Deferral of retirement benefits

Employment Tax | Inheritance tax and trusts | Personal tax



02 March 2021

Mike Bonner-Davies and Seamus Murphy consider some potential inheritance tax implications for FURBS and EFRBS following the Parry case

Key Points

What is the issue?

Funded unapproved retirement benefit schemes (FURBS) and funded employer-financed retirement benefit schemes (EFRBS) are unapproved pension schemes that were funded with employer contributions. The Parry case has raised some potential inheritance tax implications.

What does it mean for me?

While the focus of this article is on FURBS and EFRBS, similar issues may arise for unfunded unapproved retirement benefit schemes (UURBS) and international pension plans (IPPs).

What can I take away?

Individuals deferring retirement benefits from FURBS or EFRBS should give serious consideration to whether the application of the decision in Parry could see inheritance tax charged on the value of the pension fund when they die and, if so, what remedial action might be taken.

Funded unapproved retirement benefit schemes (FURBS) and funded employer-financed retirement benefit schemes (EFRBS) are unapproved pension schemes that were funded with employer contributions. Generally speaking, FURBS were funded prior to 6 April 2006 and EFRBS thereafter.

Both tend to be trust-based arrangements where the trust deed sets out the powers and obligations of the trustees and the plan rules set out the members' entitlement to benefits, the precise terms of which will be relevant to the ultimate inheritance tax position.

As we are focusing on inheritance tax, we have not delved into the nuances of how other taxes may apply to FURBS and EFRBS, most notably income tax, but suffice to say that the analysis can in some cases be complex. For present purposes, we adopt a very broad-brush approach:

- UK FURBS follow the taxed, taxed, exempt (TTE) approach. The member was most likely assessed to income tax on the employer contributions to the FURBS

and the trust pays tax on its investment income and gains. This should allow a UK tax resident member to access retirement benefits as an income tax free lump sum (but retirement benefits structured as pensions remain chargeable to income tax).
- UK funded EFRBS follow the exempt, taxed, taxed (ETT) approach. For employer contributions between 6 April 2006 and 5 April 2011, the member would probably not have been taxed on those contributions. The trust pays tax on its investment income and gains. A UK tax resident member would be chargeable to income tax on their retirement benefits at their marginal rate.

HMRC v Parry and others

In the case of HMRC v Parry and others [2020] UKSC 35, the facts were as follows. Shortly before her death, Mrs Staveley ('the deceased') transferred funds from her existing pension scheme to a personal pension. She did not take any retirement benefits from the personal pension during her life and so a death benefit became payable when she died. The deceased had nominated her two sons as beneficiaries, subject to the discretion of the pension scheme trustees, and after her death the death benefit was paid to them.

HMRC determined that inheritance tax was due, on the basis that both the transfer of funds to the personal pension, and Mrs Staveley's omission to draw any benefits from the plan before her death, were lifetime transfers of value within Inheritance Tax Act 1984 s 3.
In the case of the transfer of funds, the Supreme Court held that, on the facts, there was an absence of gratuitous intent which precluded an inheritance tax charge.

In the case of Mrs Staveley's omission to draw benefits before her death, however, the Supreme Court agreed with HMRC that Inheritance Tax Act 1984 s 3(3) was engaged and that inheritance tax was due.

Inheritance Tax Act 1984 s3(3)

By way of recap, s 3(3) applies when:

- there is an omission to exercise a right by a person;
- the value of that person's estate is diminished as a consequence; and
- the value of another person's estate (or settled property) is increased as a consequence;

- unless it is shown that the omission was not deliberate.

Where s 3(3) is engaged, the omission is treated as a disposition made at the very last moment at which the right in question could have been exercised. As s 3(3) treats an omission as a disposition, it appears – at least based on the discussion in Parry – that s 10 (dispositions not intended to confer gratuitous benefit) might apply if the relevant conditions are met.

In the Parry case, it was common ground (so not discussed on appeal and with only limited discussion at the First-tier Tribunal) that the omission to take benefits from the personal pension decreased Mrs Staveley's estate.

The Supreme Court decided that the increases in the sons' estates (due to receipt of the death benefits) were a consequence of the omission. This was held to be so notwithstanding the discretion afforded the trustees regarding who would receive the funds. And as it was not shown that the omission was not deliberate, s 3(3) was therefore judged to have been engaged.

Section 10 was considered not to exclude the omission from being a transfer of value because the deceased had, as at least one motivating factor, the intention to increase the death benefits. As a consequence, inheritance tax was due.

What does this mean for FURBS and EFRBS?

As the discussion above sets out, the analysis of s 3(3) turns firstly on the rights involved. Therefore, it is critical to understand the rights under a FURBS or EFRBS and the points in time at which they crystallise.

FURBS and EFRBS are trust-based arrangements, often with bespoke plan rules which can vary from one scheme to the next. This means that the specifics of the rights involved vary from scheme to scheme and so it is necessary to consider each on its own merits.

That said, a not unusual example might be a right to a pension at retirement (as defined in the deed, which can vary) with the fund balance to provide death benefits, but with the option of exchanging the pension entirely for a lump sum (and probably nil balance for death benefits).

A member seeking to draw a smaller pension than stipulated (if allowed) or defer a pension, or opting not to elect for a lump sum, may wish to consider the risk of s

3(3) applying. Of course, the risk depends on a wide range of factors. Deferring benefits while still working at age 55 (say) might be distinguished from Parry in the event of an untimely death on the basis that the member intended to draw benefits at a later date and had no gratuitous intent towards another.

However, a continual deferral of benefits at age 80 (say) would, based on Parry, appear to be within s 3(3) and might carry a higher risk, depending on the facts. There might be reasons for such a deferral to engage s 10, but again it would turn on the facts and the evidence that could be provided to support those facts, which may in turn also be viewed with some element of hindsight.

Deferring retirement benefits specifically with the intention of increasing the death benefits payable could be problematic. As to the matter of intention, it is worth noting that in Parry, professional advice to the deceased was adduced as evidence to help establish what the deceased's intentions may have been in deferring benefits.

Finally, while UK registered pension schemes have been specifically protected from s 3(3) in recent years, HMRC's manuals explicitly make the point that FURBS and EFRBS remain within scope. (Generally, UK registered pension schemes, QNUPS or Section 615 schemes are not within the scope of the 'omission to exercise a right' test in IHTA 1984 s 3(3) as a result of s 12(2ZA) and s 12A inserted in 2011 and 2016 respectively. The Supreme Court's judgment in Parry does not change this.)

It might be argued that in the case of a trust-based arrangement, the increase in another's estate does not flow from any omission but from the trustees' discretion. A similar argument was advanced in Parry that the sons' estates were not increased by the omission but rather by the trustees' discretion in deciding to pay the death benefits to them. While practitioners may find this surprising, the Supreme Court ultimately found in HMRC's favour on this point, stating that it did 'not see the limited discretion of the scheme [trustee] as breaking the chain connecting the two events'; i.e. the omission and the [resulting] increase in the sons' estates.

In certain cases, it might be argued that a particular FURBS or EFRBS was distinguishable on the facts from those of Parry, and so the same reasoning should not necessarily follow. However, such an argument would be likely to require a tribunal hearing to resolve.

What should FURBS and EFRBS members think about?

There may be a perception that the accumulated pension fund in a FURBS or EFRBS is a long-term inheritance tax ‘efficient’ arrangement. However, the decisions that a member makes in respect of retirement benefits may mean that this is not so. In some cases, the whole fund may be challengeable under s 3(3).

A decision to defer benefits at age 55 (say) might be demonstrable to fall outwith Parry in the event of an untimely death. However, as time goes by, a continued decision to defer benefits may become less clear cut – and it is important to bear in mind that the facts will be viewed only after death and will be largely shaped by what can be evidenced. If a member dies at age 80 (say) having never drawn benefits, the obvious question is ‘why not?’

Members may therefore feel it worthwhile to consider their long-term objectives and plans vis-a-vis any FURBS and EFRBS entitlements. If there is a possibility that benefits will be deferred indefinitely, then there may be other options for them aside from suffering the s 3(3) risk. If the death benefits were to go to adult children, for example, then thought might be given to withdrawing all the funds now (with potentially no income tax) and making lifetime gifts. If the member has philanthropic ambitions, the funds could be withdrawn and donated to charity. Or if there are business ventures of interest, it could be withdrawn and invested in a business which qualifies for business property relief.

The point is that there may be other life goals which can be achieved while at the same time removing any s 3(3) risk, so there is merit in thinking about it now. Naturally, these areas should be looked at in the round and inheritance tax will be only one consideration, but the important point following Parry is not to assume that the position will be straightforward.

It is also worthwhile exploring exactly what rights are conferred under any FURBS or EFRBS, which will usually involve reviewing the trust deed and plan rules. Some plan rules may be vague on certain points, such as when rights crystalise. For example, some deeds specify that the member cannot draw benefits until they have ceased to work but may not clarify whether that means working with the sponsoring employer or working more generally. It may be unclear whether remaining on as a part-time consultant would be sufficient. Some members may have rights which have already crystallised and of which they are unaware.

With all arrangements, it is necessary to look carefully at both the facts and the nature of the rights, and to consider carefully what could be within the scope of

inheritance tax for both the individual and the trustees.