED RIGHTS:

£136,500 + £240,229 = **£376,729**

OUR UNDERSTANDING OF THE VALUE OF LOSS TO ESTATE

£502,513 - £376,729 = £125,784 within the estate

IHT @ 40% = £50,313.60

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CASE STUDY TWO: BRENDA

Summary of position on death

	OPTION ONE (DIS/CHILDREN'S PENSION, RETURN OF CONTRIBUTIONS)	OPTION TWO (DIS/SIHLS)	OPTION THREE (TRANSFER)
Total lump sums	£225,000	£456,500	£200,000
Dependant's flexi-access drawdown	n/a	n/a	£546,000
Dependant's scheme pension	£5,700 pa (payable for up to 8 years)	n/a	n/a
Income tax	£0	£0	£0
Inheritance tax	£0	Potentially, as £256,500 within estate	Potentially, as £546,000 could be within the estate

CASE STUDY TWO: BRENDA

How option three produced excellent customer outcomes:

- Brenda has the flexibility to access her pension to fund private treatment if needs be.
- Emma's guardians have complete, tax-efficient control over a total fund to provide for her until she is old enough to take control herself.
- Even if HMRC pursue an IHT charge of £50,313 Emma is still in a better position than if her mum stayed in the scheme.

CASE STUDY THREE: JIM

- Jim is a widower age 76 with a pension worth £800,000
- He has 4 grown up children and 3 grandchildren all under age 18
- Jim has already spent his PCLS

JIM'S ADVISER TELLS JIM TO MAKE SURE THAT ALL HIS CHILDREN ARE MENTIONED ON THE NOMINATION FORM. AS HIS CHILDREN WILL GET THE MONEY, THE GRANDCHILDREN WILL BENEFIT BY DEFAULT.

CASE STUDY THREE: JIM

The trustees can pay a lump sum and/or drawdown to nominees, but:

Jim's children are all higher rate taxpayers and in future plan to send their own kids to private schools

On death, as Jim is over age 75, any death benefits will be taxed at the recipient's marginal rate

CASE STUDY THREE: JIM

Jim's adviser should have made sure all potential beneficiaries were named for tax-efficiency:

- Nominate **each** of the grandchildren to allow £12,500 p.a. towards school fees to be paid over 7 years from age 11 to 18 from nominee FAD (£87,500 each)
- This makes use of the grandchildren's personal allowances so some or all school fees are paid **tax-free**
- Remaining fund can be split between grown up children or grandchildren for **legacy** planning or lump sums or withdrawals if tax circumstances change

IF JIM HADN'T CHANGED HIS NOMINATION, HIS CHILDREN WOULD HAVE PAID £175,000 IN TAX
(£20,833 @40% = £12,500 net, so £8,333 tax x 3 x 7)

CASE STUDY FOUR: BRIAN

- Brian is 45, married to Margaret and has 3 children
- He has been a member of his employer's group personal pension since 1992 with a current fund value of £360,000

BRIAN HAS A HEART ATTACK WHILE OUT RUNNING AND DIES A FEW DAYS LATER

CASE STUDY FOUR: BRIAN

Margaret requests dependant's drawdown for her and her children

Although the nomination is completed properly, only a lump sum is payable

The group personal pension rules have not been updated to provide nominee drawdown

MARGARET COULD HAVE HAD FULL DEPENDANT'S DRAWDOWN HAD BRIAN SWITCHED TO A MODERN CONTRACT. REMEMBER PARTIAL TRANSFERS MIGHT BE POSSIBLE

FINAL THOUGHTS

HOW MUCH RISK IS WITHIN YOUR BUSINESS?

AT RETIREMENT PENSION HEALTH CHECK

ENSURING GOOD CUSTOMER OUTCOMES

RETIREMENT OUTCOMES

D. Legacy planning	YES	NO	CRA
• Does the current pension plan offer a lump sum death benefit?	○	○	✓
• Does the current pension plan offer dependant, nominee and successor flexi-access drawdown with no minimum age of entry?	○	○	✓

- S226 RETIREMENT ANNUITY CONTRACTS
- S32 BUY-OUT PLANS
- MOST MONEY PURCHASE OCCUPATIONAL PENSION SCHEMES (i.e CIMP)
- FSAVCs
- GPPs
- STAKEHOLDER

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WHEN A CLIENT DIES, MAKE SURE THEIR PENSION DOESN'T DIE WITH THEM

Key messages and immediate actions:

Asset values are increasing while tax bands/allowances are static or decreasing

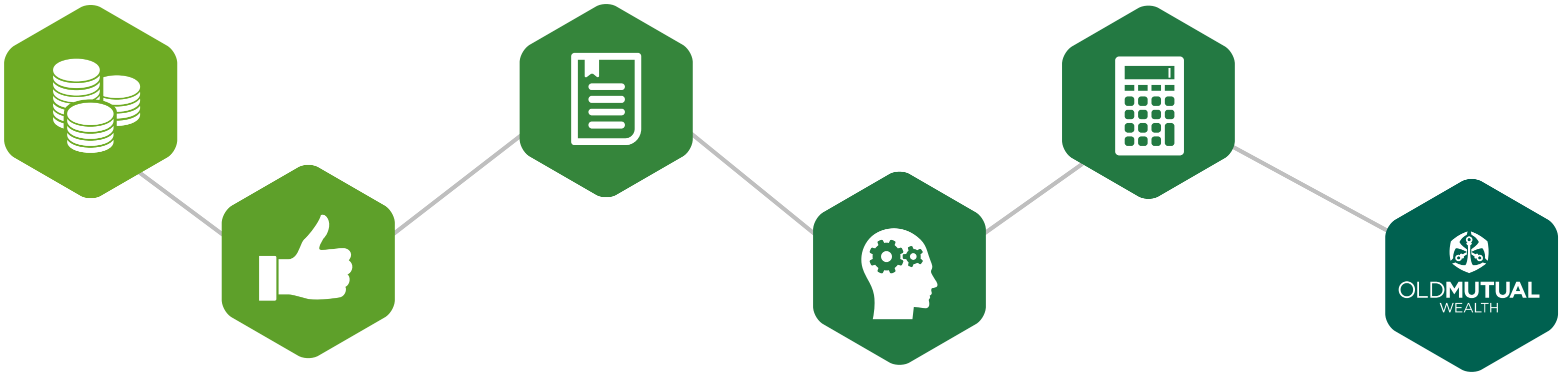
The tax treatment of pension death benefits has never been so good

Making nominations on expressions of wish is key

The family cascade of pension benefits is now possible

You need to be in a modern pension like the CRA to make the most of the opportunity

Old Mutual Wealth can help



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HELPING YOU TO DELIVER GREAT CLIENT OUTCOMES

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The value of any tax relief will depend on the investor's individual circumstances.

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